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11 May 2012

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

Dear Sir

AER NATIONAL GAS RULES RULE CHANGE PROPOSAL – REFERENCE AND REBATEABLE SERVICES

DBNGP (WA) Transmission Pty Ltd (**DBP**) thanks the Australian Energy Market Commission (**the Commission**) for the opportunity to participate in the rule change assessment process regarding the definitions of reference and rebateable services. On 26 April 2012, DBP made a submission responding to the Commission's Draft Rule Determination released on 15 March 2012 (**Draft Determination**) and largely supporting that determination.

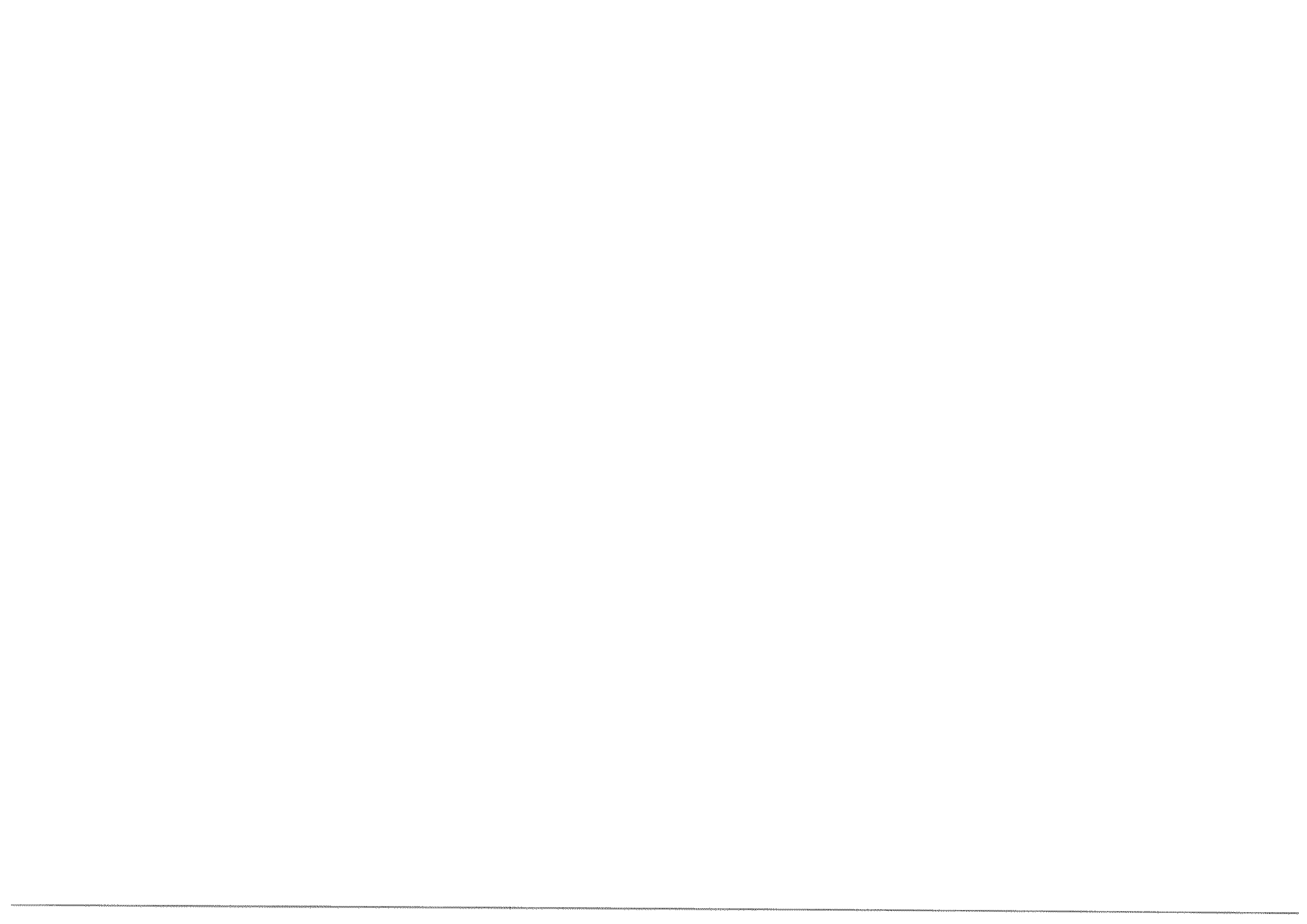
Of particular relevance from the Draft Determination (in so far as this letter is concerned) are the following two reasons the Commission relied on to not agree with the request to change the definition of rebateable service in the NGR:

1. the impact that the proposed definition may have on "most favoured nation" clauses in negotiated contracts and the consequences that may have for investment incentives (**MFN Reason**); and
2. the impact that the proposed definition may have on the Fixed Principle in the DBNGP Access Arrangement and the consequences that may have for investment incentives (**DBNGP Reason**).

Executive Summary

DBP notes that the AER provided substantive submissions on 27 April 2012 responding to the Draft Determination. It argues that there is no legal basis or policy ground for relying on the MFN Reason or the DBNGP Reason to not agree to the requested change to the definition. The AER's submissions in this regard rely heavily on an opinion issued by its counsel, Mr Scerri QC.

DBP submits that the bases for the AER's submission that there is no legal basis or policy ground for the AEMC to rely on the MFN Reason and the DBNGP Reason are incorrect and accordingly, they are still valid reasons for the AEMC to rely on to not agree to the proposed change to the definition of "rebateable services".



DBP addresses the AER's submissions on the MFN Reason and the DBNGP Reason in turn below. Before doing so, it is important that DBP respond to a preliminary issue.

Preliminary issue – What was the policy behind the DBNGP Fixed Principle under the NGR?

There is a suggestion from the AER's submission that there is a policy ground to not protect the fixed principle for the DBNGP. DBP submits that this is not correct. To the contrary - there was clear policy intent of the WA Government that the Fixed Principle would not be unwound or negated by either the NGR or its application by regulators.

At the time of the development of the NGR, DBP acknowledges that it was made clear in the SCO deliberative process that the general position was that fixed principles approved under the Gas Code were not to be protected from any subsequent changes in the law that had the effect of negating them. This was what led to the introduction of Rule 99(4) in the NGR.

However, DBP submits that there was one exception to this position – the DBNGP Fixed Principle. That the DBNGP Fixed Principle was to be an exception was accepted by SCO officials during the deliberative process because of how important the continuation of that principle was in ensuring investment in the DBNGP. Furthermore, in signing off on the NGR and in enacting the NGR as a part of the law of Western Australia, the Western Australian Government recognized the need to exempt the Fixed Principle for that reason. It was therefore protected through the inclusion in the Western Australian National Gas Law of not only Transitional Rule 6 but also through the inclusion of a specific regulation making power in section 21(5) of the National Gas Access (WA) Act 2009.

There were a number of reasons for why the DBNGP Fixed Principle was protected through multiple legislative means and not just by means of a regulation. Firstly, it was appropriate to be dealt with in the NGR rather than the National Gas Law. This was because the topic of Fixed Principles was a topic to be regulated under the NGR. Any state based transitional arrangements concerning matters to be covered by the NGR were dealt with in the Transitional Rules.

The second reason was that it was acknowledged that the inclusion of Transitional Rule 6 in the NGR did not fully protect the DBNGP Fixed Principle. This was because the NGR rule change process set out in the NGL could enable the NGR to be changed in a way that the WA Parliament could not control. Furthermore, a regulator might decide to not give the intended effect to Transitional Rule 6 in a future access arrangement decision for the DBNGP. Accordingly, section 21(5) of the National Gas Access (WA) Act 2009 was included to enable the State to make a regulation to protect the DBNGP Fixed Principle should the Transitional Rule cease to have its intended effect.

Response to AER's Submissions

1. AER's Submissions on the MFN Reason

The AER has sought legal advice on the impact of the AER's proposed rule change on triggering MFN clauses in existing contracts.

That legal advice concludes that the proposed rule change would not result in the potential triggering of the MFN clauses and that even so, the National Gas Law (specifically ss 24(6) and 28(2)) and the National Gas Rules (**NGR**) require the AER to have regard to the impact of triggering MFN clauses in existing contracts when deciding whether to permit the rebating of revenue under rule 93 of the NGR. The AER's legal advice further concluded that this would be

comparable to the requirement under s 2.24(b) of the former Gas Code. So, according to the AER, there is no increased risk

These submissions raise two issues.

First, DBP submits that there is doubt that sections 24(6) and 28(2) of the NGL are comparable to section 2.24(b) of the Gas Code. There is judicial precedent to the effect that section 2.24(b) of the Gas Code was a consideration that a regulator was required to give fundamental weight to when it made a decision in relation to an access arrangement[1]. However, sections 28(2) and 24(6) require the regulator to only take into account the principle that "regard should be had to the economic costs and risks of the potential for under and over investment by a service provider in a pipeline with which the service provider provides pipeline services".

There is a subtle but important distinction in drafting of the Gas Code provisions and the NGL provisions that suggests that the NGL provisions could be interpreted to mean that the Regulator may not have to give fundamental weight to the principle of the economic costs and risks of the potential for under and over investment and instead, the regulator only has to have regard to the principle. That this may be the interpretation being favoured by regulators is borne out in recent submissions made by regulators to the Australian Competition Tribunal.

While there is hope that there may be some judicial precedent shortly established on the role that the revenue and pricing principles play in the regulator's decision making process under the NGR (for at least reference tariff matters), at the moment there is doubt.

The second issue raised by the AER's submissions is that, regardless of the importance of the revenue and pricing principles in the regulator's decision making process, DBP is of the view that it is not appropriate to establish a regime whereby it is left to the regulator to exercise its discretion in a way that that may trigger MFN clauses in existing contracts.

These bilateral contracts containing MFN provisions were negotiated between the parties on the understanding that the trigger events of those MFN clauses could only be as a result of the actions of the party providing the pipeline services. To allow a third party's actions (in this instance, the regulator) with the ability to trigger the relevant MFN clause drastically alters the risk/reward balance in these contracts. Had the parties contemplated that these MFN clauses could be triggered by third parties, the risk/reward balance would have been structured differently to account for the increased risk in the MFN clause being triggered. Without that re-structuring, it is most likely to create an adverse impact on investment incentives.

2. AER's Submissions on the DBNGP Reason

The AER claims that there is no legal basis for relying on the DBNGP Reason to reject the proposed rule change. This stems from the legal advice from Mr Scerri QC.

That advice contains two reasons for why there is no legal basis:

(a) Transitional rule 6 does not have any application to clause 13(a)(ii) of the current Dampier to Bunbury Natural Gas Pipeline access arrangement; and

(b) In any event, the proposed rule change, if implemented, would not affect the fixed principle for the DBNGP because it is protected by rule 99(3) of the NGR.

DBP addresses each of these reasons in turn

[1] *Re: Dr Ken Michael Am; ex parte Epic Energy (WA) Nominees Pty Ltd & Anor [2002] WASCA 231 (23 August 2002)*

(a) *Applicability of Transitional Rule 6 to the current fixed principle in the DBNGP access arrangement*

DBP would like to consider that this is not a correct interpretation of Transitional Rule 6. Transitional Rule 6 uses the wording that it is the *"fixed principle referred to"* in clause 7.13(a)(ii) of the access arrangement dated 21 November 2006. And so, so long as the substance of the fixed principle that was in clause 7.13(a)(ii) of the 2006 access arrangement remains in any subsequently revised access arrangement, that fixed principle is still afforded the protection of Transitional Rule 6.

However the AER's submission has increased the uncertainty as to the correctness of this view, particularly when this submission has been stated so emphatically and publicly, and is also supported by legal advice from a QC.

(b) *Is the DBNGP Fixed Principle protected by Rule 99(3)?*

The AER's submission and legal advice takes a narrow view of the operation of r 99(3), in isolation of how that interpretation may be altered in the context of the remaining provisions of r 99 of the NGR.

DBP has sought legal advice from its external lawyers, Clayton Utz, on the impact of the AER's proposed rule change on the DBNGP access arrangement. Relevantly, DBP asked them:

(i) Assuming there is doubt as to the operation of transitional Rule 6 of Schedule 1 to the NGR, what is the proper construction of rule 99?

(ii) Assuming that the negotiated (or non-reference) services provided under contract by DBP to its shippers are different services to any of the reference services included in the access arrangement and assuming that the fixed principle is not consistent with other rules in the NGR and/or the revenue and pricing principles, could the ERA decide (as part of its assessment of a revised access arrangement proposal) that the fixed principle of clause 13(a)(ii) of the current access arrangement no longer should be included in an access arrangement for the DBNGP?

A copy of their opinion is enclosed with this letter which DBP accepts.

In response to question (i), the opinion concludes that Rule 99 must be read as a whole and in particular, Rule 99(3) must be read with Rule 99(4). Therefore, if a rule is inconsistent with the fixed principle, the rule operates to the exclusion of the fixed principle. The reference to "inconsistent" is intended to be a reference to both an inconsistency on the face of the legislation and also an inconsistent operation.

So, if the rule is applied in an access arrangement decision so as to create an inconsistency with a fixed principle, the Rule will prevail over the inconsistency.

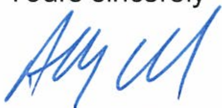
In response to question (ii), the opinion states that the change which is proposed to Rule 93(4) will enable a determination to be made that services which are currently the subject of the fixed principle in the DBNGP Access Arrangement would become rebateable services for relevant purposes under the operation of the amended rule. That is a relevant inconsistency for the purposes of Rule 99.

> As outlined in the opinion, "the approach which has been put forward by the AER and Mr Scerri QC does not lead to any certainty that the fixed principle contained in clause 13(a)(ii) of the DBP Access Arrangement will continue to be accorded primacy. The approach advocated by the AER makes it seriously questionable whether that will be the case."

For these reasons, DBP submits that both the MFN Reason and the DBNGP Reason are valid reasons to justify the rejection of the proposed change to the definition of "rebateable service" in the NGR, as proposed by the AER.

DBP appreciates the opportunity it has had to date to engage in the Commissions' rule change assessment process. If the Commission wishes to make any queries regarding the issues raised in this submission please contact myself or Trent Leach, Manager Regulatory & Government Policy on (08) 9223 5347 or via trent.leach@dpp.net.au.

Yours sincerely



Anthony Cribb
General Manager, Corporate Services
Company Secretary

DBP

Memorandum of Advice - Proposed Rule Change

1. The Australian Energy Regulator (**AER**) has applied to the Australian Energy Market Commission (**AEMC**) to change the definition of "rebateable service" under the National Gas Rules (**NGR**).

2. The AER has proposed the following amendment to Rule 93(4) of the NGR:

   "*(4) A pipeline service is a **rebateable service** if:*

   (a) the service is not a reference service; and

   (b) either:

   (i) substantial uncertainty exists concerning the extent of the demand for the service or of the revenue to be generated from the service; or

   (ii) it is not commercially and technically reasonable to set a reference tariff for the service. ~~and~~

   ~~*(c) the market for the service is substantially different from the market for any reference service."*~~

3. The AEMC released a draft decision on 15 March 2012 that proposed not to change the definition of rebateable service. One of the reasons the AEMC gave for that conclusion was the consequences which the change to the definition of rebateable service might have for the DBP Access Arrangements. Specifically, the AEMC concluded that if the amendment sought by the AER were made to Rule 93(4) that rule could take precedence over the fixed principle contained in DBNGP's access arrangement. As a consequence, it would be possible for a rebateable service included in any future DBNGP access arrangement to:

   - rebate off the reference tariff and trigger any most favoured nation clauses in existing contracts; and
   - draw on revenue earned under existing contracts to create a rebate off the reference tariff.

4. The AEMC recognised that if this were to happen, revenues earned from negotiated services may be less, potentially exposing DBP to greater financial risk. That greater level of financial risk would not be conducive to efficient investment in natural gas services and would not be in the long term interests of consumers.

5. The AER has made a submission in response to the draft decision which includes, as an attachment, an opinion from Charles Scerri QC.

6. We have been asked to advise on the following questions:

   (a) Assuming there is doubt as to the operation of transitional Rule 6 of Schedule 1 to the NGR, what is the proper construction of rule 99?

   (b) Assuming that the negotiated (or non-reference) services provided under contract by DBP to its shippers are different services to any of the reference services

included in the access arrangement and assuming that the fixed principle is not consistent with other rules in the NGR and/or the revenue and pricing principles, could the ERA decide (as part of its assessment of a revised access arrangement proposal) that the fixed principle of clause 13(a)(ii) of the current access arrangement no longer should be included in an access arrangement for the DBNGP?

7. Rules 99(3) and 99(4)(b) of the NGR deal with fixed principles. They read as follows:

"***99 Fixed Principles***

(3) A fixed principle approved before the commencement of these rules, or approved by the AER under these rules, is binding on the AER and the service provider for the period for which the principle is fixed.

(4) However:

(b) if a rule is inconsistent with the fixed principle, the rule operates to the exclusion of the fixed principle."

8. Transitional Rule 6 of the NGR was introduced to ensure that Rule 99(4)(b) did not apply to the fixed principle contained in the Dampier to Bunbury Natural Gas Pipeline Access Arrangement which was in force at the time the rules were introduced. It states that:

"*Rule 99(4)(b) does not apply to the fixed principle referred to in clause 7.13(a)(ii) of the Revised Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline dated 21 November 2006.*"

9. Since that time revisions to the access arrangement have been approved by the ERA under the NGR. In the current access arrangement, the fixed principle referred to in transitional Rule 6 is now at clause 13(a)(ii). Given the change to the provision in which the fixed principle is contained, there is doubt as to whether the transitional Rule 6 has application to the current access arrangement.

10. Given there is doubt as to the operation of transitional Rule 6, we have been asked to comment on the proper construction of Rule 99.

11. Rule 99 must be read as a whole. In particular, sub-rule (3) must be read together with sub-rule (4). Sub-rule (4) imposes limitations on the principle set out in sub-rule (3), namely that a fixed principle is binding on the AER and the service provider for the period for which the principle is fixed. Sub-rule (4) qualifies that in two respects. First, with the consent of the service provider, the AER may vary or revoke a fixed principle. Secondly, if a rule is inconsistent with the fixed principle, the rule operates to the exclusion of the fixed principle.

12. The AER's position appears to be that Rule 99(3) operates to give primacy to fixed principles and accordingly, there is no basis for the concerns expressed by the AEMC about the impact that the proposed change to the definition of rebateable services could have on the operation of the DBP access arrangement and therefore on investment risk.

13. The AER submission does not deal at all with Rule 99(4) in the body of its submission. Rule 99(4) is touched on in the opinion from Mr Scerri QC. Mr Scerri states in paragraph 34 of his opinion,

"*... 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."

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.

15. There is then a question as to what is meant by a rule being "inconsistent."

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

17. Mr Scerri's advice suggests 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.

19. In the present circumstances, the change which is proposed to Rule 93(4) will enable a determination to be made that services which 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. That is, in our opinion, a relevant inconsistency for the purposes of Rule 99.

20. If the negotiated services are different services to any of the reference services included in the access arrangement and assuming the fixed principle is not consistent with other rules in the NGR and/or the revenue and pricing principles, then the ERA could determine that the relevant services are rebateable services. There would then be an inconsistency between the rule and the fixed principle and, in my view, the rule would prevail. The ERA would not directly decide that the fixed principle should no longer be included in the access arrangement but would not have regard to it to the extent of the relevant inconsistency.

21. On Mr Scerri's analysis, his argument appears to be that Rule 99(3) applies so that the fixed principle applies unless there is an inconsistency and the limitation in Rule 99(4)(b) only has application where there is an inconsistency on the face of the rule, not as a result of the application of the rule by the regulator. Mr Scerri concludes that there is not inconsistency on the face of the proposed changed rule. Therefore no priority is accorded to the rule.

22. It does, however, appear to be accepted by Mr Scerri that a determination could be made under Rule 93(4) as amended which would have an effect different from the operation of the fixed principle. He simply does not address whether in that situation:

    (a) the determination under Rule 93(4) would be invalid because it would be contrary to the fixed principle given the terms of Rule 99(3); or

    (b) in that situation, he contends that Rule 99(3) would operate to invalidate such a determination.

23. Implicitly, it seems to be the case that he prefers the latter view. However, that gives rise to an interpretation which is inconsistent with reading Rule 99 as a whole and we doubt whether that is the approach which a regulator is likely to take.

24. The approach which has been put forward by the AER and Mr Scerri QC does not lead to any certainty that the fixed principle contained in clause 13(a)(ii) of the DBP Access Arrangement

will continue to be accorded primacy. The approach advocated by the AER makes it seriously questionable whether that will be the case. The fixed principle in clause 13(a)(ii) of the DBP Access Arrangement was a key element underpinning the investment in the DBNGP and its continued application remains so and adopting the approach put forward by the AER puts that at risk.

Date: 11 May 2012

Clayton Utz