



**The Australian Gas Association**

**Submission to the Australian Competition and  
Consumer Commission**

***Victorian Gas Transmission Review –  
GasNet Access Arrangement Revisions***

**Implications for the ACCC Draft Decision from the  
Epic Energy Supreme Court Judgement**

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# 1. Overview

The Australian Gas Association (AGA) welcomes the opportunity to comment on the *Draft Decision on GasNet Australia Access Arrangement Revisions for the Principal Transmission System* (Draft Decision) released by the Australian Competition and Consumer Commission (the Commission) in August 2002. The Draft Decision is in the process of being finalised at a time in which there have been a number of key developments relating to the present regulatory framework applying to gas transmission and distribution businesses.

Most recently, the Supreme Court of Western Australia has delivered its judgement in the case of *Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor*<sup>1</sup>. As the Commission will be aware, the case related to an appeal made by Epic Energy from the Office of the Gas Access Regulation Draft Decision on the proposed Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline.

The appeal raised a number of critical issues relating to the interpretation and application of the *National Third Party Access Code for Natural Gas Pipeline Systems* (National Gas Code) which have direct relevance to the Commission's assessment of Access Arrangement revisions proposed by GasNet Australia. The Supreme Court judgement on the appeal has particular relevance to the issue of appropriate factors to be considered by regulators in reaching regulatory determinations. It also addresses critical issues of the treatment of past investment decisions and the relationship between economic considerations and broader social and political factors in regulatory decision-making.

The AGA considers elements of the Commission's approach to the review of GasNet's proposed revisions to its Access Arrangement and its Draft Decision may be inconsistent with both key general principles established in the judgement on the Epic Energy case and specific findings on the application of the National Gas Code. The AGA urges the Commission to ensure that the finalisation of the Draft Decision takes into account general issues of principle and specific findings on the interpretation of the National Gas Code set out in the Supreme Court judgement.

## Background

This submission provides further specific information on a number of important matters considered in the recent Supreme Court decision in the Epic Energy appeal, particularly those related to the judicial interpretation of the National Gas Code. These issues have a direct relevance to many elements of the Commission's *Draft Decision on the GasNet Access Arrangement Revisions for the Principal Transmission System* released in August 2002.

The submission summarises in point form the main conclusions of the Court, and provides excerpts of direct relevance to the Commission's consideration of its Draft Decision. This submission is not intended to in any way comment on merits of the

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<sup>1</sup> [2002] WASCA 231, [55]

particular issues in contention in the Supreme Court case, or the arguments raised by any party to the case. It is intended only to clarify the Supreme Court's judicial interpretation of the National Gas Code in relation to the Commission's approach in reviewing GasNet's proposed revisions to its Access Arrangements.

The AGA represents the downstream sector of Australia's natural gas industry. Its members include owners and operators of regulated gas distribution networks and gas pipelines and gas retailers. This submission represents the views of AGA members owning regulated gas transmission assets within Victoria, and complements submissions to the Commission from GasNet Australia.

## **Structure of the submission**

**Part 2** of this submission below summarises the key outcomes of the Epic Energy appeal, including the establishment of some general principles of appropriate regulatory approaches and the interpretation of some key parts of the National Gas Code.

**Part 3** of this submission briefly examines specific implications of the Epic Energy appeal to the Commission's Draft Decision, including a number of possible inconsistencies and/or potential errors of law (page 5).

## **2. Key outcomes of Epic Energy judgement**

The Supreme Court found a number of errors of law made by the Western Australian regulator in reaching the Draft Decision on the Dampier to Bunbury Natural Gas Pipeline (DBNGP) of 7 August 2001.

The Court indicated for a number of reasons that it was not appropriate for it to entirely set aside, or to replace any specific elements of, the Draft Decision (such as the determined Initial Capital Base) with its own views. It made clear, however, that there should be a reconsideration of the Draft Decision and a correction of the errors of law found. The Court will finalise a series of declarations which, along with the judgement, can be expected to guide the regulator's finalisation of the DBNGP Draft Decision.

The Epic Energy court decision establishes a number of important principles highly relevant to the regulation of gas transmission and distribution networks under the National Gas Code.

These principles fall into two broad categories. Firstly, general principles of regulatory approach, and secondly specific principles relevant to applying the provisions of the National Gas Code.

## General principles of regulatory approach

The principles established by the Supreme Court's judgement include:

- regulatory decisions on third party access prices should take into account a number of policy principles established in Section 2.24 of the National Gas Code<sup>2</sup>;
- in the determination of third party access prices the regulator should consider a wider range of political and social considerations, not just economic theory<sup>3</sup>;
- regulators must fully take into account the effect of their decisions on past investment made prior to the introduction of the National Gas Code to ensure that sound commercial investment decisions made in the past are not rendered loss-making because of regulatory determinations<sup>4</sup>;
- the National Gas Code is not aimed at replicating the outcomes of a theoretically 'perfect' market, which is an abstraction. It is designed to promote outcomes similar to those that might occur in a 'workably' competitive market (which may sometimes include elements of persistent market power)<sup>5</sup>;
- the recovery by a regulated business of the actual price paid for an asset including a return on investment is a legitimate business interest, and for a range of social, political and public interest considerations it may be appropriate to consider asset purchase prices in establishing initial regulatory capital bases<sup>6</sup>;
- there is no provision of the National Gas Code that supports the views of regulators that future revenues available to the regulated business must be no more than the efficient cost of delivering the service. There may be public policy grounds in either not distorting investment, or in protecting the legitimate business interests of regulated businesses, to allow the recovery of more than 'efficient' costs<sup>7</sup>; and
- the National Gas Code deliberately adopts two different standards of treating investment, one directed to investments made prior to the introduction of regulation, the other to investment made under the current regulatory framework.<sup>8</sup>

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<sup>2</sup> *Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, [55]

<sup>3</sup> *Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, [152-153]

<sup>4</sup> *Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, [149]

<sup>5</sup> *Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, [128]

<sup>6</sup> *Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, [130]

<sup>7</sup> *Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, [142, 206]

<sup>8</sup> *Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, [182]

## **Specific principles for applying the National Gas Code**

The judgement also establishes a number of more specific principles that give guidance on the correct interpretation and application of specific National Gas Code provisions.

These principles include:

- the assessment of proposed Access Arrangements by regulators should be guided by the factors in Section 2.24 (a)-(g), with each factor being given weight as ‘fundamental elements’;
- the factors in Section 2.24 should guide the regulator in determining how the tariff principles in Section 8.1 of the Code should be reconciled, where these principles conflict;
- the regulator may, to ensure that their decision does not distort investment in gas pipelines or in upstream or downstream industries, take into account the actual investment of a service provider in approving a reference tariff or reference tariff policy. This includes in establishing an initial capital base under Section 8.10 and 8.11 of the Code;
- the regulator may properly take into account an asset purchase, the circumstances of the purchase, and any value according to a recognised asset valuation methodology revealed by a purchase price, in deciding whether the initial capital base should be higher than the depreciated optimised replacement cost (DORC) under Section 8.11 of the Code; and
- in establishing an Initial Capital Base under the National Gas Code it is not the case that only ‘efficient’ capital investment or ‘regulated revenues’ are to be taken into account. That is, it is not true that the initial capital base should only represent a value that is consistent with future regulated revenues or efficient capital investment.

### **3. Implications for the Draft Decision**

It is important that the Commission carefully assesses and accords weight to the Epic Energy appeal decision. The decision represents one of the few judicial statements available to guide regulators on the application of the National Gas Code, and in particular, the assessment of proposed Access Arrangements, a task before the Commission. While the decision of the Supreme Court is not a legal precedent that the Commission is bound to apply, it is the only judicial interpretation of core provisions of the National Gas Code that are central to the Commission’s assessment of the proposed revisions to the Access Arrangement of GasNet Australia.

The Commission's Final Decision on GasNet's proposed Access Arrangement revisions will be one of the first significant regulatory decisions since the WA Supreme Court judgement. For this reason, the AGA is particularly concerned to ensure that this Final Decision appropriately considers and incorporates the key principles of regulatory decision-making and Code interpretation detailed in the judgement and summarised in this submission. The AGA has made a similar submission in respect of the Victorian Essential Services Commission's Draft Decision.

From the ACCC's Draft Decision, the AGA considers that there is an appreciable risk that some elements of the Commission's assessment of GasNet's proposed revisions to their Access Arrangement might be inconsistent with key findings and guidance from the Epic Energy decision. Some of these inconsistencies may represent potential errors of law.

Potential inconsistencies are apparent in a number of specific areas of the Commission's Draft Decision. The AGA considers that the Commission may have erred in the Draft Decision by *inter alia*:

- **giving undue weight to one factor in Section 8.1** – The Commission has narrowly characterised Section 8.1 of the Code by referring to the 'central theme' of the Section as being the pursuit of 'economic efficiency'.<sup>9</sup> This appears to give undue weight to Section 8.1(a), to the possible exclusion of broader public interest considerations underlying, for example, Section 8.1(d). The Supreme Court judgement clearly holds that the fulfilment of Section 8.1 should not be narrow exercise in economic theory.<sup>10</sup> The Court instead concluded that due to provisions such as Section 8.1(d), the application of Section 8.1 should take into account wider political and social considerations, including the effect of regulatory decision-making on past and future investment decisions<sup>11</sup>;
- **failing to have regard to Section 2.24 in reconciling conflicting principles in Section 8.1** – The Commission fails to indicate in the Draft Decision that it has had any regard to the factors in Section 2.24 in carrying out the task of reconciling the conflicting principles in Section 8.1. The Commission states that the principles in Section 8.1 may be 'reconciled' purely by the adoption of price controls based on a regulator's assessment of 'efficient costs'.<sup>12</sup> This appears to be inconsistent with the Supreme Court judgement, which highlighted the necessity of looking outside of Section 8.1 (i.e. to Section 2.24) to reconcile the conflicting principles within Section 8.1<sup>13</sup>; and

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<sup>9</sup> ACCC Draft Decision - GasNet Australia Access Arrangement Revisions for the Principal Transmission System August 2002, Section 5.1, p.52

<sup>10</sup> Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor [2002] WASCA 231, [153]

<sup>11</sup> Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor [2002] WASCA 231, [149, 152-153]

<sup>12</sup> ACCC (2002), Section 5.1 p.52 and see also Section 8.3.1 p.151

<sup>13</sup> Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor [2002] WASCA 231, [136] The Court judgement makes the point that reference to the broader Section 2.24 appears to be required by the National Gas Code in reconciling the potential disparate principles of Section 8.1, and that reconciling those principles solely by reference to Section 8.1 is not possible.

- **incorrectly interpreting Section 8.1(a) as an ‘overarching requirement’** – The Commission describes in its considerations of National Gas Code requirements a single element of Section 8.1 as an ‘overarching requirement’.<sup>14</sup> The ‘overarching requirement’, the Commission states, is that prices should be based on ‘efficient costs’.<sup>15</sup> Whether Section 8.1 (a) had any overarching effect was a key matter in the WA Supreme Court ruling, where the clear finding was made that this was an interpretation not supported by the actual terms of National Gas Code.<sup>16</sup>

The AGA also has significant concerns regarding the Commission’s process in giving due consideration to Section 2.24 for the purposes of assessing GasNet’s proposed revisions to their Access Arrangement. In its Draft Decision the Commission does not provide details of how it considers it has met the mandatory requirement to apply Section 2.24 in the assessment of the proposed Access Arrangement revisions. The Commission’s Final Approval in respect of the Moomba to Adelaide Pipeline System, however, does address this issue of regulatory due process. It states:

The Commission agrees that all aspects of an access arrangement must be considered in light of the factors set out in section 2.24 of the Code. While the *Draft* and *Final Decisions* do not contain lengthy discussions of this section, the Commission did consider the factors set out in section 2.24, albeit implicitly in some sections. *By way of example, in its consideration of the submissions from both users and the service provider, the Commission took into account the interests of those parties and in doing so demonstrates compliance with the Code’s requirement under section 2.24.*

Not all of the section 2.24 factors will have equal relevance to all provisions of the access arrangement. Accordingly, the Commission does not believe that it must provide detailed consideration of each of the factors set out in section 2.24, in relation to every provision of the access arrangement and consequently, has not done so.<sup>17</sup> (emphasis added)

The AGA does not believe that the consideration of public submissions in any substantial way discharges obligations of the regulator under the National Gas Code to fully consider and apply as fundamental elements the factors set out in Section 2.24.

The AGA has strong concerns if that statement from the Commission represents a substantial description of its approach in assessing a range of critical public policy considerations. If the Commission has solely adopted this approach in relation to either the Moomba to Adelaide Pipeline System Final Approval or the assessment of proposed revisions to GasNet’s Access Arrangement, the AGA considers that the Commission may have seriously erred in the application of the National Gas Code.

In the view of AGA these potential inconsistencies and errors of law warrant the Commission closely considering the issues involved to ensure that its Final Decision recognises and incorporates key underlying principles of the Epic decision. This may require as a first step re-examining elements of the Draft Decision to ensure that

<sup>14</sup> ACCC (2002), Section 8.3.1 p.151

<sup>15</sup> See ACCC (2002), Section 8.3.1 p.151. Section 8.1(a) of the National Gas Code refers to ‘...a stream of revenue that recovers the efficient costs of delivering the Reference Service...’

<sup>16</sup> See *Re: Dr Ken Michael AM; Ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, [157-162]

<sup>17</sup> ACCC *Final Approval – Access Arrangement proposed by Epic Energy South Australia Pty Ltd for the Moomba to Adelaide Pipeline System* July 2002, p.4

errors of law and fact have not been made with regards to the interpretation of, and weight given to, specific provisions of the National Gas Code. Secondly, the Commission should consult with AGA and GasNet on any concerns that the Draft Decision may incorporate errors of law.

The Australian Gas Association  
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