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9 November 2004

Mr Michael Walsh
Director, Gas Group
Regulatory Affairs Division
Australian Competition and Consumer Commission
GPO Box 3648
SYDNEY NSW 2001

Dear Mr Walsh

Draft Regulatory Reporting Guidelines for Gas Pipeline Service Providers

Australian Pipeline Trust ("APA") welcomes the opportunity to provide a further submission to the Commission in relation to the draft Reporting Guidelines.

As we submitted in our letter of 25 June 2004, APA believes it is important that when the Commission imposes guidelines under section 4.2, the guidelines are properly based in powers delegated to the Commission as regulator under the Code. APA does not object to the lawful issue of guidelines under section 4.2; the Code delegates to the regulator the power to issue guidelines and APA recognises the potential benefits from the development of standard requirements. However, we remain of the view that the imposition of guidelines in the form of the draft Reporting Guidelines would be beyond the power delegated to the Commission under the Code.

Given the significance of this issue, we have obtained legal advice as to whether the issue of the draft Reporting Guidelines would be within the power delegated to the Commission under the Code. A copy of that advice is attached. As you will see, the advice concludes that the imposition of the draft Reporting Guidelines in their current form this would be beyond the power delegated to the Commission under the Code.

If the Commission remains of the view that the imposition of the draft Reporting Guidelines is within power delegated to the Commission under the Code, we seek an opportunity to discuss this with the Commission to understand the reasons for the Commission's view as to the extent of its powers.

We would be pleased to discuss this submission if the Commission wishes to do so.

Yours faithfully

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9 November 2004

Ms Sandra Dureau
General Counsel
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Dear Ms Dureau

Draft Regulatory Reporting Guidelines for Gas Pipeline Service Providers

You have sought our comments on the draft *Regulatory Reporting Guidelines for Gas Pipeline Service Providers* (**Draft Guidelines**) issued by ACCC in May 2004 purportedly in relance on sections 4.1, 4.2, 4.12 and 4.13 of the *National Third Party Access Code for Regulated Gas Pipelines* (**Code**).

In this advice, references to parts and sections are references to the Code.

Conclusions

We are of the view that the Draft Guidelines have largely been issued beyond the power delegated to the relevant regulator under the Code for the following reasons:

1. sections 4.2(a) and 4.2(b) do not give ACCC the power:

   - to require APT to prepare a Regulatory Accounting Manual;
   - to, except to the extent that the manual includes matters that relate to the preparation of the accounts under sections 4.1(c), (d) and (e) so as to enable ACCC to verify the calculation of the Reference Tariff during the review of an Access Arrangement, require APT to use the Regulatory Accounting Manual to prepare Regulatory Financial Statements; and
   - to require APT to annually comply with the Annual Reporting Requirements by providing the Regulatory Financial Statements, preparing a Statement of Compliance and obtaining and providing an Auditors Report;

2. the courts, when considering whether any part of the Draft Guidelines is issued beyond the power delegated to ACCC, will adopt a narrow interpretation of what is within power;

3. the Draft Guidelines themselves cannot be properly described as 'general accounting guidelines' as they are prescriptive as to form and content and are better described as accounting standards;

4. section 4.12 does not authorise ACCC to require APT to prepare a Regulatory Accounting Manual; and

5. sections 4.12 or 4.13 do not authorise ACCC to require APT to comply with the Annual Reporting Requirements.

As a consequence, APT may choose not to comply with the Draft Guidelines.

If, however, ACCC imposes a guideline in the form of the Draft Guidelines, then APT will have to determine whether:

- to comply with the Draft Guidelines, when it is of the view that ACCC had no legislative basis for promulgating all or most of the guidelines; or

- it is prepared to face enforcement proceedings for failure to comply.

As a major listed company, we are instructed that APT seeks to actively comply with legislative requirements as a matter of good corporate governance. However, APT has a responsibility to its unitholders to ensure that it does not embark on courses of action that are costly and administratively burdensome where it has no legitimate obligation to do so.

Thus, the issue by ACCC of the Draft Guidelines in the current form will place APT in the difficult position where it must choose to either comply with a formal requirement of ACCC which it regards as unlawful or refuse to comply and face threat of legal action by ACCC.

Similarly, ACCC will be in a difficult position as it will either have to seek to enforce the Draft Guidelines knowing that they are ultra vires or be seen to accept apparent non-compliance by service providers.

The Draft Guidelines

The Code imposes on service providers obligations to ring fence each of its Covered Pipelines, including requirements with respect to the preparation of separate, consolidated and disaggregated accounts (ie sections 4.1(c), (d) and (e)) and requirements with respect to reporting on compliance with the ring fencing obligations (ie sections 4.12, 4.13 and 4.14).

Section 4.2 of Part 4 of the Code authorises the regulator to publish or approve general accounting guidelines that relate to matters addressed in sections 4.1(c), (d) and (e) (**GAGs**). The Draft Guidelines have purportedly been published as GAG's under sections 4.2(a) and 4.2(b).

Clause 1.1 of Draft Guidelines is entitled "Purpose and overview" and sets out ACCC's stated purposes in issuing the Draft Guidelines. They are:

(a) to assist service providers to develop a set of principles governing the preparation of their accounts under sections 4.1(c), (d) and (e);

(b) to assist ACCC to monitor compliance with those sections;

(c) to ensure that reports are prepared using consistent, transparent and verifiable principles;

(d) to set out principles to assist a service provider to prepare a Regulatory Accounting Manual (**RAM**), the purpose of which is:

(1) to allow the service provider to set out the procedures and processes that will instruct the service provider's preparation of Regulatory Financial Statements (**RFS**), which ACCC will then approve;

(2) to help ACCC understand the basis on which the RFS have been prepared; and

(3) to allow an Auditor to determine whether the RFS are presented fairly in accordance with the RAM;

(e) to require the service provider to prepare and submit to ACCC for each Covered Pipeline an Annual Reporting Requirement (**ARR**); and

(f) to enable ACCC to monitor compliance by setting out the basis on which ACCC can require service providers to provide additional information.

These stated purposes clearly demonstrate that ACCC understands, and is of the strong view, that there are no effective constraints on its powers to require service providers to comply with these purposes, even if the method chosen by ACCC is in conflict with the structure of Part 4.

The Draft Guidelines impose the following specific obligations on service providers:

(a) to prepare and maintain a RAM which describes the policies and procedures for construction of the regulatory accounts and associated financial statements for approval by ACCC;

(b) to prepare the RFS using the approved RAM consisting of the following reports:

(1) General Purpose Financial Statements (**GPFS**), which are treated as equivalent in nature to the accounts to be prepared under section 4.1(d);

(2) Special Purpose (Regulatory) Financial Statements (**SPRFS**), which are treated as equivalent in nature to the accounts to be prepared under section 4.1(c), which have been audited to Auditing Standard AS802; and

(3) Disaggregation Statement (**DS**), which is treated as equivalent in nature to the accounts to be prepared under section 4.1(e);

(c) to provide to ACCC annually the ARR consisting of:

(1) the RFS;

(2) a Statement of Compliance (**SC**) which is approved by the Board of the service provider and signed by the CEO and a director; and

(3) an Auditors Report on the RFS prepared by an independent auditor (**AR**).

Reflecting the purposes stated by ACCC, the Draft Guidelines split these obligations into three separate GAGs:

(a) principles for preparing the RFS (Part 1, section 2 and Appendices 4 and 5), that is the principles to guide the preparation of the RFS as the accounts required to be prepared by the service provider under sections 4.1(c), (d) and (e) – these are stated to be intended to be issued as a GAG under section 4.2(b) (**RFS GAG**);

(b) preparation of the RAM (Part 1, section 3 and Appendix 1), which set out the principles to guide the preparation by a service provider of a RAM – these are stated to be intended to be issued as a GAG under section 4.2(b) (**RAM GAG**); and

(c) reporting requirements (Part 2, sections 4 and 5 and Appendices 2 and 3), which require a service provider to provide to ACCC the ARR consisting of the RFS, a SC and an AR – these are stated to be issued as a GAG under sections 4.2(a), 4.12 and 4.13 (**Reporting GAG**).

Scheme of Part 4 of the Code

The question of whether the Draft Guidelines have been issued lawfully will be assessed against an assessment of the overall scheme of the Code and the particular powers that Parliament delegated or intended to be delegated to the regulator under and in the context of the scheme and, in particular, under and in the context of Part 4 of the Code.

The Code deals with the rights of third parties to access to regulated natural gas pipelines. Structurally, whilst the Code imposes an obligation on service providers to comply with the terms of the Code and the terms of Access Arrangements approved by the regulator (including Reference Tariffs charged by a service provider to an access seeker) under the Code, it also gives service providers substantial discretion as to the methods that a service provider may adopt to ensure compliance.

The Code does not provide any on-going role for the regulator to assess or review Access Arrangements at any time other than on reviews of Access Arrangements proposed by a service provider. The Code also does not provide a general compliance role for the regulator. The scheme of the Code is that obligations are imposed on a service provider, but the manner of compliance with those obligations (including many aspects of Access Arrangements and many aspects of ringfencing) is left to the discretion of the service provider.

Part 4 of the Code is not a general "powers" section. It is concerned only with the separation of ownership and retail activities. The accounting obligations that are imposed under Part 4 are done so in the context of ring fencing and are directed toward the identification of the costs of providing services through a Covered Pipeline. Any question of the extent of the regulator's powers under section 4.2 is, therefore, coloured by the function of section 4.

Section 41 of the *Gas Pipelines Access Act* allows the regulator to collect information from service providers to enable the regulator to monitor compliance with the Code – this is the relevant Code/Law information gathering mechanism to enable the regulator to monitor compliance where the regulator is given that monitoring role. There is no separate ability for the regulator to issue guidelines seeking to obtain this information in absence of a clear role to monitor compliance accompanied by a delegated power to issue the guidelines.

The regulator's role in considering and reviewing Reference Tariffs under the Code is limited to specifically designated periods, being the time that the Access Arrangement is initially established and then at pre-determined review dates. It is not the structure of the Code that the regulator has an ability to verify Reference Tariffs or review revenues or costs on an on-going ad-hoc basis.

At the time of exercising a power to review Access Arrangements, the regulator can obtain information either through Access Arrangement information provided under section 2 by a service provider, by issuing section 41 notices or through voluntary provision by a service provider. Given these specific information gathering powers, it is not structurally intended that the section 4 guideline-making power be used by the regulator to obtain information for the purposes of a review of Access Arrangements.

The Code also does not give the regulator a general power to issue guidelines governing either Access Arrangements or any other obligations of service providers under the Code. The only power delegated to the regulator to issue guidelines is in Part 4, section 4.2, which authorises the regulator to issue GAGs.

In particular, section 4.2:

(a) empowers the regulator to either publish a GAG (section 4.1(a) or second limb, section 4.2(b)) or, if the regulator has not published a GAG, approve a GAG prepared by a service provider (first limb section 4.2(b));

(b) provides some guidance on what the GAGs may deal with, that is, amongst other things, a requirement that the accounts prepared under sections 4.1(c), (d) and (e) contain sufficient information and are presented in such a manner as would enable the regulator to verify the calculation of the Reference Tariffs for Covered Pipelines; and then

(c) requires service providers to use a properly issued GAG when complying with sections 4.1(c), (d) and (e) (ie comply with the GAG provisions when preparing the accounts under those sections).

If the regulator issues GAGs that impose obligations that go beyond the scope of section 4.2, then the issue of the GAGs will beyond power.

In terms of internal procedure and reporting requirements imposed on a service provider, the Code contains specific account maintenance and reporting obligations under sections 4.12, 4.13 and 4.14 that were intended by the legislature to apply to Part 4. Under these sections, the onus is on a service provider to comply, not on the regulator to specify the manner of compliance.

There is no separate power that allows the regulator to impose conditions or methods of compliance in respect of matters dealt with by sections 4.12 – 4.14. If the regulator does issue GAGs which attempt to impose conditions or specify a manner of compliance, the issue is beyond power.

RFS GAG

The issue of some parts of the RFS GAG may be an ultra vires exercise of the power delegated to ACCC under section 4.2.

Section 4.2 specifically delegates to the regulator the power to issue GAGs relating to the preparation of the accounts under sections 4.1(c), (d) and (e), including with the objective that the accounts contain sufficient information and be presented in such a manner to enable the regulator to verify the calculation of the Reference Tariffs.

Therefore, prima facie, to the extent that the RFS GAG is a general accounting guideline dealing with matters relating to the preparation of the accounts under sections 4.1(c), (d) and (e) with the purpose of enabling ACCC to verify the calculation of the Reference Tariffs at the time that ACCC is exercising its power to review Reference Tariffs, it **will not be** beyond power. Conversely, to the extent that the RFS GAG deals with matters not relating to the preparation of the accounts under sections 4.1(c), (d) and (e), the RFS GAG **will be** beyond power.

It is important to note that if the courts are called upon to consider whether the RFS GAG (and the other GAGs referable to the Draft Guidelines discussed below) is issued beyond the power delegated to ACCC, we believe that the courts will adopt a narrow interpretation as to what is within power. That is, unless ACCC demonstrates that the RFS GAG addresses matters that are squarely within the ambit of the express delegated power, the courts may find that some or all of the exercise of power in issuing the RFS GAG is ultra vires to the extent that it exceeds the delegated power or constitutes an exercise of power that was not intended by Parliament

However, even if the RFS GAG has prima facie been issued within power, arguably the RFS GAG is not a 'general accounting guideline' for the purposes of section 4.2. The RFS GAG appears not to be a set of *general principles or procedures of accounting* on how to prepare the accounts under sections 4.1(c), (d) and (e), but a set of specific directions on what must be included in the form and content of the accounts under sections 4.1(c), (d) and (e). This is more in the nature of an accounting standard than a general accounting guideline and is therefore outside the scope of section 4.2. In this case, the RFS GAG is ultra vires.

RAM GAG

The issue of the RAM GAG is an ultra vires exercise of the power delegated to ACCC under section 4.2.

In our view, ACCC does not have the power to require a service provider to prepare a RAM under either of sections 4.2 or 4.12.

Section 4.2

There is no provision in section 4.2 that gives the regulator the power to require a service provider to submit a RAM to the regulator for approval, including by way of an 'invitation' to the service provider to submit a RAM on its own accord under threat that a failure to do so will result in the regulator imposing its own RAM, even if the intention of the regulator in inviting a service provider to prepare the RAM is to minimise the extent to which the regulator prescribes inputs of accounting processes and procedures for a particular pipeline.

The only power given to the regulator under section 4.2 is to either:

(a) publish a general accounting guideline; or

(b) advise a service provider of a service provider-specific GAG (really a non-GAG) that it must comply with if the regulator itself has not published a GAG and a service provider has not submitted a GAG to the regulator for its approval.

For the same reasons as enumerated above for the RFS GAG, it is also arguable that the RAM GAG is not a 'general accounting guideline' but an accounting standard. It is, therefore, ultra vires.

Section 4.12

It may be considered by the regulator that the regulator has the power to require a service provider to prepare a RAM as an 'internal procedure to ensure compliance with section 4' under section 4.12.

However this may be challenged on the basis that the obligation to establish and maintain appropriate internal procedures under section 4.12 is placed on the service provider, not given to the regulator. No power is delegated to the regulator to require the service provider to adopt internal procedures in a particular format. The regulator's only power is to require a service provider to demonstrate that the procedures it adopts to ensure compliance with the Code are adequate and, if the regulator is not satisfied as to adequacy, to then bring enforcement action for breach of a Regulatory Provision.

Reporting GAG

The issue of the Reporting GAG is an ultra vires exercise of the power delegated to ACCC under sections 4.2, 4.12 and 4.13.

Section 4.2

Section 4.2 does not give the regulator any power to require that a service provider provide the ARR to the regulator.

Section 4.2 only gives the regulator the power to issue GAG's as to how a service provider is to prepare accounts under sections 4.1(c), (d) and (e). The delegated power does not extend to the issuing of a GAG that requires a service provider to provide reports in respect of those accounts. Within the context of Part 4, all reporting requirements are exclusively dealt with under sections 4.12, 4.13 and 4.14.

Accordingly, a Reporting GAG that requires a service provider to provide the ARR is not a valid GAG on:

(a) how to prepare the accounts under sections 4.1(c), (d) and (e); or

(b) what constitutes sufficient information to include in the accounts or the manner in which the accounts must be prepared,

as none of the requirements to provide the RFS and the SC to ACCC or to engage an auditor to prepare and provide to ACCC the AR (and, in the process owe a duty of care to ACCC), are contemplated or authorised by Part 4.

Section 4.12

Section 4.12 does not give ACCC the power to require the preparation and provision to ACCC of the ARR as required by the Reporting GAG.

Rather, Section 4.12 requires a service provider to establish and maintain 'appropriate' internal procedures to ensure that it complies with its section 4 obligations and allows the regulator on reasonable notice to require a service provider to demonstrate that the internal procedures are adequate. However, the Code gives service providers discretion as to the form of the internal procedures they adopt and the manner that they ensure compliance with the internal procedures.

The section does not give the regulator power to mandate a form of report or procedure, much less a prescriptive series of reports consisting of the ARR. In our view:

(a) the RFS is not an 'internal procedure' as it is the actual accounts required to be prepared under sections 4.1(c), (d) and (e);

(b) the SC is not a demonstration of the 'adequacy' of the service provider's internal procedures, but a statement of compliance (as matter of fact); and

(c) whilst the AR is a report prepared by a service provider (ie a service provider causes it to be prepared) and may, therefore, be a report that 'demonstrates the adequacy of service provider's internal procedures', the requirement that a service provider must produce an AR may be beyond power on the grounds that:

    (1) there is no evidence that the Legislature intended to impose an obligation on a service provider to provide a report in a form mandated by the regulator;

    (2) rather, Part 4 gives a service provider discretion as to how it demonstrates adequacy with the onus on the service provider to justify its position under threat of compliance action by the regulator;

    (3) prescription as to the form of the report to be provided under section 4.12 may indicate that the regulator has pre-determined the outcome of a service provider's demonstration of the adequacy of its procedures, in that the regulator has determined to not be satisfied as to adequacy if the report is not in the prescribed format; and

    (4) to mandate only one measure of demonstrating adequacy (ie audit on the terms set out by the regulator) is, therefore, beyond power.

Section 4.13

Section 4.13 does not give ACCC the power to require the preparation and provision to ACCC of the ARR as required by the Reporting GAG.

Rather, section 4.13 requires a service provider to provide a report to the regulator, at reasonable intervals determined by the regulator, describing the measures taken by the service provider to ensure compliance with its obligations under section 4. The report must also provide an accurate assessment of the effect of those measures.

Not all of the components of the ARR can be described as a description of the measures that a service provider has taken to ensure compliance with section 4.

The RFS are the actual accounts produced by a service provider, not a description of measures taken to ensure compliance. The RFS are produced in accordance with the RAM required under the RAM GAG, which is a description of the processes to be adopted. But, the RFS are the product of applying the RAM, not a description of the measures taken to ensure compliance.

The SC is a statement taking formal responsibility that a service provider has complied with its obligations under sections 4.1(c), (d) and (e) and has complied with the Draft Guidelines, including the RFS GAG and the RAM GAG. If the RFS GAG and RAM GAG were validly issued, the SC could be one means of demonstrating compliance with the service provider's obligations. However, while the SC does provide an accurate assessment of the effect of those measures (ie if the CEO + Board sign off, ACCC can be comfortable that the effect of the measures adopted is sufficient to mean compliance), it is beyond power for ACCC to prescribe only one manner by which compliance can be demonstrated.

The AR is an external report on whether the SPRFS has been prepared in accordance with the RFS GAG and the RAM GAG, section 4.1 and the Code. It is a report prepared by a service provider, in that the service provider causes the auditor to produce it, and it is then supplied by the service provider to ACCC. It can therefore be said to be a report that describes the measures taken by a service provider to ensure compliance with its obligations under section 4. The AR may also be a report that provides an accurate assessment of the effect of those measures (ie did or did not a service provider comply with the RAM GAG and the RFS GAG when preparing the SPRFS?). The provision of the AR annually probably also satisfies the requirements that ACCC can require a report 'at regular intervals'.

However, the requirement that a service provider must produce an AR is nonetheless beyond power on the grounds that:

(a) there is no evidence that the Legislature intended to impose an obligation on a service provider to provide a report in the form of the AR as the report under section 4.13, including the requirement for appointment of an auditor, let alone an auditor on the terms set out in the AR;

(b) prescription as to the form of the report to be provided under section 4.13 may indicate that the regulator has pre-determined the outcome of a service provider's demonstration of its compliance in that the regulator has determined to not be satisfied as to compliance if the report is not in the prescribed format;

(c) rather, the Legislature intended under section 4.13 to give a service provider flexibility as to how it prepared reports, provided that the reports described properly the measures taken by the service provider and was an accurate assessment of the effect of those measures (which could occur in a number of ways without the need to obtain an audit); so

(d) to mandate only one measure (ie audit) is, therefore, beyond power.

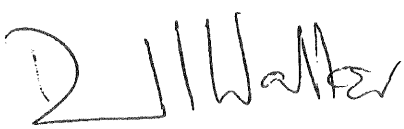
Consequences for APT

The issue of the Draft Guidelines in final form without any substantive change to its structure or form will be substantially ultra vires and as such will place APT and other service providers in a difficult position.

In our view, APT must seek a substantial re-write of the provisions before the Draft Guidelines are imposed as a binding GAG.

Please do not hesitate to contact me to discuss this advice.

Yours sincerely



David Walker
Partner