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15 June 2012

Mr Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

AER supplementary submission to the AEMC Draft Rule Determination – reference and rebateable services

The AER has provided a supplementary submission to address comments provided by DBNGP (WA) Transmission Pty Ltd's (DBP) in their submission of 11 May 2012 on this matter. These comments relate to:

- The application of the revenue and pricing principles; and
- The interpretation of the National Gas Rules (NGR) in relation to a fixed principle.

However, before commenting on DBP's further submission, the AER considers it important to re-emphasise that the AER's rule change proposal was considered necessary to address not just the APA GasNet's AMDQcc service, but also broader issues from other emerging pipeline services, such as backhaul and interruptible services, which are likely to become more significant. .

The AER's previous submission provided evidence of these emerging services, such as those related to the AER's current review of the Roma to Brisbane pipeline access arrangement, and services offered by pipeline operators in the Short Term Trading Market (STTM).

The proposed rule change would allow any additional revenue from these emerging services to be taken into account in setting reference tariffs (where appropriate) for pipelines subject to full economic regulation. In particular, the rule change proposal seeks to provide the AER with the ability to return some additional revenue from pipeline services to users without the

need to potentially set inefficient reference tariffs. Accordingly, the AER considers that the proposed amendments to the definition of a reference service and a rebatable service are necessary as they work alongside each other in order to better contribute to the National Gas Objective (NGO).

While the AER considers that its rule change proposal is necessary to address possible over-recoveries for pipeline services in addition to APA GasNet's AMDQcc service, it is now evident that the additional revenue APA GasNet will receive from the AMDQcc service is significant. In particular, the AER in its submission estimates that APA GasNet may receive an additional $27.5m over 2013-17 from its AMDQcc service. This compares to the estimated total regulated revenue of $35m that APA GasNet may receive from its reference service over the 2013-17 access arrangement period.

The AER further notes that based on the proposed reference tariff for the Port Campbell injection tariff of $1.969/GJ, the AMDQcc price is *85 per cent above* this proposed reference tariff for 2013. The AER considers that unless the definition of a rebateable service is amended consistent with the AER's rule change proposal, the AER will not be able to consider whether some of this additional revenue should be returned to users through a lower reference tariff(s).

As noted previously, it is not possible for the AER to consider this higher revenue as part of an access arrangement unless the AEMC amends the definition of a rebateable service. While the AER could consider including the AMDQcc service as a reference service in APA GasNet's forthcoming access arrangement, should it consider this to be desirable, this reference tariff would have no force given the terms and conditions of the AMDQcc service have already been determined in bilateral contracts with users.

Matters raised by DPB

Revenue and Pricing Principles

Further to its previous submission on the impact on existing contracts (refer to 1.3 of AER's submission, including the legal advice at Appendix 1 of that submission), the AER notes the following in relation to DBP's submission of 11 May 2012.

The AER provides the following response in relation to DBP's view that there is a distinction between s 2.24(b) of the Gas Code and ss 24(6) and 28(2) of the NGL.

The AER draws your attention to the relevant passage in the judgment relied upon by DBP. In *Re: Dr Ken Michael Am; ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231 (23 August 2002) (Re Michael), Parker J in delivering the judgment states at paragraph 55:

> It is clear that an expression such as "have regard to" is capable of conveying different meanings depending on its statutory context. In s 2.24 the phrase "must take the following into account" is apt to convey as an ordinary matter of language that the Regulator must not fail to take into account each of the six matters stipulated in (a) to (f), and by (g) any other matter the Regulator considers relevant. If anything, "take into account" appears, as a matter of language, little different from "have regard to". Indeed, in R v Hunt the expression "have regard to" was understood as requiring that the specified matters be taken into account. The matters specified in (a) to (f) appear, by their nature, to be highly

> material to the task of assessing a proposed Access Arrangement, given the legislative purpose and objects of the Act and the Code in this regard. It is difficult to conceive that it could have been intended that the Regulator might decide to give no weight at all to one or more of the factors stipulated in s 2.24(a) to (f). In my view, in the context of the Act and the Code, the Regulator is required by s 2.24 to take the stipulated factors into account and to give them weight as fundamental elements in assessing a proposed Access Arrangement with a view to reaching a decision whether or not to approve it.

His Honour concluded that the all the factors in s 2.24 are to be given "weight as fundamental elements".

This conclusion as to the weight to be given to the factors in s 2.24 of the Gas Code is based on the text of s 2.24 which is directly reflected in the text of s 28(2)(a) and s 24(6) of the National Gas Law.

Under s 28(2)(a) of the National Gas Law, the AER "must take into account the revenue and pricing principles" [emphasis added] when exercising a discretion in approving or making those parts of an access arrangement relating to a reference tariff or when making an access determination relating to a rate or charge for a pipeline. Under s 24(6) "Regard should be had to the economic costs and risks of the potential for under and over investment...". In the context of the NGL, including the National Gas Objective and s 28(2), the text of s 24(6) of the NGL must be read as meaning the principles are "highly material" considerations.

The Second Reading Speech for the National Gas (South Australia) Bill 2008 also makes clear that the revenue and pricing principles are "fundamental" to the operation of the NGL, in achieving efficient investment and providing certainty. The Second Reading Speech is "extrinsic material" that can be considered to assist in the interpretation of the NGL. It states:

> These principles are fundamental to ensuring that the Ministerial Council on Energy's intention of enhancing the efficient delivery of natural gas services is achieved. To provide certainty to the industry and consumers, these principles will be applied through the National Gas Law. The aim of the pricing principles is to provide the necessary balance between allowing the regulatory regime to evolve as the industry evolves through the National Gas Rules and provide the framework for efficient investment in pipelines.
>
> ....
>
> The fifth principle explicitly requires the Australian Energy Regulator to have regard to the economic costs and risks of the potential for under and over investment by a regulated service provider in its network. The cost of under investment is lower service standards for consumers and ultimately higher costs to correct these, while the cost of over investment is unnecessarily high prices to consumers.

Also, with reference to the "fit for purpose" framework, it states:

> Under this model, the regulator is not given absolute discretion for different elements of the proposal, but is guided in its decision-making by the National Gas Objective, the revenue and pricing principles, and the fit-for-purpose framework established in the National Gas Rules.

The AER notes DBP's comment regarding judicial precedent and refers the AEMC to the following recent decisions of the Australian Competition Tribunal which make specific reference to the AER's application of the revenue and pricing principles.

In *Application by Envestra Ltd (No 2)* [2012] ACompT 3, the Tribunal stated at paragraph 40:

> The AER must have regard to its own reasons for refusing to approve the service provider's proposal. Rule 64(2) must be read in conjunction with obligations on the AER imposed by the NGL, such as the obligation to exercise its economic regulatory functions in a manner that will or is likely to contribute to the achievement of the national gas objective (NGO) and the obligation to take into account the revenue and pricing principles when performing certain economic regulatory functions: NGL s 28.

In *Application by Energy Australia and Others* [2009] ACompT 8 (12 November 2009), the Tribunal reviewed the AER's rejection of Energy Australia's proposed averaging period under the National Electricity Law and National Electricity Rules. The relevant provisions of the National Gas Law (s 28(2) and s 26) are based on the mirror provisions in the National Electricity Law. At paragraph 73, the Tribunal stated:

> A number of principles should be stated which assist in a determination of this issue:
>
> (a) an interpretation of the Transitional Rules that will best achieve the objective or purpose of the NEL is to be preferred to any other interpretation; ...
>
> (d) relevant considerations bearing on the decision to withhold agreement include:
>
> (i) ...
>
> (ii) the achievement of the national electricity objective revenue and pricing principles;

Further, at paragraph 78, the Tribunal stated:

> The Transitional Rules provide the context for the proposing of an averaging period, but the proposal must be in accordance with the NEL, and more specifically with the national electricity objective and the revenue and pricing principles set out in s 7 and s 7A, respectively.

The AER notes DBP's reference to submissions by "regulators" and its view of the interpretation that may be favoured by regulators. However, DBP has not cited any such submissions.

The AER can clarify that it did submit to the Tribunal in *Application by Energy Australia and Others* [2009] ACompT 8 (12 November 2009) that the revenue and pricing principles are clearly relevant considerations that must be taken into account. However, the principles did not control the outcome of the AER's exercise of discretion in the manner claimed by the applicants. Putting aside the particulars of the claims to which the AER was directly responding, the AER's general position was that it must be informed by the principles when exercising its discretion. This point was accepted by the Tribunal (as set out above).

Therefore, the AER considers that DBP's conclusion that there is doubt as to the role that the revenue and pricing principles play in the AER's decision making processes is incorrect. It is apparent from the text of the NGL, as interpreted by the Tribunal and as expressed in the Second Reading Speech, that the principles are fundamental and obligatory considerations in the exercise of the AER's discretion. This reflects the approach set out by the Court in Re Michael with respect to the factors in s 2.24 of the Gas Code.

As explained in the Second Reading Speech, the AER's discretion is not "absolute". For this reason, the AER could not exercise its discretion in any decision to determine whether a service was rebateable or not without regard to the revenue and pricing principles. DBP's suggestion that this could occur is misguided.

Fixed Principle in the NGR

Further to the AER's previous submission on the impact on the Dampier to Bunbury Pipeline Access Arrangement (refer to 1.4 of the AER's submission), and with reference to DBP's submission of 11 May 2012, including the attached Memorandum of Advice from Clayton Utz, the AER sought further legal advice (refer to attachment).

The advice concludes that the inconsistency referred to in rule 99(4)(b) is between "a rule" and a fixed principle. It is not an inconsistency between a "supposed determination" by the AER, that is a determination that Clayton Utz is suggesting the AER might make under a Rule (and which it could only make if it disregarded r 99(3), and a fixed principle).

Accordingly, the AER maintains its view that its proposed change to the definition of rebateable service could not result in a determination by the AER that overrode an existing fixed principle. Under r 99(3), the AER would remain bound by existing fixed principles in making its determination.

Yours sincerely

Chris Pattas
General Manager
Network Operations and Development

ATTACHMENT:

CHARLES SCERRI QC
Barrister

IN THE MATTER OF the AER's Proposed Rule Change and the AEMC's Draft Rule Determination on National Gas Amendment (Reference Service and Rebateable Service Definitions) Rule 2012

SUPPLEMENTARY MEMORANDUM OF ADVICE

INTRODUCTION

1. In August 2011, the Australian Energy Regulator (**AER**) submitted a rule change proposal to the Australian Energy Market Commission (**AEMC**) that sought changes to the definitions of reference service and rebateable service. These proposed changes related to the regulation of Authorised Maximum Daily Quantity Credit Certificates (**AMDQ CC**).

2. I provided a memorandum of advice dated 11 April 2012 dealing with a number of specific questions in respect of the rule change proposal. My advice was provided to the AEMC in support of a further submission by the AER in respect of the rule change proposal. DBNGP (WA) Transmission Pty. Limited (**DBP**) made a further submission to the AEMC on 11 May 2012, and in support of the submission provided a memorandum of advice dated 11 May 2012 from Clayton Utz (**the Clayton Utz advice**). I have been asked to provide a supplementary advice dealing with paragraphs 14 to 24 of the Clayton Utz advice (but I think that paragraph 13 is also relevant so I have discussed that as well).

3. This memorandum needs to be read with my memorandum of 11 April 2012 and with the Clayton Utz advice.

"INCONSISTENCY"

4. In paragraph 13 of the Clayton Utz advice, Clayton Utz quote part of paragraph 34 of my memorandum

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of 11 April 2012. That paragraph was a part of my response to a specific question that I was asked. The question was in two parts, but only the second part is relevant for present purposes. That part, and my answer to that was:

"(d) In relation to the fixed principle in clause 13(a)(ii) of the Dampier to Bunbury Natural Gas Pipeline Revised Access Arrangement of 22 December 2011:

(i) .....

(ii) what would be the impact of rule 99(3) of the NGR on the Dampier to Bunbury Revised Access Arrangement should the definition of rebateable service be amended in the manner proposed by the AER?

Answers: (i) .....
(ii) It would protect the fixed principle.
See paras. 31 to 43, below."

5. In paragraph 34 I said:

"34. Rule 99(4)(b) provides that "if a rule is inconsistent with a fixed principle, the rule operates to the exclusion of the fixed principle". It seems that it is this rule that concerned the AEMC: see para. 32 above. However, as Instructing Solicitors have pointed out, the rule proposed by the AER is a change to the definition of rebateable service. This rule could not be 'inconsistent' with the fixed principle. The inconsistency could arise only if the rule change were made and then the AER (ignoring Rule 99(3) for present purposes – see below) applied the new definition so that in its application the rule resulted in an outcome that was inconsistent with the fixed principle."

6. In paragraph 14 of the Clayton Utz advice it is said:

"14. In our view, there is no basis upon which Rule 99(3) can be read separately from Rule

99(4). It is plain from the terms of the rule that sub-rule (4) is a qualification to sub-rule (3). Accordingly sub-rule (3) must be read with the qualification that if a rule is inconsistent with the fixed principle, the rule operates to the exclusion of the fixed principle."

7. It is unclear whether it is sought to suggest in this paragraph of the Clayton Utz advice that I was seeking to read "*Rule 99(3) .... separately from Rule 99(4).*" As is clear from the full quotation of paragraph 34 of my 11 April 2012 advice, I was "*(ignoring Rule 99(3) for present purposes*" (underlining added) and went on to discuss both rules. Far from overlooking either Rule 99(3) or 99(4), one of my criticisms of the analysis by the AEMC was that "*the analysis does not consider, or even mention, Rule 99(3)*".

8. The third sentence in paragraph 14 of the Clayton Utz advice is "*Accordingly sub-rule (3) must be read with the qualification that if a rule is inconsistent with the fixed principle, the rule operates to the exclusion of the fixed principle.*" That is correct but, as apparently accepted in paragraph 15 of the Clayton Utz advice, that leads to the question of what is meant by "inconsistency". It is the answer to the latter question which determines whether a rule "*operates to the exclusion of the fixed principle*".

9. As to that question, Clayton Utz say:

"16. *In other contexts, inconsistency can have various meaning including direct inconsistency, indirect inconsistency and an inconsistency arising by reason of one set of provisions intending to cover the relevant field and their (sic) complete code in respect of those matters.*

"17. *Mr Scerri's advice that it is only where there is an inconsistency on the face of the provisions that Rule 99(4)(b) has any application. We do not agree with that conclusion.*

"18. *It is, in our view, the better interpretation of the legislative intent that the reference to a rule being inconsistent is intended to be a reference to both an inconsistency on the face of the legislation and also an inconsistent operation."*

10. It is correct, in my opinion, that inconsistency can have different meanings in different contexts. The High Court in September 2011 discussed once more what s.109 of the Constitution means by "inconsistency" between Commonwealth and State legislation: see *Momcilovic v The Queen [2011] HCA 34*. The case is particularly relevant in the present case because it concerned a "declaration of inconsistent interpretation" made under section 36 of the *Charter of Human Rights and Responsibilities Act 2006 (Vic.)*. The Victorian Court of Appeal had made a declaration that the reversal of the onus of proof in a Victorian statutory provision dealing with the possession of illegal drugs was "inconsistent" with the human right of the presumption of innocence. French CJ agreed with the Court of Appeal that there was "inconsistency" under the *Charter of Human Rights and Responsibilities Act* because the reversal of the onus was "not compatible" with the presumption of innocence (see [79]).

11. In relation to "inconsistency" between the relevant Victorian and Commonwealth statutes for the purposes of s.109 of the Constitution, French, CJ agreed with Gummow, J. In lengthy reasons, Gummow, J. emphasised that the concept of "inconsistency" in s.109 occurs in a constitutional context of one legislature having primacy over the other legislatures. His Honour also emphasised (see, e.g. [258]) that the "first task" is to construe the federal law before determining whether it is "inconsistent" with the State law. Gummow, J. also considered the concept of "covering the field" that is alluded to in paragraph 16 of the Clayton Utz advice. His Honour described the "covering the field" metaphor as "apt to distract attention" and approved judicial descriptions of the phrase as "ambiguous" and "of little assistance" ([264]). His Honour concluded ([264]) by referring to the test as expressed by Dixon, J., namely, whether the State law would "*alter, impair or detract from the operation of*" the Commonwealth law.

12. Hayne, J reached substantially the same conclusion. His Honour also emphasised the constitutional context (see, e.g. [309]). He then referred to "six points of present relevance". These included

> "314. ..... *First, application of s.109 requires determination of the valid reach and operation of the federal law in question.* .....
>
> "315 *Second, the reach and operation of the federal law is to be determined by construing that law; that is, by reference to the language, purpose and scope of the law, viewed as a whole within its context, as well as by reference to considerations of consistency and fairness*
>
> .....

> *"317 Fourth, one law is 'inconsistent' with another where they 'are in conflict, so much so that they cannot be reconciled one with the other' .....Laws cannot be reconciled if to give effect to one would alter, impair or detract from the other.*
>
> *"318 Fifth, care must be exercised lest the classification of some examples of inconsistency as 'direct', and others as 'indirect', mask the central importance of deciding whether there is conflict by diverting attention to the attempt to classify what species of conflict is encountered."*

13. In relation to the "covering the field" concept, Hayne, J said (at [339]):

> "..... the *consequence* of a conclusion that the federal law 'covers the field' is that to give effect to the State law would detract from the full operation of the federal law, and it is on that account that inconsistency arises. That is, the case in which it is concluded that a federal law covers the relevant field is a particular example of a more general principle of inconsistency: that there is inconsistency whenever a State law alters, impairs or detracts from the operation of federal law."

14. Crennan and Kiefel, JJ said (at [630]) that "*the different approaches to inconsistency [are] all directed to the same end [and] are inevitably interrelated. That end is to determine whether there is a 'real conflict' [citation omitted] between the laws under consideration*".

15. It seems to me that the passages that I have quoted above from the High Court's reasons in *Momcilovic* are completely consistent with the view expressed in my 11 April 2012 advice. In particular, the first task is to compare the rule change proposal and the fixed principle and to assess whether there is 'inconsistency'. When assessing "inconsistency" one has regard to whether one rule would "*alter, impair or detract from the operation of*" the other, or be "*not compatible*" with the other, or whether the two rules *'are in conflict, so much so that they cannot be reconciled one with the other'* or whether *there is a 'real conflict'*.

16. It remains my view that when "inconsistency" is properly understood, there is no relevant "inconsistency" between the rule change proposal and the fixed principle. It is too simplistic to characterise my view in the way that is done in paragraph 17 of the Clayton Utz advice (see para. 9 above). The contention in paragraph 18 of the Clayton Utz advice (also quoted in para. 9 above) is also too simplistic.

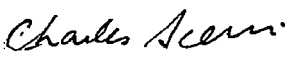
APPLICATION OF PROPOSED RULE

17. Paragraphs 19 to 24 of the Clayton Utz advice discuss the propositions that "... *the change which is proposed to Rule 93(4) will enable a determination to be made that services that are currently the subject of the fixed principle in the DBNGP Access Arrangement would become rebateable services for relevant purposes under the operation of the amended rule*" and "*That is ... a relevant inconsistency for the purposes of Rule 99.*"

18. It seems to me that the inconsistency referred to Clayton Utz is between the supposed determination and the fixed principle. I remain of the view that Rule 99(4) is not concerned with that kind of inconsistency. As it says, it is concerned with an inconsistency between "a rule" and "the fixed principle".

19. In my 11 April 2012 advice I said that, in my opinion, Rule 99(3) would continue to give binding force to existing fixed principles in existing access arrangements. By that I meant to convey that the AER was bound by the fixed principle in making a determination. I do not agree that this proposition (which paragraph 23 of the Clayton Utz advice describes as "implicitly" my view) "*is inconsistent with reading Rule 99 as a whole*" (see paragraph 23 of the Clayton Utz advice). Indeed, I would contend that the contrary view ignores Rule 99(3) in the same way that the AEMC's draft determination ignored it.

20. I have discussed a draft of this memorandum with Instructing Solicitors before I finalised it, but should Instructing Solicitors have any queries they should not hesitate to contact me.



CHARLES SCERRI

Chancery Chambers

4 June 2012