Government of Western Australia
Department of Treasury

Regulatory framework for the Pilbara electricity networks: Light handed access regime

Detailed Design Consultation Paper

Department of Treasury | Public Utilities Office

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Table of Contents

Abbreviations

Term	Description
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
DAC	Depreciated actual cost
DORC	Depreciated optimised replacement cost
ENAC	*Electricity Networks Access Code 2004*
ERA	Economic Regulation Authority
ISO	The proposed Pilbara independent system operator
PNAC	Pilbara networks access code (to be implemented under these reforms)
NEM	National Electricity Market
NEO	The National Electricity Objective
NGR	National Gas Rules
NSP	Network Service Provider
NWIS	North West Interconnected System, the common name of the interconnected system of networks described in the current Bill as the “interconnected Pilbara system”
Rules	Pilbara network rules
RAB	Regulated Asset Base
SWIS	South West Interconnected System

Glossary

Term	Description
Building Block Approach	A method to calculate the aggregate cost of service by summing a series of individual cost components. Also known as "building block cost of service" method
Covered / coverage	A decision by the Minister under Chapter 3 of the ENAC that a network meets the "coverage criteria", i.e. should be subjected to third party access regulation
Cost of capital / WACC	A measure used to determine the return ***on*** investment component for the building block model, to represent a risk reflective return on capital invested. The opportunity cost of making a specific investment and so the rate of return that is required so that an investor is willing to make a specific investment
Depreciation	A component to reflect the return ***of*** capital component for the building block model . Typically calculated by applying straight line depreciation over the forecast economic life of the asset.
ENAC	*Electricity Networks Access Code 2004*
Full regulation / full up-front price setting	A form of regulation where a full access arrangement setting out terms of access, including pricing, must be submitted and approved by a regulator
Light regulation	Where there is no, or a much smaller, up-front regulatory determination, and the terms of access, including prices, are left to be negotiated, or, failing agreement, arbitrated
Negotiate / arbitrate regulatory framework	This is a form of regulation that relies first on negotiation between the parties for prices, and terms and conditions. When there the parties cannot agree a formal dispute resolution framework applies whereby disputed matters are determined by an arbitrator
Pilbara Networks Access Code	Includes the proposed components for the light handed access regime
Participants	Collectively, Pilbara NSPs and users
Network service provider (NSP)	A person who owns, controls or operates a network infrastructure facility for the purpose of transporting electricity from generators to other electricity networks or to end users of electricity
Regulatory asset base / asset value / RAB	A measure, for regulatory purposes, of the value of network assets at a point in time. It increases with capital expenditure and declines with depreciation. The RAB is used to determine the return ***on*** and return ***of*** capital in the building block model.
Users	Users of the Pilbara networks that use services provided by NSPs

Executive Summary

The need for a regulatory framework for electricity networks located in the Pilbara region of Western Australia has been long recognised, and many reviews have identified potential efficiency improvements for participants in the region.

In August 2017, the Minister for Energy (the Minister) announced[1] the Western Australian Government's intention to implement a light handed regulatory regime to facilitate fair and reasonable access by third parties to Pilbara networks. The objective of this reform initiative was to establish a fit-for-purpose regulatory framework that can deliver better outcomes for electricity consumers and assist in driving regional development in the Pilbara region.

The Public Utilities Office was requested to develop the design of a new regulatory framework and associated arrangements for an independent system operator for Government's consideration. Over the period November 2017 to March 2018, the Public Utilities Office has engaged with stakeholders to progress the requirements of the design, culminating in the publication of a Design Report for a new regulatory framework for Pilbara electricity networks.

In April 2018, the regulatory framework for the Pilbara networks was presented to Government, and approval provided to commence the detailed design, comprising five workstreams.

1. System operations arrangements design - Establishing the formalised system operations environment, including the functions to be performed by the Independent System Operator (ISO).
2. Access regime design - Designing the light handed access regime.
3. ISO establishment - Establishing the necessary capacities and systems within Australian Energy Market Operator (AEMO) to enable that organisation to become the ISO.
4. Institutional arrangements - Drafting the Electricity Industry Amendment Bill 2019, the Pilbara networks access code (PNAC) and the Pilbara Networks Rules (Rules); and associated parliamentary and executive processes.
5. Transition - Working with Pilbara participants to ensure a smooth transition to the new regulatory environment.

This consultation paper addresses the specific design for Workstream 2 – Designing the light handed access regime, and where relevant, draws from the work completed in other workstreams.

As a part of the Detailed Design phase, and in developing this consultation paper, the Public Utilities Office has undertaken an extensive stakeholder consultation process.

The features of the light handed access regime that are covered in this paper are:

- the form of regulation process;
- the Pilbara electricity objective;

[1] https://www.mediastatements.wa.gov.au/Pages/McGowan/2017/08/Regulatory-reform-to-the-Pilbara-electricity-system.aspx

- the pricing arrangements, which includes the revenue and pricing principles that guide the approach to pricing and pricing rules to be adhered to;
- the transparency requirements for covered networks, such as what information they are required to produce and maintain as well as the requirements for reviewing prices;
- the framework for negotiations and dispute resolution; and
- the approach to ring-fencing, including the allocation of costs between the covered and other activities.

The main body of this paper provides a summary of the proposed approach, as well as the reasons for the relevant proposals. An appendix sets out the detailed specification of the proposed regime.

Governance

The Pilbara electricity reforms will be implemented under amendments to the *Electricity Industry Act 2004*, and the matters discussed in this consultation paper will largely be set out in a new "Pilbara Networks Access Code". Like the Electricity Networks Access Code 2004 (ENAC), this code will be made and amended by the Minister.

The primary responsibility in this light regulation regime will fall on the NSP, to develop and publish a range of information including prices, access guides and policies. The main regulatory scrutiny for this role will come from the arbitrator, through an access seeker's (and in some instances an existing user's) ability to bring an access dispute.

The Minister will retain their existing role as coverage and revocation decision maker, and will take on an additional role as the form of regulation decision maker, if a Pilbara network becomes covered.

The ERA's role is much smaller under this light regulation regime, being limited to an opening cost of capital determination for the Alinta and Horizon networks, managing the arbitration regime, approving ring-fencing arrangements and publishing guides.

The form of regulation process

The Pilbara electricity reforms exist to create a "light regulation" option for covered Pilbara networks, adapted from Part 23 of the National Gas Rules (NGR) (Part 23), and to be set out in the new PNAC.

At present, when a Minister makes a "coverage decision" to "cover" a network, the only regulatory option available is "full regulation" under the ENAC.

The light regulation model avoids most or all of the up-front time and resources cost associated with full regulation, by deferring various issues (e.g. asset valuation, tariff structure) from up front determination, to negotiation and if necessary arbitration between the access seeker and the network service provider (NSP).

Application to Pilbara networks

Horizon Power's and Alinta DEWAP's coastal networks will be subject to light regulation from the outset. For all other Pilbara networks, the Ministerial coverage process will continue unchanged.

If the Minister decides to cover the network, the Minister will then make a separate "form of regulation" decision to determine whether full regulation under the current ENAC, or light regulation framework under the PNAC, should apply. The decision will be guided by "form of regulation factors" which assess competition, market dynamics, market power and information asymmetry in the relevant marketplaces.[2]

A network can 'opt in' to light regulation at any time, and if so will be protected from a Ministerial coverage decision and full regulation.

Status changes – coverage and form of regulation

The existing ENAC coverage revocation process will continue unchanged – any covered network can apply to have coverage revoked. On revocation, regulation ceases.

A network which opted in to light regulation can opt back out again on 12 months' notice. Applications and access disputes in progress will continue despite the opting out. Existing access contracts will be preserved.

If a Pilbara network is light regulated, an access seeker can apply to have it fully regulated, with certain exceptions. And, a full regulated Pilbara network can apply to be light regulated at any time.

If a network changes from light to full regulation or vice versa while there is an application or access dispute in progress, each applicant can elect whether to continue under the previous regime, or transition into the new regime. Existing access contracts will be preserved.

Pricing arrangements

The Public Utilities Office is proposing refinements to the detailed pricing arrangements that were set out in the Design Report. Under the pricing arrangements, covered networks will be required to demonstrate how they have complied with revenue and pricing principles and pricing rules in a transparent manner. The price list and accompanying materials published under these arrangements, such as policies for network development (e.g. the network planning standard) and customer contributions, will guide access negotiations. Further, when disputes arise the arbitrator will be required to apply the pricing arrangements when deciding on that dispute.

Pilbara electricity objective

The proposed objective for the Pilbara electricity reforms is based on the National Gas Objective and National Electricity Objective, but enhanced to direct the decision maker to consider the specific circumstances of the Pilbara (i.e that the Pilbara comprises the minerals extraction and processing sector and associated large end-users, which has materially different features and requirements to the markets served by the majority of the utilities regulated in Australia (i.e. utilities serving large population centres).

The Pilbara electricity objective itself is as follows:

[2] The form of regulation factors in the *National Electricity Law*, s 2F are set out on page 10.

The Pilbara electricity objective

To promote efficient investment in, and efficient operation and use of electricity services for the long-term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity, and the reliability, safety and security in the Pilbara region.

Two options are proposed for the enhancement. The first option is to expand on the meaning of the word "consumers" in the Pilbara electricity objective. The second is to include a separate objective reflecting the importance of the resources sector to the State, and the importance of the Pilbara networks to that sector and its investment.

Revenue and pricing principles

The revenue and pricing principles will provide high level guidance on the outcomes that are expected from network pricing. They will be very similar to the revenue and pricing principles already set out in the NGL and NEL.

The pricing rules will be specified to prescribe a standard two-step approach to deriving prices, whereby:

1. a covered network must determine a target revenue to reflect its estimated cost of service; and
2. publish a tariff-setting methodology setting out how target revenue is to be recovered from customers (either individuals or groups/classes) and, related to this, how prices are to be structured, and publish a price list.

Step 1: Determining target revenue

The Public Utilities Office proposes that key aspects of the determination of target revenue be prescribed or guided by the pricing rules in order to reduce the likelihood of dispute being raised, specifically:

- requiring the application of the widely-used building block cost of service approach to determine target revenue. It is envisaged that this would direct parties to consider and apply standard regulatory practices.
- providing that the initial regulatory asset base (RAB), which is a key input in the building block cost of service model, is to be:
  - for Horizon Power, prescribed in the subordinate legislation; and
  - for all networks other than Horizon Power, determined by the NSP in accordance with specific principles and parameters set out in the PNAC, and able to be challenged before an arbitrator in an access dispute;
- the RAB will be required to be an "objectively reasonable" value, and will normally fall between depreciated actual cost (DAC) and depreciated optimised replacement cost (DORC);

- provide that once the RAB is set for a network, it is to be updated mechanistically over time (that is, by adding in prudent capital expenditure and deducting depreciation and disposals);
- the cost of capital is another key input to the building block cost of service model, and:
  - is to be commensurate with the financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the covered network;
  - is to be calculated on a pre tax basis;
  - for the Alinta and Horizon networks, for the first five year pricing period only, is to be determined up-front by the ERA; and
  - for all other networks, and for the Alinta and Horizon Power networks after the first pricing period, the cost of capital is to be determined by the NSP and scrutinised by the arbitrator.

Step 2: Tariff-setting methodology and price lists

In relation to the requirements for determining the prices, the Public Utilities Office proposes that:

- standard principles for tariff setting should apply, namely that prices should, to the extent practicable, be subsidy-free, signal cost (namely the effect of use on future investment) and that the residual cost should be recovered in the most efficient manner;
- non-discrimination requirements between access seekers will apply that permit discrimination where this is consistent with the tariff setting guidance, but not otherwise; and
- covered networks be required to set their standard prices on the assumption that all users are paying the standard price, and so ignoring the specific terms that may be negotiated with individual users.

Transparency requirements

The intention of the proposed transparency requirements is to:

- ensure that a level of information is generally available to assist negotiations and, if necessary, an arbitrator in an access dispute;
- ensure that the assumptions that underpin the setting of prices are fully documented and thereby open to scrutiny; and
- subject the covered network's price setting and access policies to moral suasion – and, where relevant, provide interested parties with the scope to submit on those policies – and so encourage efficient behaviour.

The key components of the proposed transparency requirements are:

- publication of information about the covered network and procedures for seeking access;

- publication of prices, the pricing methodology and underpinning policies and information, and a requirement to review prices and to consult with customers and the public on this at intervals of not more than five years; and
- annual disclosure of information related to the actual circumstances of the network, spanning matters such as expenditure on the covered network, service usage, and available capacity for the prescribed future period.

Negotiation and dispute resolution

As proposed in the Design Report[3] a negotiation framework will be prescribed, adapted from the framework in Part 23 of the NGL. This will govern the lodgement of access requests, the making of access offers, and the conduct of negotiations. Details appear in Appendix A.[4]

The dispute resolution regime will provide for arbitration of access disputes as follows:

- the arbitrator is to be chosen from a pool administered by the ERA, or is to be an arbitral panel whose chair is chosen from that pool;
- arbitrations will generally be in private, but a redacted version of the decision will be made public;
- there will be scope for other parties to join an access dispute if their interests are directly affected and there is no other way for their concerns to be addressed, but in general, in order to avoid cost and delay, the dispute will be restricted to the original two parties;
- expert input can be obtained by the parties in the normal way, by the arbitrator appointing an expert, or by use of an arbitral panel with expert members to supplement the chair;
- the arbitrator may be able to refer matters to the ERA for broader consultation;
- the arbitrator's award will be binding on the parties, although the applicant will have an election as to whether or not to proceed with access on the awarded terms;
- arbitrators' decisions will be made public, redacted to preserve the parties' confidential information, and will have effect as guiding, but not necessarily binding, precedents;
- there will be an expedited process for queuing disputes;
- costs of the arbitration (the arbitrator's fees, room hire, any common experts) will normally be split 50/50 between the parties, but the arbitrator will have discretion to vary this.

The above regime applies to access disputes, not contractual disputes. The latter will be dealt with by whatever means the contract prescribes.

Ring-fencing arrangements

The proposed ring-fencing arrangements are designed to deliver a 'fit-for-purpose' approach that recognises the costs and benefits of some measures may different between networks, noting also the nature and circumstances of what networks may be light regulated in future is not known with certainty.

[3] Design Element 15; see also Design Consultation Paper, Appendix C.
[4] Appendix A, section A.5.

It is proposed that the ring-fencing measures comprise a propose-respond model, whereby a covered network would be required to propose ring-fencing arrangements to the ERA for its assessment. The ring-fencing arrangements will include a cost allocation method (which is to be implemented by all networks), and any measures considered necessary to address the potential for anti-competitive effects in the related markets.

In deciding whether the ring-fencing measures are reasonable, the ERA would have regard to the potential costs (broadly defined) and unintended consequences that the ring-fencing measures may cause in the context of the particular network, the efficacy of the proposed measures in addressing those harms, and the costs of those or alternative measures. A periodic review of ring-fencing measures is also proposed, which would provide the flexibility for a cautious approach initially in relation to possible high-cost ring-fencing measures.

Transitional arrangements

Transitional arrangements will be implemented to accommodate:

- the results of the ERA's approval of the covered networks ring-fencing arrangements (which include a cost allocation method) and setting of the cost of capital for the first pricing period; and
- the competing desires for covered networks to disclose their proposed prices, pricing methodologies and associated policies as soon as practicable after commencement of the Pilbara regime, but for these also to be subject to a transparent review, including consultation with stakeholders and the public.

The Public Utilities Office will explore whether the ERA's approval of ring-fencing arrangements and WACC determination can be made prior to the commencement of the regime. Otherwise, it is proposed that covered networks be required to:

- release interim prices, pricing methodologies and associated policies within three months of the commencement of the regime (these interim prices are proposed to apply for a period of up to 18 months);
- update the interim prices within three months of the ERA's processes being completed (the ERA is expected to take six months to do its tasks); and
- complete the first review of prices, and implement those prices, within 18 months of the commencement of the Pilbara regime (this is expected to leave 12 months for this process after the release of the ERA's decisions noted above).

Invitation for submissions

The Public Utilities Office invites written submissions on this consultation paper. Submissions are requested by 5:00pm (WST) on 16 April 2019.

Electronic submissions are preferred and should be emailed to PUOSubmissions@treasury.wa.gov.au.

1. Introduction

1.1 Background to the Pilbara electricity reforms

For background to the Pilbara electricity reforms, please refer to the Design Report published on the Public Utilities Office website[5].

1.2 Scope of this consultation paper

This consultation paper discusses the detailed design of the light handed access regime only. The main body of this paper provides a summary of the proposed approach, as well as the reasons for the relevant proposals. An appendix sets out the detailed specification of the proposed regime.

Alignment with the Design Elements

The Design Report established 35 design elements that provide for a fit-for-purpose light handed access regime and the establishment of an independent system operator to enhance network security, manage ancillary services and facilitate overall network coordination and planning in the region. Of the 35 design elements, as outlined in the table below:

- 11 design elements relate explicitly to the design of the light handed access regime to networks and so are the topic of this paper;
- one element will be implemented in part through the design of the access regime and in part by other work streams, and so is addressed in part in this paper; and
- one design element (an appropriate transitional plan) is common to all workstreams.

The following table sets out the design elements that are addressed in this consultation paper.

Design element	Addressed / location
1, 2, 3 (coverage)	**Directly** addressed (section 2)
4 (pricing principles)	**Directly** addressed: • Regime objective (section 4.2) • Revenue and pricing principles (section 4.3) • Detailed pricing guidance (section 4.4)
5, 6 (onus on networks to develop and defend prices and methodologies)	**Directly** addressed: • Via transparency measures (section 5) • In negotiation and dispute resolution (section 6)
7 (ability for parties to agree a non-reference tariff)	**Directly** addressed: • Ability to dispute terms for a non-reference service (section 6) • Pricing principles for non-reference service (section 4.5.1)
11 (loads to be provided access at default security levels to be defined)	**Partly** addressed in this consultation paper. • Planning criteria / reliability standards for loads to be specified by networks and disclosed (section 5.3) • System security standards addressed through ISO workstream.

[5] http://www.treasury.wa.gov.au/uploadedFiles/Site-content/Public_Utilities_Office/Industry_reform/Pilbara-Electricity-Reforms-Design-Report.pdf

14 (information disclosure requirements)	**Directly** addressed (section 4).
15 (negotiation framework)	**Directly** addressed (section 6.2).
16 (dispute resolution framework)	**Directly** addressed (section 6.3).
17 (structural or functional separation)	**Directly** addressed (section 7).
18 (transitional plan)	**Partly** addressed. • Transitional plan in relation to access regime considered (section 8).

Details of other workstreams within this initiative, including the Public Utilities Office's consultation papers and stakeholders' submissions are available on the Department of Treasury's website.[6]

1.3 Consultation process

The Design Report is provided as the Decision Regulatory Impact Assessment, demonstrating the application of regulatory analysis to support evidence-based decision making[7].

As a part of the Detailed Design phase, the Public Utilities Office has undertaken an extensive stakeholder consultation process. Consultation has involved:

- one-on-one stakeholder engagement;
- the provision of a three discussion papers that outlined a proposed approach to implementing key components of the light handed access regime; and
- a technical stakeholder workshop.

The consultation process has resulted in a strong consensus on the need for reform and support for the framework proposed in this consultation paper.

Full details of the consultation process, including the Public Utilities Office's consultation papers and stakeholders' submissions are available on the Department of Treasury's website.

1.4 Making a submission

The Public Utilities Office invites written submissions on this consultation paper. Submissions are requested by 5.00 pm (WST) on 16 April 2019.

Electronic submissions are preferred and should be emailed to PUOSubmissions@treasury.wa.gov.au.

Alternatively, submissions can be sent to:
Attn: Alyce Lines
Project Leader, Energy Networks
Public Utilities Office
Department of Treasury
Locked Bag 11
Cloisters Square WA 6850

[6] www.treasury.wa.gov.au/Public-Utilities-Office/Open-consultations-reviews/NWIS-Regulatory-Reform/
[7] https://www.treasury.wa.gov.au/uploadedFiles/Site-content/Public_Utilities_Office/Industry_reform/Pilbara-Electricity-Reforms-RG1646.pdf

2. Governance

2.1 Legislation and legislative instruments

The Pilbara electricity reforms described in this consultation paper will be:

- enabled by a new Bill to be tabled in 2019 (see separate consultation paper), which will make suitable amendments to the *Electricity Industry Act 2004*;
- set out in a new "PNAC";[8] and
- complemented by the proposed new Pilbara networks rules (Rules) to establish the ISO regime (see separate consultation paper).

The PNAC will be implemented and amended in the same way as the ENAC:

- the Minister will make the PNAC;
- the Minister will make any amendments to the PNAC, after public consultation (except in the case of urgent amendments, in which case there will be retrospective consultation); and
- the PNAC will be "subsidiary legislation" for the purposes of the *Interpretation Act 1984* (WA) and will be a "disallowable instrument", meaning that Parliament may disallow the code or an amendment, within a defined period after it is made.

2.2 Roles and responsibilities

2.2.1 The Network Service Provider

In this light regulation regime, the primary actor is the Network Service Provider (NSP). The NSP will:

- determine prices and terms and conditions for access, including (section 4):
  - except in the case of Horizon, determining its own regulated asset base (RAB); and
  - except in the case of Horizon and Alinta for the first price period, determine its own rate of return; and
- determine and publish its own pricing policies and methodologies including (section 4):
  - a building block cost of service approach to determine target revenue;
  - a tariff-setting methodology to allocate target revenue to individual tariffs;
  - a Network Development Policy which will include its own prudence test for expenditure (section 4);
  - a User Access Guide and a range of network and financial information (section 5); and
  - a Cost Allocation Method and possible Competition Protection Measures (section 7);

[8] Physically, the Pilbara Networks Access Code may be contained in a separate instrument, or it may appears as new chapters in the ENAC.

- publish information about access, the network and prices (section 5); and
- consult periodically with the public regarding the above information.

2.2.2 An arbitrator

Except for a small number of matters for which the ERA provide up-front approval, the main regulatory scrutiny for all of the NSP's material above will come through an access seeker's ability to bring an access dispute, and to challenge not only the proposed terms, prices and requirements for access, but also the basis on which they have been determined (i.e. the above policies). The dispute resolution arrangements are described in section 6.

2.2.3 The Minister

The Minister will, as now, administer the (unchanged) "coverage" process, which determines whether networks should be regulated, and also the coverage revocation process (see section 3.2).

If a Pilbara network gets covered through that process, the Minister will make a new "form of regulation decision" to determine whether the network should be subject to full regulation under the current ENAC, or light regulation under the PNAC.

2.2.4 The ERA

In this light-handed regime the ERA has no general up-front approval role as it does under the ENAC for the SWIS.

The ERA will have a limited consultation and approval role in this regime, being:

- determine the cost of capital for the Alinta and Horizon networks for the first pricing period;
- administer the pool of arbitrators and the arbitration regime;
- perhaps, undertake a broader consultation role if an issue is referred to it by the arbitrator;
- approve ring-fencing arrangements; and
- publish guidelines such as the financial reporting guideline.

2.2.5 The Independent System Operator

The Independent System Operator's (ISO) roles and responsibilities, including in relation to access negotiations, are discussed in a separate consultation paper. In brief, the ISO will have a role in modelling the system impacts of any application, and resulting network planning.

3. The form of regulation process

3.1 Introduction

The Design Report set out three design elements (1, 2 and 3) for a new light regulation alternative for Pilbara covered networks. This chapter sets out the proposed approach to implementing those design elements.

3.2 Current arrangements

The *Electricity Industry Act 2004* (EI Act) requires the operators of certain Western Australian electricity networks to provide network services to third party access seekers, that is, to allow third parties to transport[9] electricity through their networks.

Networks which are subject to this obligation are said to be "covered" networks.

3.2.1 Coverage

At present, there are two ways a network can become covered:

- by prescription in the *Electricity Networks Access Code 2004* (ENAC) – Western Power's South West Interconnected Network (SWIN) is covered in this way;[10] or
- as a result of a Ministerial "coverage decision" – Horizon Power's Pilbara network is covered in this way.[11]

The ENAC sets out the process and criteria for the Ministerial coverage decision.[12] Any person can apply to have a network covered.[13]

3.2.2 Consequences of coverage – full regulation

At present, the only regulatory mechanism available for covered networks is "full regulation" under the ENAC. Under full regulation, the network service provider (NSP) of the covered network must lodge with the ERA a proposed "access arrangement", setting out its proposed access terms and prices. This access arrangement undergoes an extensive public consultation and approval process, and ultimately the ERA will either approve the proposed access arrangement with whatever amendments the ERA considers necessary, or reject it and write and approve its own access arrangement.

[9] Although it is usual to speak of a network service provider "transporting" or "conveying" electricity for a network user, which implies a point-to-point service, in fact most contracts for network services involve primarily point-specific services, ie. to connect at a point(s), and to inject electricity into, or withdraw electricity from, the network at that point(s). In practice very little turns on this distinction, and this consultation paper will disregard this distinction, and use the expressions interchangeably.

[10] Access Code s 3.1

[11] Hon. Ben Wyatt MLA, Minister for Energy, *Coverage of the Horizon Power electricity network in the North West Interconnected System – Final Coverage Decision*, 2 February 2018 (available here) (**Horizon Coverage Decision**).

[12] Access Code Chapter 3

[13] Access Code s 3.2..

In regulatory language, full regulation under the ENAC comprises a propose-respond model, even though it also contains negotiation and arbitration, because the NSP proposes a form of access arrangement and the ERA responds. Once the approved access arrangement is in place, however, access is governed by a negotiate/arbitrate model, in which the access seeker will negotiate with the NSP for access, and failing agreement has a right to have an arbitrator determine access terms and compel the NSP to allow access on the determined terms.

The approved access arrangement creates a reference benchmark for subsequent access negotiation and arbitration. The arbitrator of an access dispute must base its decisions on the reference services and reference tariffs set out in the access arrangement.[14] Because of this, the parties in access negotiations will also use those reference services and tariffs as a yardstick.

This is the main advantage of full regulation. Because the access seeker and NSP can predict the likely outcome of any access arbitration concerning a matter dealt with in the access arrangement, they are at least theoretically more likely to reach agreement during the negotiation phase. Also, if arbitration does become necessary, the dispute will be more tightly focussed because many of the most controversial issues (e.g. reference tariffs) have already been determined in the access arrangement. Disputes should thus be both quicker and cheaper.

A secondary advantage of full regulation is transparency. The access arrangement approval process and its associated disclosure requirements require the NSP to make available some of the commercial and technical information needed by access seekers to negotiate access, and to evaluate any access offers made by the NSP.

The main disadvantage of full regulation is the substantial time and cost required from the NSP and the ERA, and also from interested stakeholders, to complete the access arrangement approval process. This is a recurring cost; access resets happen every three to five years.

3.2.3 Revocation of coverage

Any covered network can at any time apply to have coverage revoked.[15] The process and criteria are the same as for coverage.[16]

3.3 Proposed arrangements

3.3.1 Light regulation option

The centrepiece of the Pilbara electricity reforms is the creation of a “light regulation” option for covered networks located in the Pilbara. The regime is adapted from Part 23 of the National Gas Rules (NGR) (Part 23). The new regime will be set out in a new “PNAC”.[17]

[14] Access Code s 10.32(b): award must not be inconsistent with access arrangement; Access Code s 10.20: tariff for reference service must (in effect) be the reference tariff; Access Code s 10.23: arbitrate tariffs for non-reference services based on a differential value compared with reference service.
[15] Access Code s 3.30
[16] Access Code s 3.31
[17] The Public Utilities Office is still considering whether the Pilbara Networks Access Code will be contained in a separate instrument, or in new chapters to be added to the Access Code.

Light regulation is a model which removes some or all of the up-front approval process. Even though both light and full regulation models depend on negotiation and arbitration, light regulation regimes are referred to as "negotiate/arbitrate" regimes because the arbitration plays a broader regulatory role in determining matters that would have been determined up front, in a full regulation regime. The main benefit of this model is the reduced up-front investment in time and resources, compared with the access arrangement approval process.

Light regulation has two main disadvantages. The first is that access negotiations can become harder, because the parties no longer have the yardstick of the pre-approved access arrangement to guide their discussions, to improve transparency, and to enable them to predict how an arbitrator is likely to decide should negotiations fail. The second is that the access dispute itself can be more complex, because it may need to resolve issues which a full regulation model would have determined up front (e.g. asset valuation, tariff structure).

The light regulation regime proposed for the Pilbara includes measures designed to mitigate both of these disadvantages. The regime will include a range of transparency measures (see section 5), adapted and expanded from the transparency regime in Part 23 NGR. It will also provide guidance to the parties, and if necessary to the arbitrator, on pricing (see section 4). The dispute resolution regime has been adapted from Part 23, and includes a number of measures designed to balance the need for a quick and cost-effective resolution of access disputes, with the additional focus which falls on the access dispute process in a light regulation regime (see section 6).

3.3.2 Applying the light regulation option– the form of regulation decision

Automatic application of light regulation to Horizon's and Alinta's networks

Consistent with Design Element 1, the following interconnected networks will be subject to light regulation at the commencement of the Pilbara access regime:

- the Horizon Power interconnected network; and
- the Alinta DEWAP (Alinta) interconnected network.

Horizon Power's network is already covered, following the Minister's February 2018 coverage decision.[18] Alinta's network will be covered by prescription.

Form of regulation decision for other covered Pilbara networks

Consistent with Design Element 3:

- the Minister will continue to apply the existing ENAC coverage process and coverage test,[19] as now; and
- if the Minister decides that a Pilbara network should be covered, the Minister will then make a separate "form of regulation decision" to determine whether the network should be subject to full regulation under the current ENAC, or light regulation under the PNAC.

[18] Horizon Coverage Decision, see footnote 11.
[19] The coverage test is set out in Access Code s 3.5. These reforms do not propose any change.

In making a form of regulation decision for a covered Pilbara network, the Minister must have regard to:

- the Pilbara electricity objective (see section 4.2);
- the form of regulation factors (see next subheading); and
- the effect of either full or light regulation on the likely costs that may be incurred by:
  - an efficient service provider; and
  - efficient users and efficient prospective users; and
  - end users.

The Minister will be able to impose conditions upon a light regulation determination, for example specifying a sunset date before which the NSP must re-apply, or triggers which may lead to a reopening of the form of regulation decision.[20]

Form of regulation factors

In making the form of regulation decision, the Minister will apply form of regulation factors, which are intended to help the Minister assess competition, market power and information asymmetry in the relevant marketplaces. The proposed form of regulation factors will be along the following lines:[21]

1. the presence and extent of any barriers to entry in a market for electricity network services;

2. the presence and extent of any network externalities (that is, interdependencies) between an electricity network service provided by an NSP and any other electricity network service provided by the NSP;

3. the presence and extent of any network externalities (that is, interdependencies) between an electricity network service provided by a NSP and any other service provided by the NSP in any other market;

4. the extent to which any market power possessed by a NSP is, or is likely to be, mitigated by any countervailing market power possessed by a network service user or prospective network service user;

5. the presence and extent of any substitute, and the elasticity of demand, in a market for an electricity network service in which a NSP provides that service;

6. the presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be); and

[20] This is the standard position for delegated decision makers: *Interpretation Act 1984* (WA), s 50(2).
[21] NEL s 2F.

7. the extent to which there is information available to a prospective network service user or network service user, and whether that information is adequate, to enable the prospective network service user or network service user to negotiate on an informed basis with a NSP for the provision of an electricity network service to them by the NSP.

The above seven factors have been modelled from the form of regulation factors in NEL s 2F. The Public Utilities Office believes that these factors are all applicable to the Pilbara form of regulation decision. The detailed implementation stage may refine, and consult further on, this wording.

Review of form of regulation decision

The Public Utilities Office proposes that, as with the coverage decision, the Minister's form of regulation decision will be subject to merits review.[22]

Opting in to light regulation

Consistent with Design Element 2, the NSP of an uncovered network in the Pilbara will also have the option to 'opt in' to light regulation at any time.

The effect of opting in will be three-fold. For so long as the opting-in applies, the network:

- will be deemed to be a covered network; and
- will be subject to light regulation under the PNAC; and
- will be protected from a Ministerial coverage decision and from full regulation, normally[23] for at least 10 years.

The Public Utilities Office has considered whether there should be any criteria or pre-conditions to a network's election to opt in, and feels at present that none are required. In practical terms, opting in will impose obligations and requirements on the NSP, e.g. it will be obliged to comply with various ISO rules. It would be possible to prescribe compliance with these rules as a pre-condition of opting in, but this would bring processing and assessment costs. On balance the Public Utilities Office believes this can be managed by the NSP itself. A prudent NSP will not opt in to a regime with which it cannot comply. It may be desirable to establish, or allow the ISO to grant, temporary exemptions for an opting-in NSP, to smooth the transition.

[22] The merits review regime is created under s 130 of the EI Act, which is proposed to be amended to include relevant Pilbara decisions including the form of regulation decision.
[23] See discussion in section 3.3.3, for when the 10 year protection may be abridged.

The Public Utilities Office has also considered whether opting in should be available once a coverage application has been lodged. On the one hand, having put the applicant to the trouble and expense of preparing and lodging a coverage application, it would be unfair if the NSP could negate that application (which, if successful, would lead to Minister-determined coverage which can only be revoked by the formal revocation process) by opting in (which creates deemed coverage which, subject to the discussion in section 3.3.3, can be "revoked" at any time by opting back out again). On the other hand, it may be efficient if the NSP can opt in and save all parties the delay and cost of the formal coverage and form of regulation processes. On balance, the Public Utilities Office thinks that there may be a risk of gaming, if an NSP could opt in after a coverage application has been made.

The ENAC already includes a mechanism for an NSP to consent to coverage, if the NSP wishes to cut the process short.[24] The Minister would then move directly to the form of regulation decision.

3.3.3 Changing a network's coverage and form of regulation

Although they are not expected to be used frequently, the regime will include a number of mechanisms for covered Pilbara networks to change their regulatory status.

Revocation of coverage (current law)

Under the ENAC, any network covered by prescription (i.e. Western Power's SWIN, and Alinta's Pilbara network) or Ministerial decision (currently only Horizon Power's NWIS network), can apply to have its coverage revoked, see section 3.2.3 above. This will be retained.

Opting out

A network that opts in to the light handed regime, may at any time elect to 'opt out'. As with opting in, the Public Utilities Office has considered whether there should be any constraints on this election.

There are reasons to keep any limits or requirements on the election to opt out as small as possible. Any such limits may deter NSPs from opting in in the first place, depriving Pilbara access seekers of the benefits of having the network regulated. Also, a network whose NSP has opted in to light regulation has not been through the Ministerial coverage process, to determine whether it meets the criteria for coverage. It is only covered because it voluntarily opted in, and this should be recognised.

However, the Public Utilities Office believes that some transitional restrictions will be needed.

First, the Public Utilities Office proposes that there should be a minimum period after opting in, before a network can opt out again. One possibility is to make this a 5 year period, because this is a common regulatory interval. However, being locked in for 5 years may deter an NSP from opting in. The Public Utilities Office is considering that the opt out election should initially be subject to a minimum notification period of 12 months.

[24] Access Code s 3.26

This 12 month period will allow access seekers time to apply to the Minister to have the network covered instead. Ideally there would not be a gap between the end of the opt-in period and (assuming coverage was imposed) the start of the coverage period. The Public Utilities Office proposes also that the Minister be able to extend the opt-in period where a coverage decision is pending and there is a reasonable prospect that the coverage criteria will be met.

The Public Utilities Office proposes to monitor the operation of the opt-out regime, and may propose and consult on changes if the 12 month notification period appears to be causing difficulties.

Second, transitional provisions will be needed to deal with any access contracts already entered into, and any access applications or access disputes already in progress when the application to opt out is made. The Public Utilities Office proposes that all contracts will be preserved,[25] and all applications and disputes currently in train will run their course as though the network had not opted out. The Public Utilities Office considers that any other approach may encourage gaming.

Applying to have a light regulation network fully regulated

The Public Utilities Office has considered whether it should be open to an access seeker[26] to apply to have a light regulated network made subject to full regulation, i.e. with price regulation and an upfront access arrangement.

A Pilbara network could have become light regulated either:

- following a Ministerial coverage decision to cover the network, and a Ministerial form of regulation decision that light regulation should apply; or
- by opting in to light regulation.

These two permutations need to be considered separately, on this question.

For a network which has been through the coverage and form of regulation process, the Public Utilities Office considers that the only constraint on an access seeker applying for a reconsideration of the form of regulation decision should be the need to avoid wasting public resources on repeated form of regulation processes, and also the need to offer NSPs a degree of regulatory stability. The Public Utilities Office is presently considering a time limit in which, once a form of regulation decision has been made for a network, no-one can apply for a fresh form of regulation decision for a minimum period of five years. However, this five year period may be abridged if:

- there has been a material change in circumstances; or

[25] The parties to an access contract would normally build in mechanisms to let the contract keep working even if there's a change in the regulatory landscape. For example, if the contract depends on a published price list, there will usually be a fall back mechanism should that list no longer be published.

[26] The regime will likely provide that this application can be made by "any person". That is, it will not be a pre-condition to the application that the person prove that they are an access seeker. In practice of course, only an access seeker is likely to be motivated to make this application.

- the Minister has reasonable grounds to determine that light regulation is failing to provide a viable path to access for access seekers, for example due to the NSP's behaviour in access negotiations and arbitrations.

For a network which has opted in, the position should be different. The idea of offering an opt in mechanism is to incentivise NSPs to provide access under light regulation voluntarily, thus saving all parties from the uncertainty, delay and expense of the coverage process. For the incentive to be effective, an opting-in network must enjoy a better protection from full regulation than a network which was covered by Ministerial decision.

One option considered was to have the opting-in network protected from full regulation completely and indefinitely, but the Public Utilities Office considers that this may be too limiting. Instead, the Public Utilities Office proposes that an opting-in network should enjoy two benefits compared with "normal" light regulation networks (i.e. those covered by Ministerial decision):

- it should be protected from full regulation for 10 years (i.e. 2 typical regulatory intervals) rather than the normal five years; and
- the test for when this period could be abridged should be harder to satisfy than for a normal covered network, perhaps being limited to situations in which the NSP has committed a serious or recurring breach of its obligations under the PNAC (e.g. a court or the arbitrator finds that the NSP has not been negotiating in good faith or has been hindering access).

Transitional provisions will be included to preserve any access contracts, and to deal with any access applications or access disputes already in progress when the transition from light to full regulation occurs.[27] The Public Utilities Office's present thinking is that the applicant be given an election whether to continue under the light regulation regime, or have its application or dispute transitioned into the full regulation regime.

Applying to have a full regulation network light regulated

A Pilbara network will only be fully regulated if it has been through a coverage and form of regulation process, i.e. the Minister has already decided that full regulation is appropriate. As a result, the main consideration for this transition is how often an NSP[28] should be able to re-apply to have the form of regulation decision reconsidered.

One option would be to include a rule that the NSP normally cannot re-apply for a form of regulation decision within the first five years after the previous decision, but to give the Minister the discretion to consider an earlier application if there has been a material change in circumstances.

But on balance the Public Utilities Office considers that this area will likely be self-regulating – a network which has failed in a form of regulation application, and in any appeal from that decision, is unlikely to invest in a fresh application in the very short term, possibly to the very same Minister. Further, as with coverage applications,[29] the Minister will have the power to dismiss trivial or vexatious form of regulation applications. The Public Utilities Office therefore proposes not to further regulate this area.

[27] This will be a low frequency, low probability event, so the transitional provisions should be kept very simple.
[28] Once again the regime will likely provide that "any person" may apply for this transition from full to light regulation, but in practical terms only the NSP would ever be likely to seek it.
[29] ENAC s 3.12.

Transitional provisions will be included to preserve any access contracts, and to deal with any access applications or access disputes already in progress when the transition from full to light regulation occurs.[30] As with the reverse transition discussed above, the Public Utilities Office's present thinking is that the applicant be given an election whether to continue under the full regulation regime, or have its application or dispute transitioned into the light regulation regime.

[30] This too will be a low frequency, low probability event, and the transitional provisions should be kept very simple.

4. Pricing arrangements

4.1 Introduction

4.1.1 Design Elements

The Design Report outlined that pricing principles would be developed to guide price setting and dispute resolution (Design Element 4). The Design Report also described a number of pricing principles that could be applied for this purpose, and discussed a possible objective for pricing.[31] Other design elements also have a direct link to network pricing, which include the ability for parties to agree to non-standard services.

This section addresses the implementation of Design Element 4, taking account of linkages to other design elements.

4.1.2 Overview

The pricing arrangements will be a central element of the regulatory framework for the Pilbara.

The Pilbara "pricing arrangements" consist of:

- high level "revenue and pricing principles" (section 4.3);
- detailed "pricing rules" (section 4.4) setting out a two-step process comprising:
  - the "building block cost of service" model used to set target revenue; and
  - the "tariff-setting methodology" used to distribute target revenue across services and users in order to derive individual tariffs.

Covered networks will be required to demonstrate how they have complied with the revenue and pricing principles and pricing rules in a transparent manner. The price list and accompanying materials published under these arrangements will guide access negotiations, and hopefully reduce the need for arbitration. Further, when a dispute arises the arbitrator will be required to apply the pricing arrangements when deciding upon that dispute.

Based on feedback received from stakeholders and its own analysis, the Public Utilities Office proposes to refine the pricing principles discussed in the Design Report, in order to:

- refine the objective for pricing;
- divide the pricing principles into high level revenue and pricing principles and more detailed guidance in the form of pricing rules;
- re-structure the presentation of the more detailed guidance to give effect to the standard two-step process for setting infrastructure prices (i.e first establish a target for overall revenue and then determine prices that are consistent with this);

[31] Design Element 5 provides that the onus will be on networks to develop, negotiate and defend their pricing methodologies in accordance with the Pricing Principles, and Design Element 6 provides that networks will be required to demonstrate that their proposal meet the pricing principles. These elements will be met through the transparency arrangements (section 5), negotiation arrangements (section 6.2) and design of the dispute resolution process (section 6.3).

- provide additional guidance on key issues; and
- deal specifically with linkages to other design elements (notably, grandfathered arrangements).

This chapter sets out the proposed arrangements for each of these areas of enhancement. It commences with the objective, then the role and inclusion of high-level revenue and pricing principles. It then outlines the proposed pricing rules. Finally, it addresses a number of other pricing related issues including:

- pricing for non-standard contracts;
- pricing arrangements for customers seeking a new or expanded connection; and
- pricing for network to network flows.

4.2 Pilbara electricity objective

The role of an objective in economic regulation is to:

- assist the regulator to interpret the detailed guidance given to it;
- provide greater certainty to service providers and access seekers about what will guide decision making in the regime;
- be clear about the threshold issues that are of most importance for the application of regulation; and
- ensure that decision makers are accountable for their decisions.

The Public Utilities Office previously proposed[32] that a separate objective applies for the light handed access regime to the one that will apply for the ISO arrangements. This objective was based on the one included in Part 23 of the NGR for non-scheme pipelines and was focused on achieving the outcomes of a workably competitive market. However, it is proposed instead that a single overarching objective apply for the arrangements in the Pilbara. It is further proposed that this be based on the National Electricity Market Objective (NEO), but with amendments that ensure the special circumstances of the Pilbara are taken into account.

Stakeholders in the October workshop supported the objective for the light handed regime being based on the NEO, but indicated a preference for the objective to have specific regard to the unique circumstances of the Pilbara, i.e. that infrastructure and economy in the Pilbara is focused on the high value resources sector and large end-users, such that the context for economic regulation is quite different to what is standard for utility regulation in Australia. On this basis, the Public Utilities Office proposes that the NEO objective be updated to reinforce the special nature of electricity customers in the Pilbara and also the benefits that are derived from their electricity use. The intention being to ensure that the unique circumstances are acknowledged when undertaking decision making.

[32] Design Report Section 2.3

The proposed objective is as follows:

The Pilbara electricity objective

To promote efficient investment in, and efficient operation and use of electricity services for the long-term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity, and the reliability, safety and security of the Pilbara region.

After discussion with stakeholders, the Public Utilities Office proposes to add some supplementary concepts to guide the interpretation of this objective in a Pilbara context. The Public Utilities Office has developed two options, which are not necessarily mutually exclusive.

The first option is to expand on the meaning of the word "consumers" in the Pilbara electricity objective:

> *For the purposes of applying this objective:*
>
> - *consumers include those who use electricity for residential, commercial and industrial purposes, with this latter class of use including the use of electricity for resource extraction and processing; and*
> - *the consideration of the long-term interests of a consumer or class of consumers requires regard to be had to the purpose for which that consumer or class of consumers uses the electricity, and the benefits that are thereby associated with that use, including but not limited to any wider economic benefits that may be generated.*

The second option is to include a separate objective reflecting the importance of the resources sector to the State, along the following lines:

> *In making a decision or exercising a discretion under this Pilbara regime, regard must be had to:*
>
> *(i) the importance of the Pilbara mining industry to the WA economy;*
>
> *(ii) the critical role that certain Pilbara networks play in that industry;*
>
> *(ii) the very substantial investment which underpins that industry, and the risk to that investment which could arise from any disruption to the operation and development of those networks,*
>
> *and accordingly, that regulatory outcomes and assumptions commonly applied to other electricity networks may not be appropriate, or may not be appropriate without modification, for Pilbara networks.*

Objectives clauses are of course among the most closely studied provisions in any access regime. During the detailed implementation stage, the Public Utilities Office will continue to refine, and consult on, the language of any words it includes to supplement the Pilbara electricity objective.

A further issue to be considered in designing a regulatory regime is what guidance to give a decision maker – here the NSP or the arbitrator – in weighing and prioritising multiple criteria and objectives. For example, the proposed approach to determining the RAB and cost of capital below, requires seven explicit factors to be considered. This is one of the reasons the NEO was introduced into the NEL, to provide an over-arching principle to guide decision makers when called on to balance or reconcile multiple conflicting objectives.[33]

If the first option above is chosen, the additional words can be absorbed into a single Pilbara electricity objective. But if the second option is chosen, there will be a new, second objective, and a decision will be needed as to whether it too ranks as an overarching principle like the Pilbara electricity objective, and how it ranks against the Pilbara electricity objective. The Public Utilities Office proposes that, if adopted, it should be an over-arching concept, ranking below the Pilbara electricity objective.

4.3 Revenue and pricing principles

The Design Report provided a list of 10 potential pricing principles[34] that could be applied to implement Design Element 4, comprising:

- high level pricing guidance, drawing principally upon the "revenue and pricing principles" in the NGL and NEL;[35] and
- more detailed guidance for certain matters, most notably around tariff structures.

In consultation with stakeholders, support was expressed for retaining both the high level pricing guidance as well as providing more detailed price setting guidance. Stakeholders also expressed support for drawing upon the revenue and pricing principles for this purpose, as discussed above.

Accordingly, the Public Utilities Office proposes to include the following high-level revenue and pricing principles: [36]

- the NSP should be given a reasonable opportunity to recover at least the efficient costs it incurs in providing network services and complying with regulatory obligations;
- the NSP should be incentivised to promote economic efficiency with respect to the network services it provides, including efficient investment in the network, efficient provision of network services, and efficient use the network;
- the tariff for a network service should allow for a return commensurate with the regulatory and commercial risks involved in providing the service; and
- regard should be had to the economic costs and risks of the potential for:

[33] *Re Michael; Ex parte Epic Energy (WA) Nominees Pty Ltd* [2002] WASCA 231 (the "Epic Energy case") provides a cautionary illustration from the earlier *Gas Code* regime, which lacked a single coordinating objective. In that case, the regulator was confronted with a list of 10+ "factors" to "consider" (s 8.10), "with a view to achieving" 6 "objectives" (s 8.1), while "[taking] into account" 6+ matters (s 2.24), and given no over-arching guide as to how to complete this task. Clearly, an unsatisfactory outcome.

[34] Design Report, pp 29-30

[35] s 7A NEL; s 24 NGL

[36] These bullet points summarise and simplify clauses 7A(2) to (7) of the NEL.

- under and over *investment in* the network; and
- under and over *utilisation of* the network.

The Public Utilities Office proposes not to include in this list the principle related to the RAB,[37] because this matter is dealt with comprehensively in the more detailed pricing rules.

4.4 Pricing rules

The pricing rules set out how pricing is to be undertaken by covered networks in the Pilbara.

The proposed pricing rules follow the common two-step regulatory process of:

- first, use the building block cost of service model to calculate the target revenue for the regulated business; and
- second, use the tariff-setting methodology to determine how target revenue is to be recovered from customers (either individuals or groups/classes) and, related to this, how the actual prices are to be structured.

Consistent with the light regulation model being adopted for the Pilbara, the ERA will have a very limited role in this process: it will undertake an up-front determination of the cost of capital for the two initially-covered networks. Otherwise, the price-setting described in this section will be the NSP's responsibility, with the results to be scrutinised first in negotiations with access seekers, and then, if negotiations fail, in arbitration of the resulting access dispute. The service provider will be required to undertake a formal process to update prices on a periodic basis, including by consulting with customers and the public. It will also be required to prepare and publish certain materials to support those prices, including relevant policies and terms and conditions (see section 5).

The ERA will have no approval roles in respect of the NSP's publications.

4.4.1 Step 1: Calculate target revenue – the building block cost of service model

The building block cost of service model

The "target revenue" is the aggregate revenue across the covered services that the prices for those services will be designed to deliver. The Public Utilities Office proposes that:

- the target revenue be set at an estimate of the aggregate cost of providing those services; and
- the building block cost of service model be applied as the method for estimating that aggregate cost.

[37] NEL s7A(4) reads:
"Regard should be had to the regulatory asset base with respect to a distribution system or transmission system adopted—
(a) in any previous—
(i) as the case requires, distribution determination or transmission determination; or
(ii) determination or decision under the National Electricity Code or jurisdictional electricity legislation regulating the revenue earned, or prices charged, by a person providing services by means of that distribution system or transmission system; or
(b) in the Rules."

Setting prices with reference to the cost of provision is the dominant approach to price regulation in Australia including light handed regulatory approaches. Cost-based pricing balances the interests of both service providers and network users. "Cost" here refers to an economic concept of cost and includes an allowance for a risk reflective return on capital invested (also called the opportunity cost of capital). Economic theory indicates that in a fully competitive market, prices will stabilise at this level. Prices which deliver a risk-reflective return on efficient costs will be sufficient to motivate continued investment. Further, if prices rose above that level, new suppliers would enter the market. If they do not, such that prices remain above the efficient cost of production, customers are said to be paying monopoly rents. In addition, cost-based prices promote efficient use of the service such that future investment driven by demand can also be said to be efficient.

Using the building block cost of service model to estimate the aggregate efficient cost of providing the covered services is standard practice in Australian utility regulation. There is thus substantial experience with the building block approach, and the NSP, arbitrator and stakeholders will be able to draw on a body of precedent and standard practice from Australian utility regulators, adjusted as appropriate to reflect the circumstances and context of the relevant Pilbara network.

The PNAC will thus prescribe that the NSPs prices must be derived as follows:

- target revenue will be defined as the aggregate cost of providing the covered services, to be calculated as the sum of four cost components (the "building blocks"), namely:
  - a return *on* capital;
  - a return *of* capital (depreciation);
  - operating expenditure; and
  - an allowance for taxation.
- an input to calculating the first two of these is the value of the NSP's investment in the covered network, known as the "regulatory asset base" (RAB). The RAB would be determined once at the time the regime first applies to the network, and thereafter carried forward to reflect (amongst other things) capital expenditure and depreciation. See separate discussion below;
- the other input for calculating return *on* capital is a measure of the cost of capital for the business. The building block cost of service approach to efficient cost-based pricing requires that the cost of capital be set at a level which would deliver a risk-reflective commercial return on the capital invested (that is, reflecting the opportunity cost of capital). See separate discussion below;[38]
- the NSP would be required to determine and publish prices to be set for a defined, future period, proposed to be 5 years. As such, the inputs to the calculation – including operating and capital expenditure and demand – would need to be forecast over that future period, and much of the focus of a price setting exercise is on the reasonableness of those forecasts;

[38] An allowance would also be included for the cost of corporate taxation; however, this could be provided via the return on the RAB (i.e.by defining the return in pre-tax terms) or through providing an explicit allowance for corporate taxation (with this allowance typically being calculated to reflect a benchmark firm).

- at the end of that period the NSP would be required to undertake a review, and recalculate the prices by re-applying the building block cost of service approach;
- the covered network would be free to review its prices earlier than proposed, although the reasonableness of an earlier review could also be a matter for a dispute.[39] It would also be open for the covered network to set out the conditions under which an earlier review may be undertaken as part of its access pricing methodology. The proposed pricing period must be specified as part of the access pricing methodology (see section 5.4.2); and
- further increments or decrements to the target revenue may be applied, for example, to include compensation for an economic cost that is not reflected in the specific line items set out in the first point.[40] However, the inclusion of such increments or decrements would need to be justified in terms of the revenue and pricing principles and objective of the regime.

Because the Pilbara regime involves light regulation, none of the above (except cost of capital for the first two covered networks) will be subject to up-front approval by the ERA. The NSP would be required to develop and publish its pricing model and price list, but any scrutiny of this would be left to the access negotiation process, and failing agreement to the arbitration of an access dispute.

The NSP's published policies

The NSP would also be required to develop and publish policies and standards it will apply to its forecast capital and other expenditure. This will include: a "Network Development Policy", setting out, among other things:

- the principles that capital and operating expenditure would need to meet before being included in the RAB and funded through prices, including the planning standards to be applied on the covered network;
- the principles that will be applied to derive customer contributions.

The Network Development Policy, in particular, is designed to create a more flexible regime, better tailored to an individual NSP's needs and better able to evolve over time. This policy would take the place of prescriptive expenditure tests in full regulation regimes such as the "new capital expenditure criteria"[41] and the "new facilities investment test"[42], and would be applied in the same way.

[39] For example, under the building block approach as applied in Australia, covered networks ordinarily bear the risk of "normal" variances of demand and expenditure around the forecast values, but may be permitted to advance a review if a material adverse event has occurred that was outside of their control (for example, substantial asset damage due to a natural disaster). Thus, seeking to advance a price review to avoid a "normal" variation may be viewed with suspicion, whereas an earlier review following a natural disaster may be considered reasonable.

[40] See, for example, clause 6A.5.4(b)(7) of the National Electricity Rules, which authorises the inclusion of compensation for "other risks" in relation to transmission determinations (the same clause is not present for distribution determinations). Whilst the Public Utilities Office's advisers are not aware that this clause has ever been applied in practice, different networks in different circumstances may be more likely to encounter an economic cost that is not compensated through the standard building blocks.

[41] NGR rule 79

[42] ENAC s 6.52

Thus, access seekers would be able to use these policies challenge the prudence and efficiency of capital and operating expenditure being added into the tariff base. In addition, consistent with the light regulation model, an access seeker would be able to challenge the prudence and efficiency of the policies themselves. To minimise the risk of the second class of challenges, a prudent NSP would likely design its policies to follow regulatory precedent as closely as possible.

A network's policies and the outputs from those policies would however be free to diverge from the regulatory norm where appropriate, for example to take account of the expenditure that an efficient firm would undertake if it was faced by the same operating environment as the covered network, which includes that the efficient entity had the same stock of assets, engaged (if applicable) in the same vertically integrated business, and served the same geographic spread and type of end-use customers.

Approach to the RAB

There are two elements of the approach to the RAB that need to be determined for the PNAC, these are:

- the starting RAB; and
- how the RAB is then updated over time.

Starting value for RAB

The building block cost of service model needs a starting value for the RAB.

Background

The setting of the starting asset value for pre-existing assets that are part way through their asset lives has typically generated substantial debate and commentary. For assets that have been in place for some time, and even if there are robust records of the amount of historical capital expenditure incurred, which is not always the case, it is very difficult to ascertain the extent of cost that has been, or that should be, assumed to have been recovered over the period to date. Further, economic principles provide limited guidance as to how the starting asset value should be set, except that it fall within the wide range between opportunity cost and the bypass cost.

In view of the above considerations, and in order to eliminate what may otherwise be a material source of dispute, the starting RAB for the Horizon Power network will be prescribed in or under the regulations or the PNAC at the start of the new regulatory regime, and will not be subject to appeal or dispute. This was the approach taken for electricity distribution networks in the NEM at the commencement of the NER.[43]

Any other network that is or becomes covered by the regime – including the Alinta Energy network – will be required to establish and publish its own initial RAB for use in its application of the building block approach.

[43] See NER Schedule 6.2, clause S6.2.1(c)(1) for distribution networks and Schedule 6A.2, clause S6A.2.1(c)(1) for transmission networks.

The PNAC will provide guidance on this, and the Public Utilities Office has been considering what form that guidance should take.

Other regimes

There are numerous precedents for how this guidance might be expressed.

The NER require the AER to determine:

> … the prudent and efficient value of the assets that are used by the provider to provide [regulated services] …[44]

having regard to a range of factors,[45] including giving the NSP a reasonable opportunity of recovering its efficient costs of complying with regulatory obligations, whether the expenditure was evaluated against a regulatory investment test, whether the expenditure was incurred in a manner consistent with good business practice, the desirability of minimising investment uncertainty and the need to incentivise NSPs to avoid inefficient expenditure.

The NGR provides different mechanisms depending on when the pipeline was commissioned. Newer pipelines (commissioned after 2008) are to be valued using a depreciated actual cost methodology.[46] Older pipelines' starting RABs are to be set by reference to the prior legislation, the *Gas Code*.[47] Notoriously, the *Gas Code* provided a very long shopping list of factors to be considered in setting the starting RAB for certain pipelines, including:[48]

a) depreciated actual cost (DAC);

b) depreciated optimised replacement cost (DORC);

c) "the value that would result from applying other well recognised asset valuation methodologies"

d) "the advantages and disadvantages of each valuation methodology applied under paragraphs (a), (b) and (c)"

e) six other factors, plus a seventh "any other factor the regulator considers relevant".

The *Gas Code* went on to say that the asset valuation "normally" should fall between DAC and DORC.

The ENAC prescribes that the initial RAB must be set using either DORC or optimised deprival value.[49]

Proposed approach – "objectively reasonable", with parameters

[44] NER, Schedule 6.2, clause S6.2.1(d)(2); Schedule 6A.2, clause S6A.2.1(d)(2)
[45] NER, Schedule 6.2, clause S6.2.2; Schedule 6A.2, clause S6A.2.2;
[46] NGR rule 77(1)(b): cost of construction plus actual additional capex since construction, minus depreciation and disposed assets. The capital costs are ***not*** subject to any prudence test, such as the "new capital expenditure criteria" in NGR rule 79.
[47] *National Third Party Access Code for Natural Gas Pipeline Systems* (***Gas Code***), a version of which is available here.
[48] *Gas Code* s 8.10
[49] ENAC s 6.47

The Public Utilities Office has considered the above, and other, options for providing guidance on how the initial RAB is to be determined. Economic advice received by the Public Utilities Office suggests that an appropriate phrase to describe the approach actually taken by regulators in establishing RABs , is to direct the NSP, and if necessary the arbitrator, to derive a value that is "objectively reasonable" in the context of the specified assets.

Advice to the Public Utilities Office suggests that although this test has not been used in a formal regulatory regime, it reflects language commonly used by economists and regulators when endeavouring to summarise the gist of the RAB valuation task.

Moreover, advice to the Public Utilities Office indicates that this test is consistent with the limited guidance provided by economic principles, namely that the initial RAB should be consistent with maintaining the confidence of all parties to continue investment.

In addition to the requirement that the determined RAB be objectively reasonable, the PNAC will oblige the NSP or arbitrator to have regard to:

- the Pilbara electricity objective;
- if an additional objective regarding the importance of mining to the State is included as discussed at section 4.2, that objective;
- the revenue and pricing principles;
- the assets' depreciated optimised replacement cost (DORC) – this is the value calculated by taking the asset as it is today, determining what an optimum replacement asset would be using today's technology, and then depreciating that value to reflect the age of the assets – in economic theory, this methodology is regarded as giving a value for the assets that would be predicted in a hypothetical workably competitive market in hypothetical long-term equilibrium. This valuation method is often applied as a maximum value because it is thought that higher values may contain monopoly rents, but the Pilbara networks regime will provide some flexibility on this point (see below);
- the assets' original cost less the recovered capital, sometimes called depreciated actual cost (DAC) – this is consistent with the recovery of cost (and a reasonable return) over the lives of the assets, but no more. While this approach is useful in some cases, as noted above it can be limited by information constraints, especially where now-regulated activities had previously been provided as part of an integrated service; and
- the desirability of avoiding material changes in prices – this reflects the policy view that the introduction of access regulation should not, in itself, provide a reason for a material change in final prices being paid by end-use customers. In some circumstances regulators have used this principle to 'reverse engineer' an asset value based on current tariffs and estimates of other costs, but this approach may be less useful in the Pilbara where some networks may not have third party access tariffs.

The PNAC will indicate that the RAB will normally be expected to lie between the network's DAC and DORC values.[50]

[50] This test appeared in the *Gas Code* s 8.11. It was examined the *Epic Energy case* (see footnote 33), which determined that the use of the word "normally" did enable the RAB to move outside the DAC-DORC bounds.

The guidance given to the NSP and an arbitrator about setting the RAB will include a rule indicating that when determining the "reasonableness" of capital expenditure the NSP/arbitrator must only take into account information and analysis that the NSP could reasonably be expected to have considered or undertaken at the time that it undertook the relevant capital expenditure.[51]

Arbitrated RAB values

If in an access dispute an arbitrator determines the RAB for a network, that determination will set a precedent for subsequent negotiations and arbitrations. It will not be a fully binding precedent, as discussed in section 6.3.11 below, but the parties to a subsequent dispute would need to persuade the subsequent arbitrator why the precedent should not be followed.

Updating the RAB over time – the roll-forward mechanism

In contrast to the initial asset value, both economic principles and regulatory convention provide much more guidance on updating the value, once established, over time. The key proposition is that the method used to set prices and update the regulatory asset value must, in combination, provide a reasonable expectation that prudent capital expenditure can be recovered. This can be accomplished by raising the regulatory asset value to reflect the actual capital expenditure that has been undertaken, and then reducing it for the return of capital (regulatory deprecation) that has been factored into prices and thereby returned to investors and disposals.[52] The Public Utilities Office proposes that the pricing rules will require the RAB to be updated over time in this manner.

Only prudent expenditure will be rolled forward in this fashion. This provides a discipline on network businesses to undertake efficient expenditure or risk it being found as inefficient by an arbitrator following dispute, and so disallowed from entering the RAB.

As noted above, the Public Utilities Office does not propose to prescribe in detail the test for prudence and efficiency. Rather it will be set out in the NSP's Network Development Policy.

As with setting the initial RAB, the prudence of expenditure will be assessed without the application of hindsight.[53] In addition, the burden of proving that expenditure was imprudent will rest on the access seeker.

However, networks should not face an open-ended risk of assets being identified as imprudent and disallowed from inclusion in the RAB. Typical regulatory practice is to review the prudence and efficiency of past capital expenditure over a recent window, often just the period since the last access reset. The PNAC will specify that an arbitrator can only examine prudence and efficiency during the 5 years immediately preceding the access dispute.

The NSP's standard terms will set out how existing contracts will respond, if a subsequent arbitration determines that certain assets should not have been included in the RAB.

[51] Adapted from NER Schedule 6.2, clause S6.6.2, resuming words after subclause (7).

[52] An example of this mechanistic roll forward can be found in the NGR, rule 77(2). The NER have a more sophisticated roll forward mechanism. The ENAC (s 6.48) does not prescribe a roll forward mechanism at all, instead leaving it open for the network to be revalued at each access reset – this would not be appropriate for the Pilbara because there is no access arrangement to have these prescribed regular resets.

[53] See text at footnote 51.

Approach to setting the cost of capital

The cost of capital is another aspect of price regulation that is often contentious. This is because the cost of capital cannot be observed, but must be estimated, and there is substantial debate about the most appropriate estimation methods as well as imprecision in the estimates produced by the available methods.

During the technical workshop, stakeholders suggested that one way to reduce disputes would be for the ERA to determine the cost of capital for each covered network , at the start of each regulatory period. While the Public Utilities Office agrees that this would reduce the prospects of dispute, it would also add material regulatory cost. Balancing these considerations, the Public Utilities Office proposes a limited use of up-front determination: for the Alinta and Horizon Power networks only, and for the first five year regulatory period only, the ERA will determine the cost of capital. The ERA's determination will bind the NSP and arbitrator for the first 5 year pricing period (expected to start on 1 July 2021).

In undertaking this determination the ERA must:

- consult the public and stakeholders in the usual way;
- have regard to regulatory precedent in electricity and other industries, but undertake a specific assessment for each of initially covered networks, based on the unique circumstances of that particular business and the Pilbara electricity sector;
- not assume that the circumstances of each network are the same, or that the same value could be applied across the two initially covered networks or to any other networks that may become covered in the future;
- apply an "allowed rate of return objective" from the National Electricity Rules as follows:

  > The allowed rate of return objective is that the rate of return for a NSP is to be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the NSP in respect of the provision of covered network services.

- have regard to the Pilbara electricity objective;
- if an additional objectives regarding the importance of mining to the State is included as discussed at section 4.2, have regard to that objective; and
- apply the revenue and pricing principles.

The same principles would apply when assessing the cost of capital for any network that becomes covered in the future, except that there would be no up-front determination by the ERA. Rather, the NSP would be expected to apply this guidance in setting its tariffs, and the arbitrator would apply it if an access dispute arose.

The ERA's determination would remove this issue as a source of dispute for the first pricing period for each of the Alinta and Horizon networks. In addition, this determination would provide stakeholders with some initial guidance on how the assessed risk of each of these two networks compares to other regulated utilities (as well as between themselves), which is expected to be the most likely source of a dispute. While the costs of capital would then need to be updated for the initially-covered networks over time to reflect changes in capital market parameters and/or other new information, the scope for dispute over these matters would be narrower. For example, regulatory decisions for other regulated businesses could, to the extent transferrable to the Pilbara, be a source of information for changes in general capital market parameters.

The formulation proposed for the "allowed rate of return objective" is slightly different to the wording suggested in the Design Report, which included an explicit reference to a "commercial" return but no reference to a "benchmark efficient entity".[54] Economic advice provided to the Public Utilities Office suggests that omitting this word is unlikely to lead to a difference in the estimated cost of capital , because the ERA and AER have always interpreted that the "benchmark efficient entity" to mean a private sector entity, necessarily implying that a commercial return is intended. Further, using exactly the same words as the National Electricity Rules will make it easier to be draw on regulatory precedent, subject always to the requirement that the NSP and arbitrator also take account of the unique characteristics of the Pilbara listed above.

The Public Utilities Office proposes two modifications to the general guidance on the cost of capital discussed above.

First, in undertaking its two up-front assessments of the cost of capital, it is proposed that the ERA be required to apply the same methods and values that are contained in its prevailing guideline on the cost of capital for the regulated gas networks,[55] with the exception of the parameters that may be affected by the specific nature (and so risk) of the activities in question. The four inputs that may vary across activities are the equity beta, leverage assumption, debt risk premium and the assumed rate of distribution of imputation tax credits.[56] This modification will permit the ERA to rely upon its existing analysis on the cost of capital that is relevant to all Pilbara covered networks – and so focus its activities squarely on the question of how the Pilbara covered networks compare to other regulated assets (and other assets more generally) – and so minimise the potential cost associated with the ERA undertaking this task.

[54] Design Report Section 2.3.1

[55] The ERA is currently consulting in relation to this guideline, and a final guideline is due in December 2018 (ERA, 2018, Draft Rate of Return Guideline – Stakeholder Forum, September, p.23). On 15 June 2018 the CoAG Energy Council agreed to pass new legislation to make the rate of return guideline binding and to remain in place for a period of 4 years (ERA, 2018, Draft Rate of Return Guideline – Stakeholder Forum, September, p.5). If the requisite legislation passes in the form that is anticipated, then the rate of return guideline the ERA is scheduled to complete in December 2018 will be the guideline that is prevailing when the ERA determines the costs of capital for each of the initially covered Pilbara networks.

[56] The ERA calculates the value of imputation tax credits as a product of the assumed distribution rate and assumed utilisation rate, and describes the former as being "firm-specific" (ERA, 2018, Draft Explanatory Statement for the Rate of Return Guidelines, June, para.835).

Second, the Public Utilities Office proposes to require the use of a pre tax version of the cost of capital. This would result in the allowance for corporate income taxation being provided via an adjustment within the cost of capital, rather than the allowance being based upon an explicit modelling of the taxation system. The differences between these two approaches for deriving the taxation allowance are the complexity introduced and the precision – the use of a pre tax cost of capital is very simple but relies upon high-level assumptions about the taxation system, whereas the explicit modelling of taxation should provide a more accurate estimate of taxation liabilities, but at the expense of (potentially materially) complexity. The Public Utilities Office considers that the simpler method is appropriate in the context of the light handed access regime being developed for the Pilbara and that prescribing the approach to this matter will reduce the costs to stakeholders, including through reducing the risk of disputes occurring.[57]

4.4.2 Step 2: The tariff-setting methodology and price list

Network prices are the means for recovering target revenues, and at a policy level providing signals for efficient use of the network. A network service provider will want to set prices that deliver a reasonable expectation that target revenue will be recovered. For network users, the price can influence decisions as to whether to connect to the network and, once connected, how much to consume and when.

The role of the tariff-setting methodology is to guide who should pay, and how much they should pay out of the total target revenue to be recovered. To promote efficient consumption, a price's structure should mimic the structure of costs, and more specifically, the marginal costs of supply. This means that if costs change when an extra unit of a good or service is consumed, then it desirable that this be reflected by a commensurate change in the price. However, the potential gains in efficiency need to be weighed against the administrative costs of setting cost reflective tariffs, as well as any technology constraints such as the ability to measure the timing of consumption.

The proposed pricing rules will require the covered NSP to develop and publish a tariff-setting methodology and price list having regard to certain criteria, as follows:

- prices should be at least equal to avoided cost and no more than stand-alone cost. If prices are excessively high (i.e. above stand-alone cost) to one customer, or class of customers, this may encourage inefficient bypass of the network. This is because it would be cheaper for the customer to duplicate the network than to pay the network price. Conversely, if prices are excessively low (below avoidable cost) this would imply a subsidy to customers and drive excessive consumption and potentially inefficient network investment to meet this level of demand;

[57] The application of a post tax WACC and explicit modelling of taxation are a reasonably new development in Western Australia. The ERA only switched to the use of a post tax WACC for gas networks after the National Gas Rules were changed to mandate this practice (the new rules were first applied in the ATCO gas distribution access arrangement that had effect from 1 July 2014), and first applied a post tax WACC for Western Power for the 2012-17 access arrangement period. In addition, consistent with the proposal here, the light handed access regime for the Port of Melbourne requires the use of a pre tax WACC (Port of Melbourne Pricing Order, clause 4.3.2).

- prices should signal the impact of additional usage on future investment costs. The objective being that prices signal, so far as practicable, the long run marginal costs associated with a customer's use. Under this principle, customers should experience the effect of a small increase or decrease in their usage on the timing and extent of the network's investment plans and hence future network costs. Consequently, where consumption is efficient there can be confidence that augmenting the network to serve observed and forecast consumption is itself efficient;
- because there are substantial sunk costs, prices set at long run marginal cost (to signal future investment cost) will likely be less than average cost and so will not fully recover target revenue, and instead will leave a large unrecovered residual amount. This residual cost should be recovered in a way that minimises distortions to efficient use, i.e. these residual costs should be recovered in a way that ensures the marginal price signal is preserved as much as possible consistent with allowing total costs to be recovered. This principle has two implications:
  - first, residual cost should (where practicable) be recovered via charging parameters that have the least impact on usage. For example, daily standing charges are one means of recovering these costs; and
  - second, the recovery of these residual costs should spread across all customers so that everyone bears a fair share;[58]
- prices should be transparent, promote stability and certainty while changes to prices should have regard to the impact on end-use consumers. Customers make investment decisions in response to their expectations about electricity prices. In order to do this effectively it is necessary that (i) they are able to understand the prices and (ii) that the prices are reasonably predictable over time. For instance, if there is little transparency about prices and they change frequently, customers will not be able to establish behaviours or make investments that promote efficient electricity use, or at least this will be far more challenging to do; and
- there should be no unfair discrimination in the setting of charges for access seekers, meaning that:
  - the price that is paid by different access seekers should reflect the characteristics of the final customers that are served by the access seeker (associated final customers);
  - the price that is paid by different access seekers should vary only to the extent that this is justified in terms of the cost of provision to the associated final customers (i.e., from application of the LRMC or lower/upper bound principles above), or with reference to differences in the economic characteristics of the associated final customers (i.e. from application of the residual cost recovery principle);[59] and
  - the price that is paid by different access seekers should include an appropriate share of the residual costs to be apportioned across the associated final customers (i.e. from application of the residual cost recovery principle).

[58] This reflects the principle in economics that the economic distortion that is caused by a gap between price and cost increases at an increasing rate with the size of that gap, which leads to the outcome that the economic distortion caused from recovering a residual cost will be minimised by spreading it as thinly as possible across the broadest possible base.

[59] An implication of this principle is that the same price should apply for similar customers unless there is a material difference in the cost of serving that customer.

4.5 Other pricing issues

4.5.1 Non-standard contracts and grandfathering of existing agreements

Design Element 7 of the Design Report provides that, by mutual agreement, an access seeker and the relevant network may agree on a Non-Reference Tariff. This would arise when an access seeker desires something other than what is available from the standard service and the standard terms and conditions of supply. If a customer requests a non-standard service and/or non-standard terms and conditions, and this imposes different costs, then the access price should also differ. Examples of this might be a difference in the physical nature of the service (such as a different level of reliability), a difference in the commercial terms (such as different credit support arrangements or invoicing cycle), or just a difference in the term of the contract (for example, the parties may agree to a price that is fixed beyond the time when the covered network will next review its prices).

The Public Utilities Office proposes to implement the principle that the price of non-standard services reflect the standard published price plus or minus the incremental or avoided cost of the non-standard feature. The purpose of this rule is to ensure that access seekers face appropriate signals for the use of services above or below standard service levels, and also to avoid cross-subsidies arising. This principle is similar to Draft Pricing Principle 7 from the Design Report, with the principle refined to focus it directly on services that are a variation to the standard service.

An implication of the capacity for users to negotiate specific arrangements is that there are likely to be customers that can be expected to be paying a different price to the default price. Also, it is expected that there are existing arrangements that will continue and that have a price that will differ to the standard price. A decision will be required, therefore, as to how bespoke arrangements should be treated when setting the price for standard services.

The Public Utilities Office proposes to specify a principle in the PNAC that the price for the standard reference service is to be set on the assumption that all customers pay the standard (published) price. This would mean that the price that is determined for the standard service would not be affected by the specific terms that may be negotiated bilaterally. The ability to ignore the terms of specific arrangements would also simplify the task of a price determination and, because confidential aspects of access contracts would not affect prices, enable greater transparency.

Grandfathering of existing agreements

At the commencement of the new regime, there will be contracts in place that have a different price to the new price that may be determined for the standard service, and there may be contracts that oblige a different (higher) level of reliability to the standard level of reliability that the network operator establishes for the relevant part of the network.

It is noted the proposal is to grandfather existing load agreements. The principles above would apply in the context of such agreements as follows.

- First, the price in all existing agreements will be ignored when setting the price for the standard service, including grandfathered agreements; and

- Secondly, where an existing agreement specifies a higher level of reliability than standard, the user will be assumed to have already paid an additional charge to secure that reliability – no additional contribution in respect of the cost incurred to provide the higher level of reliability may be sought.

4.5.2 Access seeker driven network augmentation

There are certain circumstances where a load may trigger network investment, namely where:

- a new end-use customer wants to connect to the network; or
- an existing end-use customer wishes to increase the capacity of its connection in order to increase its use.[60]

In order to encourage efficient decisions in these cases, and to ensure that existing customers remain at least neutral when new or expanded connections occur, special charging arrangements are typically employed. In the South West Interconnected System (SWIS), one limb of the new facilities investment test[61] calculates the contribution to an augmentation that is "covered" by the standard tariff (and so able to be included in the RAB), with the remainder to be recovered as a capital contribution, assuming it cannot be recovered under another limb of the test. In the NEM, distribution network businesses are also required to apply a capital contributions policy that requires new customers to cover the gap between an estimate of the tariff revenue the customer is expected to contribute and the estimated incremental cost the customer is expected to cause.

The Public Utilities Office does not propose prescribing in the PNAC specific principles for determining capital contributions. Rather, covered networks will be required to publish their "Network Development Policy", which contains their connections and capital contributions policy, as part of the package of material released with the covered network's proposed pricing arrangements and price list. To the extent that an access seeker had a concern with the covered network's policy, this could be the subject of an access dispute. The arbitrator would be guided in this instance by the objective of the regime and the revenue and pricing principles, and be expected to place appropriate weight on capital contribution policies in place in comparable contexts.

4.5.3 Pricing for network-to-network flows

The Pilbara comprises a number of networks that are owned by different parties, and cases will occur where the supply to a particular customer will entail the use of more than one of those networks. This raises the issue of whether any specific guidance in the pricing rules is required to enable the efficient and fair charging for the use of all networks in these circumstances.

[60] A customer may also seek a bespoke level of reliability that exceeds the default reliability. This would be a non-standard service, and so falls within the discussion above.
[61] ENAC s 6.52

Unlike the case where a "market" is created to undertake the balancing function for energy,[62] it will be possible in the Pilbara for the networks to charge for the services they provide and where it is appropriate to do so. Accordingly, the Public Utilities Office proposes not to include specific rules on this matter.

In relation to the planned flows of electricity, the market design will require electricity supply agreements (ESAs) to identify the generator and load, and generators will be required to operate to follow their loads. In this circumstance, all of the networks that are used to give effect to that supply will be identified and network charges are able to be imposed. For example, if the supply traverses two networks, then the arrangement will imply one "consumption" at the interface point between the networks and then a second "consumption" at the end-user's premises.

Network charges are not likely to be needed for ancillary services apart from the energy balancing service.[63] This is because these services manage unavoidable and inevitable events and so ensure the common objective of stability and security of the networks. The Public Utilities Office is proposing a philosophy in which the cost of these services is to be shared in an equitable manner.

However, the energy balancing service is different, because it reflects a circumstance where a party's imbalance is outside of the agreed tolerance band (which delineates the permitted range of unavoidable imbalances). The Public Utilities Office proposes that the cost recovery arrangements for the energy balancing service would discourage participants from relying on this service, i.e., will incentivise participants to remain within their tolerance level. Applying a charge for the use of the networks involved in providing the energy balancing service would assist with this objective, and would also avoid a situation whereby network charges would apply if the supply had been planned (and reflected in an ESA), but not if the same supply occurred via the energy balancing service.

The proposed network pricing rules are sufficiently flexible for each of the networks to set a network charge for the energy balancing service, although each NSP would retain the onus to justify and defend this charge. Ideally, such a charge would be defined for each of the interfaces with neighbouring networks. The detailed arrangements for ancillary service charges could then enable this charge to be levied whenever a user was deemed to have consumed the energy balancing service.

[62] In contrast, where a "market" is created for energy, a customer will "use" whatever generation is dispatched and implicitly "use" the network that exists between the customer and that generation. Where the market operates over multiple, interconnected networks, this means that a customer may "use" both the network to which it is connected and a neighbouring network, although ordinarily only have a relationship with the network to which it is connected. In this circumstance, payments may be made between the networks (which may be positive or negative depending on the direction of dominant flow, and that collectively sum to zero) to ensure that customers are charged for all of the networks that they are deemed to use. The inter-regional TUOS regime in the NEM is an example of this.

[63] This position was supported by a number of participants at the stakeholder workshop of 19 October 2018.

5. Transparency requirements

5.1 Introduction

Design Element 14 provided that the regulatory regime for the Pilbara will include transparency requirements (information disclosure) on covered networks. Design Elements 5 and 6 also provided that covered networks would be required to develop and defend their prices and pricing methodologies, which is in part achieved through transparency measures.

The purpose of transparency measures is to:

- ensure that a level of information is generally available to assist access negotiations and, if necessary, an arbitrator in an access dispute;
- ensure that the assumptions that underpin the setting of prices are fully documented and thereby open to scrutiny; and
- subject the covered network's price setting and access policies to moral suasion – and, where relevant, provide interested parties with scope to submit on those policies – and so encourage efficient behaviour.

The key objective of these requirements is to increase the certainty and predictability of outcomes and so reduce the prospects of dispute. Transparency provisions will also assist access seekers by allowing them to consider the merits of obtaining access without revealing that interest to the service provider. This is particularly relevant given the vertical integration that exists in the Pilbara.

The Public Utilities Office proposes three components to the transparency requirements in the Pilbara regime, as follows:

1. publication of information about the covered network and procedures for seeking access – which are items the covered network will be required to publish shortly after it is covered, or the Pilbara regime commences, and to keep current over time;
2. publication of prices, the pricing methodology and underpinning policies and information, and to consult with customers and the public– under which the covered network will be required to publish these items and to conduct a transparent review (with stakeholder input) at intervals of not more than 5 years. As part of this, the covered network will be required to;
   - prepare and disclose their policies that have a material effect on the proposed prices or inputs thereto;
   - disclose information that explains and justifies its proposed pricing methodology and prices, which would include forecasts of expenditure and service usage over the proposed pricing period; and
3. annual disclosure – of information related to the *actual* circumstances of the network, and span matters such as expenditure on the covered network, service usage and available capacity for a prescribed future period.

5.2 Disclosure standards

The PNAC will prescribe a standard for NSP disclosure, adapted from the NGR Part 23 "access information standard".[64]

The standard will require that all information published by the NSP:

- is not false or misleading in a material particular;
- if technical, is prepared, published and maintained in accordance with good industry practice; and
- if a forecast or estimate, is supported by a statement of the basis of the forecast or estimate, is arrived at on a reasonable basis, and represents the best possible forecast or estimate in the circumstances.

The NSP will be required to periodically review published information for accuracy, currency and completeness, and to remedy any non-compliance as soon as practicable.

The Pilbara electricity objective will be used in evaluating the NSP's compliance with these transparency requirements.

5.3 Disclosure of information on the covered network and procedure for seeking access

The Public Utilities Office proposes that covered networks will be required to first publish this category of information within 20 days of becoming covered or the Pilbara regime commencing, and then to keep it updated as necessary. The items proposed for this category are:

- a description of the covered network, including relevant diagrams and a summary of technical constraints;
- the provision of a User Access Guideline; and
- the publication of a standard contract, including commercial terms and conditions.

The purpose of the User Access Guideline is to provide a starting point for those that are interested in seeking access to the network. It will set out contact details, the access request process and identify how an access offer will be made, including what investigations or information may be needed for this. It will set out, and clearly delineate, the roles and responsibilities of the NSP and the ISO in relation to any investigations or modelling required. In addition, the User Access Guideline will provide a clear statement of how confidential information will be protected and used, in accordance with the ring-fencing requirements.

[64] NGR rule 551

Standing terms and conditions will set out the NSP's proposal for its standard access contract. They will specify matters such as service characteristics and quality, the curtailment regime, a risk and liability regime, payment terms and prudential requirements. Although they will be set out in the standing terms and conditions, these matters will nonetheless be a matter for negotiation and arbitration between parties.

The Public Utilities Office also proposes that covered networks be required to keep the information noted above current at all times. To the extent that the information reflects a decision of the covered network (for example, the nature of the commercial terms in the standard contract), then this could be the subject of a dispute.

The NSP will be obliged to review this material after any arbitration determination, and to consider what changes should be made in light of the determination.

5.4 Publication of prices and pricing methodology and periodic review

As noted above, Design Elements 5 and 6 determined that covered networks will be required to develop, negotiate and defend their pricing methodologies in accordance with the pricing arrangements.

Consistent with this, the Public Utilities Office proposes that covered networks be required to:

- publish their prices, pricing methodologies and related policies and information;
- consult with the public with respect to their prices, pricing methodologies and related policies; and
- review their prices – again, undertaking consultation with customers and the public – at least once every five years.

An interim arrangement is also proposed to govern the period between a covered network first becoming covered (or the Pilbara regime commencing) and the finalisation of the first review of prices (see section 8).

These components of the regime are discussed in turn below.

5.4.1 Publication of prices, pricing methodology and associated policies and information

The information the network would need to publish in this category includes:

- service definitions and terms and conditions;
- price lists;
- a pricing methodology; and
- associated policies and information.

The pricing methodology would need to describe how the covered network has derived its prices and to defend this against the requirements of the Pilbara electricity objective, revenue and pricing principles and pricing rules.

This will require a comparable level of disclosure to the access arrangement information under full regulation, and the test will be similar: the information must be sufficient to allow access seekers to understand how tariffs have been calculated to verify those calculations.

The *associated policies* relate to the covered network's proposed practices and procedures in relation to matters that will have a material influence on its prices (or the inputs that flow into prices, such as its expenditure forecasts). As outlined in section 4.4.1, it is proposed that the covered network be required to produce and publish a "Network Development Policy", which would describe the network's proposed:

- planning standards for the network;
- principles for deriving the capital contribution that may be sought from a customer; and
- principles for determining the extent of capital expenditure that would be included in the RAB and recovered through prices.

As part of the proposed ring fencing requirements, the covered network would also be required to prepare (and have approved by the ERA) a method for allocating costs between the regulated and other activities.

The information the covered network provides to explain and defend its pricing proposal would include providing and explaining forecasts of expenditure and demand over the relevant pricing period, and details of how the RAB was determined including valuations and valuation methodologies. This forecast information would be complemented by the information on actual expenditure and demand that would be released as part of annual disclosures, as discussed in section 5.5.

5.4.2 Covered network to undertake a periodic review of prices

The Public Utilities Office proposes that:

- covered networks undertake a review of their prices at intervals of not more than five years; and
- as part of the price review, the covered network will be required to consult with the public and substantial network users, which would include providing a documented pricing proposal covering the matters described above and inviting submissions on all elements of the pricing proposal.

Importantly, the review need only occur *at least* every five years. It will be open to the network business to review prices more frequently than this, albeit after consulting with the public and substantial customers. However, the network business will be required to specify at the time of a price review when it intends to next review prices. In order to accommodate material events, such as natural disasters, the network business will also be permitted to specify the circumstances that would permit it to review prices earlier than it had decided at the previous review. This 're-opening' of a pricing period would be something that would be available for access seekers to dispute so that network businesses were not open to bring forward a price review only when "normal" variations of demand and expenditure turn against them.

Requiring service providers to formally review and justify their pricing proposals is intended to ensure that a detailed review of costs and prices is done at regular intervals and to enable customers to provide their views on this. By having this as a formal requirement it is hoped that it would reduce the likelihood that parties would activate the dispute resolution process as agreement could be sought through this process. However, if a dispute were to occur, these formal consultation arrangements would ensure that there was a substantial information base that could be used by the arbitrator.

In addition to this, it would be expected that this would be a time that the terms and conditions, and the policies of the NSP are given focus by substantial customers and access seekers. For instance, the reliability that an NSP proposes to deliver to loads will drive investment needs. As such, customers are likely to focus not just on the cost forecasts themselves, but also what is driving costs.

5.4.3 Interim prices

At the commencement of the regime it will be necessary for covered networks to develop prices so that the regime can function as intended. However, it will take some time for a full consultation and determination of prices to be completed. In addition, this first review will require that the network businesses know what cost of capital is to apply and what their approved cost allocation method is, but these are matters that require determination by the ERA, which itself will require time to make these decisions. Therefore, it is necessary to have in place a process that allows the regime to function as intended from the outset, while also allowing for other decisions to be made.

The Public Utilities Office proposes that covered networks be required to develop an Interim Tariff Methodology and Interim Access Tariffs, which include the assumptions under-pinning prices as well as the method adopted, within three months of coverage. The prices are required to be designed to apply only for the period until the completion of the first full review of prices. Once the decisions have been made by the ERA on the cost of capital and the cost allocation method, covered networks will be required to update the Interim Access Tariffs to reflect the decisions of the ERA within three months after the ERA determination.

Further detail is provided in section 8.

5.5 Annual and ongoing disclosure requirements

Ongoing disclosure requirements relate to those things which require regular updating and so will be published on a periodic basis. This information will cover both financial/expenditure information as well as service usage and availability information.

Financial information is to be published annually no later than four months after the end of the financial year of the service provider of a covered network. The specific financial information that is to be presented will be determined by the ERA through financial reporting guidelines published by the ERA and modelled on the Part 23 arrangements. The guidelines must provide details of the following:

- the publication of:
  - financial statements;

  - information on the methods, principles and inputs used to calculate the RAB, depreciation allowances and the allocation of costs; and
  - financial performance metrics;
- specify the level of detail of information required, which must be at the level of detail reasonably required given the objective of the regime and to provide a true and fair statement of the financial performance of the covered network;
- specify any accounting or audit standards that apply to the reported information; and
- provide for the manner in which the financial information and price information is to be certified as being true and fair.

6. Negotiation and dispute resolution

6.1 Introduction

Design Element 15 provides that the Pilbara regime will set out a negotiation framework. The negotiation framework governs the NSP and access seeker's attempt to reach agreement on access prices and terms.

Design Element 16 provides for there to be a clear and binding dispute resolution framework, when negotiations fail.

6.2 Negotiation framework

Any third party access regime, whether light or full regulation, exists to create a framework within which the access seeker and NSP can negotiate and hopefully agree access. The "teeth" in this framework lie in the regime to resolve access disputes if negotiations should fail, but the negotiation framework itself should be designed to minimise the chances of an access dispute arising.

As a general principle, most negotiation frameworks leave it open for parties to negotiate outside of the formal framework should they wish. The Pilbara regime will do likewise, placing as few restraints as possible on how the parties negotiate, and what terms they may choose to agree. The formal negotiation framework exists as a fall back to this freedom to contract. It is designed to establish procedural arrangements and disclosure obligations, to facilitate successful negotiations.

The information provision requirements described in section 5 will support the negotiating framework. In particular, the User Access Guide will set out the process for negotiation.

Appendix C of the Design Consultation Paper set out in detail an indicative negotiating framework based on Part 23 of the National Gas Law.[65] The Public Utilities Office proposes to adopt that indicative framework without material change.[66] Key features are:

- rules for access requests – such as how the access request is to be presented and when and how further information or investigations are to be conducted;
- rules for access offers – such as the details an access offer must contain, a prescribed period of time within which an offer must be made, and the circumstances when an NSP is not required to make an access offer; and
- rules for the conduct of access negotiations – such as the disclosure and use of confidential information, and a duty on both parties to negotiate in good faith.

[65] See ss 559-562, NGL.
[66] See Appendix A, Item A.5

6.3 Dispute resolution

Although the objective of every access regime is to maximise the chance that access can be negotiated without a dispute, a binding dispute resolution regime is in fact an access regime's defining characteristic: in the final analysis, if negotiations fail, an asset operator can be compelled to provide access whether it wishes to or not.

The dispute resolution framework is thus the "teeth" of any access regime. It is also the place where the need to balance parties' interests becomes most acute. An arbitrator can force an asset operator to provide services against its will – clearly this needs to be done carefully, balancing numerous factors including the NSP's interests.

6.3.1 Design considerations

Criteria for choosing a dispute resolution regime

The Public Utilities Office established the following criteria for choosing the dispute resolution framework, namely that the chosen process:

- is cost effective and efficient;
- provides an appropriate level of predictability and certainty to parties to a dispute, as well as potentially to other access seekers; and
- allows parties to access expertise relevant to the dispute in question.

In choosing these criteria for selecting the dispute resolution framework, the Public Utilities Office considered the various types of access disputes that may arise, how disputes in the access context may differ from normal commercial disputes, how parties may conduct themselves once a dispute has arisen, and the desirability of determining access disputes as quickly and efficiently as possible.

Types of access disputes

The issues to be determined in an access dispute will be varied and may involve a dispute on more than one issue. Access disputes may include disputes about:

- prices;
- non-price terms of the access contract, including for example relating to risk allocation provisions (indemnities, limitations of liability, etc.), default and termination, change in law, curtailment/interruption, contract duration, and other matters;
- the type of connection infrastructure required;
- the application process itself, including disputes about queuing, timely processing of applications or discrimination; or
- technical matters, including the nature and extent of any network constraints, the need for any reinforcement to achieve the access seeker's desired level of dispatch, or the way modelling is conducted or interpreted.

Because of this variety of issues, the framework must enable the parties to access relevant expertise where required.

Disputes in an access context

Access disputes are not necessarily the same as other commercial arbitrations, and it cannot be assumed that the parties will have similar motivations, incentives or resources.

The value of a positive access determination will not be the same for both parties – it may be highly valuable for an access seeker, but of marginal commercial benefit for the NSP. Indeed, for a vertically integrated NSP such as those in the Pilbara, access could easily have a negative value overall for the NSP's group, if it enables the access seeker to compete in upstream or downstream markets.

In many cases, delay will impact differentially on access seekers and NSPs. Delay will often pose little risk for the NSP beyond the modest ongoing resources needed to deal with the applicant. In contrast, delay can be a very serious or even existential risk for the access seeker, especially if it is endeavouring to develop a new project with a limited window of opportunity.

Finally, in some (but by no means all) cases there will be asymmetry between the NSP's and access seeker's access to technical and financial resources.

Any chosen dispute resolution mechanism should be sensitive to these asymmetries.

Behavioural considerations

Any dispute resolution regime needs also to be sensitive to the way in which a formal dispute has the potential to change a party's behaviour. This conduct can be exacerbated by:

- the adversarial nature of arbitration (or other litigation) generally; and
- the tactics of dispute resolution.

Managing this conduct, and managing the tactics which may be deployed by one or both parties in the course of a dispute, requires a particular skill set and expertise, quite separate from any expert knowledge which may be needed to resolve the particular technical matter in issue. Indeed, while the technical expertise required will change depending on the subject matter at issue, the need to effectively manage disputants' adversarial conduct will likely be a constant across all disputes.

It is noted that a legally qualified individual with sufficient seniority and experience will be best equipped to facilitate a process that meets the requirements of natural justice, because such individuals will have the requisite skills to manage the arbitration, and if necessary the parties' behaviour, in a way which promotes rapid and efficient resolution of the issue.

The fact that an access dispute may require specialist technical expertise is addressed in section 6.3.9 below.

Regime does not apply to contractual disputes

The proposed arbitration regime applies to access disputes not contractual disputes. Once an access contract has been entered into, disputes under the contract will be dealt with by whatever means the parties have agreed.

However, because this light regulation regime depends on the arbitrator to scrutinise and enforce the NSP's compliance with its various regulatory requirements, the arbitration arrangements will allow existing users to commence a dispute regarding such matters, if they are adversely affected by the NSP's non-compliance. In this consultation paper, enforcement disputes have been grouped with access disputes by the access seeker.

6.3.2 The arbitration framework

As indicated in the Design Report, the Public Utilities Office has based the dispute resolution framework for the Pilbara on the non-scheme pipeline arbitration mechanism in Part 23 of the National Gas Rules, with bespoke changes to address the specific objectives of the Pilbara.

The elements retained from Part 23 of the National Gas Rules include:

- procedures and timelines;
- establishing the ERA as the scheme administrator with responsibility for:
  - establishing a pool of arbitrators;
  - publication of guides;
  - correcting minor errors in access determinations; and
  - publishing information about access disputes.

Following feedback from stakeholders and further analysis, the Public Utilities Office has developed further aspects of the arbitration framework. Those aspects of the arbitration framework that have been updated since the Design Report are:

- the identity of the arbitrator;
- whether arbitrations are public or private;
- the parties to a dispute and whether others can join;
- whether mediation is required or an option;
- the scale of the ERA's system administration role;
- how expert input can be obtained;
- whether the arbitrator's decision is binding;
- whether final access determinations have effect as precedents;
- an expedited process for queuing disputes; and
- the treatment of the costs of arbitration.

6.3.3 Identity of the arbitrator

The ERA, as scheme administrator, will establish a pool of legally qualified individuals to act as arbitrator.

The Design Report contemplated that the ERA may itself act as the arbitrator for a dispute. As a result of further consultation, the Public Utilities Office considers that, as discussed above at section 6.3.1, a senior legally qualified individual is likely to be best equipped to manage the arbitration process and hearing.

However, parties may sometimes want their dispute resolver to have specialist expertise (e.g. economic or engineering expertise). To address this, the regime will permit parties to elect to have their dispute heard by an arbitral panel rather than a single arbitrator. The panel will be chaired by a legally qualified person drawn from the ERA's pool, but can include one or two other individuals with particular expertise, as agreed between the parties.

Section 6.3.9 below deals with other avenues for expert assistance.

The arbitrator (or chair of the arbitral panel) will be selected from the pool by agreement between the parties, and failing agreement will be appointed by the ERA.

6.3.4 The nature of arbitrational proceedings

Arbitral proceedings are generally held in private. This is one of the attractions of arbitration, because it protects parties' commercially sensitive information. In general, the Pilbara regime will preserve this position, with two exceptions:

- other parties may in certain limited circumstances be able to join proceedings, see section 6.3.5 below; and
- a redacted version of the arbitrator's determination will be made public, see section 6.3.11 below.

6.3.5 Parties to a dispute

Some disputes will concern matters which only interest the individual access seeker and NSP, but many may potentially be directly or indirectly relevant to industry participants generally. This will be obviously the case with general pricing parameters and many non-price contract terms, which are clearly capable of applying to more than just one access seeker. But it could also be the case with subjects that may initially only appear to affect the two parties. For example, although the precise nature of interconnection works required for an access seeker will likely be specifically relevant to only that access seeker, numerous aspects of a dispute on that subject could interest other access seekers, such as the assumptions to be used in modelling the interconnection, the engineering standards to be applied and so on.

It is proposed in the current framework that a party may apply to join an access dispute. The application to join is then assessed by the arbitrator, with the arbitrator taking into account the views of the existing parties to the dispute. It is also proposed that the ERA will have the power to notify possible interested parties, and invite them to join where appropriate.

One of the unavoidable side effects of a light regulation regime is that some controversial matters are resolved in bilateral disputes rather than in a public regulatory hearing. Trying to fully mitigate that outcome by letting third parties join the dispute, risks making disputes very long and complex, which in itself will become a substantial barrier to access. The reason for allowing third party participation in certain access disputes is the recognition that determinations may have implications beyond the interests of the negotiating parties. Broader participation in certain disputes would also provide a degree of assurance to consumers that the outcomes (including prices) arising from negotiations or dispute resolution will be determined having regard to consumers' interests.

But for the original parties, the prospect of third parties joining the arbitration will usually be seen as adding cost and complexity, both of which increase exponentially, not linearly, as parties are added. There is thus a direct tension between on one hand the objective of having disputes resolved as quickly and cheaply as possible, and on the other hand getting the best quality decision and having all relevant voices heard. Following stakeholder consultation and further consideration, the Public Utilities Office proposes to emphasise the former objective.

To this end, the arbitrator will be directed to only allow third parties to join if there is a compelling case for their inclusion, and the benefits of doing so clearly outweigh the time, cost and other disadvantages, after giving due weight to need to resolve access disputes quickly and cheaply. The arbitrator will also be directed to consider what complexities may arise regarding the management of confidential information if the third party were to join, and whether there may be other means for the third party's issue to be heard, without them having to become a party to the dispute.

This issue is related to the question of whether past decisions should be binding precedents, see section 6.3.11 below. Adopting the proposal that past decisions will be influential but not binding, reduces the pressure on both the arbitrator and the third party, to ensure that their voices are heard in this particular dispute.

The Independent System Operator

Access disputes may well involve a disagreement about modelling, network constraints and required augmentations, areas which under the Pilbara regime will be the ISO's responsibility.

The arbitration rules will deal with the ways in which the ISO's knowledge and expertise can be brought to bear, and (if necessary) the ISO's conduct can be brought to account. This may include requiring the ISO to present a report to the arbitrator, to appear as a witness in the arbitration, or in some circumstances it may be necessary for the ISO to be joined as a party.

6.3.6 Preventing vexatious claims

It is also important that access providers are protected against vexatious or constant applications for dispute resolution. The arbitrator will be given a discretion to dismiss claims that it considers to be frivolous or vexatious. A 'frivolous' dispute might be one in which the benefits of a successful outcome, are unlikely ever to outweigh the costs of the dispute resolution process. A 'vexatious' dispute might be where a claim is largely recycled from a previous unsuccessful claim.

Rather than giving this power only to the arbitrator, the Public Utilities Office is considering giving it also to the ERA in its role as scheme administrator. The advantage of giving the ERA this gatekeeper role is that it may enable unmeritorious disputes to be shut down earlier, thus saving the cost of finding and appointing an arbitrator. The disadvantages may include that the ERA will need to resource at least some form of standing capacity to undertake this role, and the parties will presumably need to make submissions on the subject, both of which will add cost and duration of the regime as a whole, and that the presence of this gatekeeper determination may just increase the number of opportunities for dispute and appeal. See discussion in section 6.3.8.

6.3.7 Requirement or option for mediation

In its submission to the Design Report, BHP suggested that some form of alternative dispute resolution mechanism should be used before arbitration, such as mediation. Mediation is a low cost and relatively fast means of facilitating negotiations with the hope that this can help to resolve some points of difference between the negotiating parties.

The Public Utilities Office proposes that, if elected by one party of the dispute or if the scheme administrator thinks fit, the parties may attend mediation, conciliation or other alternative dispute resolution processes before arbitration. In some cases the parties' positions can be such, or so far apart, that alternative dispute resolution would only delay resolution of the matter.

The mediator would be chosen by agreement between the parties, or by the arbitrator if the parties cannot agree. The mediation framework would provide relevant timeframes and guidelines in order to facilitate efficient negotiations.

Once again, an alternative to giving this case management role to the arbitrator, or only to the arbitrator, would be to give it to the ERA, on the grounds that this may permit earlier intervention and hence earlier resolution of the dispute. For the ERA to make a determination on whether a matter will, or will not, benefit from mediation, will require it to invest at least some time becoming familiar with the dispute. This too will involve cost, and potentially time. See discussion in section 6.3.8.

6.3.8 Scale of ERA's scheme administration role

As noted above, some roles in the dispute resolution process could be performed by either (or both of) the arbitrator her- or himself, or by the ERA as scheme administrator. This includes making a determination on whether an access dispute is vexatious or frivolous, and deciding whether mediation is or is not required.

Giving this role to the ERA may enable these determinations to be made before an arbitrator is appointed, but will come with some standing costs for the ERA, possible some additional time and resource costs for the parties as they deal with this additional step, and likely some additional transaction costs for the parties as well if the ERA appoints a case manager to consider the questions.

6.3.9 Expert input in access disputes

In access disputes, as in many other commercial disputes, a single arbitrator will often not have personal knowledge and expertise in all issues to be determined. Three mechanisms are proposed to address this, with a possible fourth.

First, as in any arbitration, parties to the dispute will put forward their own technical and expert information as part of making their case in the normal way. In many circumstances this will be sufficient. Judges and arbitrators frequently decide complex technical matters about which they had no prior personal knowledge.

Second, it is proposed that the arbitrator will be able, with the parties' agreement, to appoint an expert to investigate a particular matter to assist in their investigation.[67]

Third, as noted in section 6.3.3 above, the rules will permit the parties to appoint an arbitral panel rather than just a single arbitrator, allowing expertise to be brought within the dispute resolving body itself.

Finally, as a variant of the second method, the Public Utilities Office is considering expanding the arbitrator's ability to appoint an independent expert, to include a power, if the parties agree, to refer matters to the ERA for its own expert consideration and potentially for wider consultation, see next subheading.

Possible referral of issues to the ERA

The Design Report contemplated two possible arbitration models, one based on Part 23 NGL, which is broadly the regime proposed in this consultation paper, and one in which the ERA might also act as arbitrator in its own right.[68] The rationales for the latter option included that:

- some access disputes will clearly benefit from the ERA's economic expertise; and
- some access disputes raise issues of potentially broad application, on which it would be desirable to consult more widely and establish a clear, broadly-applicable regulatory precedent. For example, a dispute on asset valuation or cost of capital, or a dispute on technical standards for interconnection.

Following further stakeholder consultation, and consideration of feedback received, based on the criteria set out in section 6.3.1, the Public Utilities Office proposes not to proceed with a model in which the ERA can act as an arbitrator.

The disadvantage of this decision is that, if a traditional arbitration model were implemented, the two benefits just listed, namely access to the ERA's economic expertise on pricing matters, and the ERA's ability to consult broadly, would cease to be available.

[67] See NGR rule 575; NGL s 199(1)(e). See Appendix A, item A.6.8.
[68] Design Report, p 40.

For this reason the Public Utilities Office is considering a model in which the arbitrator will be able, with the parties' consent,[69] to refer matters to the ERA in a similar way to any other expert. In this model, the ERA's costs would likely not be costs of the arbitration, and would need to be recovered through market fees. The ERA will have a discretion whether or not to accept the reference, and would only do so if the question was genuinely one of broad relevance which justified incurring costs for the market. The Public Utilities Office considers that this feature is unlikely to be used often, because it will have implications for the access dispute's timing – the dispute will likely need to be suspended while the ERA considers the referred issue. However, there could be circumstances in which it might be useful, e.g. where there is a matter which is likely to recur, or a matter on which one or both parties wishes to gain broad stakeholder input.

Costs of expert input

The Public Utilities Office considers that the parties will bear the costs of expert input, including when the arbitrator retains its own expert, except if a matter is referred to and accepted by the ERA as just discussed.

6.3.10 Is the arbitrator's decision binding

The Public Utilities Office proposes that the arbitrator's decision will be binding on both parties, except in the case of manifest error or error of law, but only if the access seeker elects to enter into an access contract in the terms of the determination. That is, once the arbitrator's decision has been determined, the access seeker has an election: either to enter into an access contract on the determined terms, or to 'walk away'. This is a standard approach in access arbitrations[70] – it would be unreasonable to force a business to proceed with access if the finally-determined terms were not commercially viable for it.

However, if an access seeker succeeds in getting an arbitrator's decision which grants access, and does so on terms reasonably comparable to those it was seeking, the arbitrator will have discretion to award costs against the access seeker if it then walks away (see section 6.3.13).

6.3.11 Do access determinations have effect as precedents

The Public Utilities Office wants to ensure that the Pilbara arbitration regime, so far as is possible, produces predictable and consistent outcomes. This raises the question of whether an arbitrator's determination stands as either a binding or non-binding precedent for future arbitrators. This in fact contains two questions:

- Are arbitrator's determinations public? They cannot stand as precedents if they are not published.
- If so, should they have effect as precedents?

[69] A point of detail still being considered is whether a matter should be able to be referred at the request of just one party.
[70] See Access Code s 10.35; NGL s 216Q.

Are determinations public?

Although normal commercial arbitrations are generally private, and the resulting determinations confidential, the Public Utilities Office proposes a different approach for the Pilbara regime.

There is no clear regulatory precedent on this point. Part 23 of the NGL provides for the scheme administrator to report on access determinations by reference to a relatively confined list of prescribed information.[71] In contrast, the NGL Chapter 6 regime (for covered pipelines) states that a final determination remains confidential. The ENAC is similar, with the arbitrator only obliged to provide a final decision to the parties and the ERA. The Part IIIA access regime in the *Competition and Consumer Act 2010 (Cth)* is similar to Part 23 of the NGL but has a broader list of material to be published.[72]

The amount of information to be made public about a decision depends on a balance to be struck between protecting the disputing parties' commercial confidentiality, and making information available to the market/the public in order to increase regulatory certainty and avoid later disputes. As noted, decisions cannot be used as precedents if they are confidential. On balance, the Public Utilities Office proposes that decisions generally be published, with certain information removed to protect the parties' commercially sensitive information.

In terms of what information should be removed, the Public Utilities Office does not propose to develop a prescriptive list. Rather, the Public Utilities Office's present proposal is that the arbitrator will be obliged to produce a for-publication version of a decision, and will be given a broad discretion as to what should be redacted, after taking into account the parties' views on that point. More work and consultation will be done on this issue during the detailed implementation stage, to find a least-cost way of achieving the two objectives of disseminating useful precedents, and protecting commercially sensitive information (where doing so is appropriate). In general, more of the NSP's information will need to be published, than the access seeker's. It will be necessary to ensure that NSPs' requests for confidentiality do not hamper the objective of achieving transparency and certainty.

Should determinations have effect as precedents?

Once again, this question needs a balance to be struck. More tightly binding the decision maker to follow past decisions, means more certainty for all concerned and less scope for subsequent disputes. But it also means less flexibility, and greater risk of unjust or inappropriate outcomes in those subsequent matters. It also increases the risk that other parties will apply for, and be granted, standing to intervene in the earlier decision, in order to protect their interests in later negotiations or disputes.

[71] The list in rule 581 in Part 23 includes the parties, the services the subject of the dispute, any valuation methodology used and any determination of asset value.

[72] s 44ZNB of the *Competition and Consumer Act 2010 (Cth)*. The list there includes principles applied, methodologies applied, reasons for adopting a valuation methodology, how the Commission took into account certain matters and any implications the Commission considers the determination has for persons seeking access to the service or similar services in the future.

In practice, each access dispute will turn on its own facts: the parties' circumstances are likely to be different from the last, the context may have changed and past disputants may have compromised on a point in order to achieve settlement. In many cases, the final determination may be a bespoke arrangement tailored to suit *those particular* parties, which would not be suitable for *every* party.[73]

Nonetheless, applied flexibly, a system of precedent can reduce disputation and enable more certain negotiations.

This issue takes on particular focus in a light regulation regime such as is proposed for the Pilbara. In these regimes, the dispute resolution mechanism also replaces the up-front determination of various regulatory issues such as tariffs (or tariff inputs), access terms, etc. This adds another level to be considered when designing the regime. In a full regulation model, although the up-front determination of such matters comes at a considerable time and resource cost for all participants, it does have the advantage that at least each issue need be determined only once, and having been determined can guide all subsequent access negotiations.

In designing a light regulation regime, this choice needs to be made as to whether individual access determinations should only bind the parties, or whether they should also fill a broader quasi-regulatory role in that a matter determined in one dispute stands as a binding or non-binding precedent for subsequent decisions. Thus, for example, if an access dispute were to involve a determination on cost of capital for a given network, is this something that should need to be re-contested in a subsequent dispute?

After stakeholder consultation and further consideration, the Public Utilities Office proposes on balance that past decisions should *not* be strictly binding but *should* hold precedential value.

To implement this, two rules will be created:

- the arbitrator must have regard to relevant aspects of past decisions and, where there is a relevant precedent, must make an explicit decision whether to follow or depart from it;
- in making this decision, the arbitrator must have regard to the desirability of promoting predictability in regulatory outcomes.

This approach balances flexibility with consistency in decision making, such that parties will know that, all else being equal, the arbitrator for their current dispute is likely to apply the same or similar principles to those which have been applied on similar matters in the past. This makes it easier for parties to predict the likely decision of the arbitrator and so hopefully prevent the matter going to arbitration at all.

[73] These are all factors the arbitrator can be expected to take into account, in deciding how much weight to give to a prior decision.

6.3.12 An expedited process for queuing disputes

The arbitrator will be directed to resolve disputes with as little formality and technicality, and as much expedition, as the requirements of the PNAC and a proper hearing and determination of the dispute, permit.[74]

In addition, however, the Pilbara arbitration regime will adapt and develop the ENAC's concept[75] of an expedited "queuing dispute". This is a dispute on an interim or procedural matter, the speedy resolution of which may permit the access seeker's application to be further progressed and an access offer made, without the parties having to resort to a full-scale dispute. This mechanism has been little used, and stakeholders' views are sought on how it can be improved into a more effective circuit-breaker without jeopardising system security or the NSP's legitimate business interests.

6.3.13 The treatment of costs of arbitration

The Public Utilities Office proposes that the costs of the arbitration (arbitrator's fees, room hire, any agreed experts, etc.) will generally be split equally between the parties.

However, the arbitrator will also have the discretion to apportion costs depending on the parties' behaviour, e.g. unreasonably prolonging or escalating the dispute, or in the case of the access seeker, 'walking away' after receiving a determination reasonably close to what it was seeking.

The Public Utilities Office is considering a proposal that the arbitrator also have the ability to take into account material differences in the parties' resources, when deciding whether to depart from the 50/50 starting point. This may enable fairer costs apportionments to be made in the case of "David v Goliath" disputes between a small project developer and a large NSP, but it invoking this rule would of course always be controversial.

[74] Access Code, Appendix 5, clause A5.3.
[75] Access Code ss 10.13 and 10.14

7. Ring fencing arrangements

7.1 Introduction

Ring-fencing refers to regulatory measures to segregate the regulated and contestable components of a service. Ring-fencing arrangements are designed to limit the potential for a vertically integrated monopoly service provider to gain an unfair advantage in a related contestable market through it owning and operating bottleneck facilities. In this case the bottleneck facility is an electricity network and the principal related "contestable" (i.e. unregulated, competitive) markets comprise the markets for electricity generation, retail and consumption.

Design Element 17 determined that covered networks' regulated activities and functions will be required to be structurally or functionally separated from their non-regulated activities and functions. The Design Report also recognised that any separation measures would need to be 'fit-for-purpose' and observed that there may be a large variance in the size and scope of a covered network's affiliated operations in the Pilbara. This chapter sets out the Public Utilities Office's proposed approach to implementing Design Element 17.

7.2 Ring-fencing issues in the Pilbara

Ring-fencing measures are designed to address the harms that may occur as a consequence of the operator of the regulated (bottleneck) infrastructure also operating in a related, contestable market. The principal categories of harm are:

- cost shifting from the contestable market to the regulated network – where the effect in the regulated market is that network prices are higher than reasonable, thus leading to higher final prices to customers, and the effect in the contestable market is that the NSP's related business can get an unfair cost advantage; and
- anti-competitive actions – whereby the NSP is able to use its control of the (bottleneck) infrastructure to raise the profits of its related party in the related market, which may include such actions as using technical matters to suppress access (and hence competition in the contestable market), imposing unnecessary costs on competitors or misusing in the related market confidential information received from other competitors in the course of access discussions.

The main choice for the design of ring-fencing arrangements for the Pilbara regime is the extent to which the PNAC prescribes the ring-fencing requirements, with the alternative being to have the requirements determined on a case-by-case basis depending on the circumstances of the covered network in question.

In consultations, a number of stakeholders have emphasised the variation across the networks that will or may become covered in the Pilbara, in terms of:

- the potential for the second of the categories of harm (the anti-competitive actions) to be pursued, reflecting the nature of the related businesses of the relevant NSPs; and
- the potential cost of measures to reflect such harm, in turn reflecting variations in:

- the size of the network operations, and so the potential for loss of economies of scale and scope from measures that segregate staff (noting that even the largest of the providers are much smaller than the networks operating in the major population centres); and
- the degree of interconnectedness of the network function in the entity in question with its other activities, and so the potential for segregation measures to cause disruption to the firm in question's main activities.

It is noted that this regime is intended to encourage networks to opt in to light regulation (see section 3.3.2). More onerous ring-fencing may be a disincentive for this.

The key implication of the discussion above is that the appropriate level of ring-fencing would be expected to differ materially across the networks that may be covered by the Pilbara regime.

"Costs" of ring-fencing

When this paper refers to the costs of ring-fencing arrangements, the expression is intended to encompass the full range of financial, operational and other burdens and unintended consequences which can accompany those arrangements. This includes disruption to existing integrated operations, loss of efficiency, and incompatibility with other corporate, financial, taxation or operational structuring needs.

The ERA will be expected to weigh the full range of such costs, when undertaking the cost/benefit analyses described below.

7.3 Proposed ring-fencing regime

Given the potential costs that might emerge for ring-fencing in the Pilbara, and the general circumstances of the participants in the Pilbara, the Public Utilities Office has sought to design ring-fencing arrangements that achieve the following:

- deliver confidence that the major harms that can arise from leveraging the regulated monopoly in a competitive market will be addressed; and
- provide a 'fit-for-purpose' approach that recognises the costs and benefits of some measures may differ between networks subject to the arrangements, and in particular that the nature and circumstances of possible future covered networks cannot be known with certainty.

Accordingly, the Public Utilities Office proposes that the ring-fencing measures for the Pilbara follow a propose / respond model, whereby a covered network would be required to propose arrangements to the ERA for its assessment. This will permit fit-for-purpose ring fencing arrangements to be developed that are suitable in the context of the specific covered network.

It is further proposed that the ring-fencing arrangements be divided into two parts, being:

- a method for allocating costs between the covered network and other activities, which is the tool for addressing the potential for cost-shifting (labelled the Cost Allocation Method), and

- measures to address the potential for anti-competitive effects in the related markets (referred to as Competition Protection Measures).

The Public Utilities Office proposes that all light regulated Pilbara networks would be required to develop and have approved by the ERA a Cost Allocation Method, and for this to meet the following principles:

- any asset values, and operating costs, that are attributable to the regulated activity or the other activities must be allocated to the activity to which they are directly attributable; and
- any asset value and operating costs that are not attributable must be allocated in accordance with an appropriate allocator, which, unless unable to be delivered without undue cost or effort or the cost is immaterial, is causation based, and otherwise reflects a reasonable and well-accepted allocation approach, having regard to the Pilbara electricity objective.

It is proposed to require all covered networks to have a Cost Allocation Method because there is a potential for cost-shifting by any entity (i.e. this does not require the covered network to operate in related markets). However, it would be expected that the approved methods would be tailored to the structure and accounting systems of the relevant covered network, and so avoid causing undue cost.

In terms of the Competition Protection Measures, it is proposed that a covered network would propose specific measures to the ERA, and that the ERA would be required to assess whether they were reasonable. In deciding whether the proposal is reasonable, the Public Utilities Office proposes that the ERA would be required to compare the potential harms caused by vertical integration in the context of the particular network, the efficacy of the proposed measures in addressing those harms, and the cost (defined broadly, as discussed above) of those or alternative measures. In addition, it is proposed that:

- the potential harms would be articulated so that the ERA's assessment remained focussed on the rationale for ring fencing; and
- an indicative list of possible ring-fencing measures would be provided.

The intention is that, where there is a strong potential for harm to competition in a related market, this framework would justify a commensurately high-cost measure to ameliorate that harm. Conversely, where there was little potential to harm competition in a related market, there may not be a need for specific Competition Protection Measures (noting that a Cost Allocation Method still would be required).

Importantly, the assessment of potential harms and the efficacy of ring-fencing measures to address these is not expected to involve a deterministic or quantitative assessment. Rather, the ERA will be required to use its judgement as to whether a particular ring-fencing measure is justified, considering all of the evidence (both quantitative and qualitative). In applying its judgement, the ERA would be expected to take into account both the direct and the indirect costs that may be caused by imposing certain ring-fencing measures,[76] and so only implement such high cost ring-fencing measures where the potential harms have a high likelihood of occurring. The ERA would also be expected to place weight on the ability for periodic reviews of the ring-fencing arrangements to remedy *possible* (but not *high-likelihood*) problems if those problems indeed manifest (see below).

Lastly, the Public Utilities Office proposes that reviews of the ring-fencing arrangements be provided for to ensure the arrangements remain current, and more specifically for a review to occur:

- just prior to a covered network undertaking a review of its prices (this is expected to lead to five yearly reviews of ring-fencing arrangements),[77] and
- as soon as practicable after any event that will materially affect the operation of the ring-fencing arrangements (for example, a corporate restructure, a major asset acquisition or a major asset disposal).

These reviews of ring-fencing arrangements need not lead to any change in arrangements. However, as noted above, the existence of periodic reviews of ring-fencing arrangements will allow the ERA to reconsider at periodic intervals whether to impose higher-cost measures, with this assessment informed by actual experience. This flexibility, in turn, is intended to encourage the ERA to be cautious when considering whether to impose high-cost ring-fencing measures. Accordingly, change to ring-fencing arrangements is intended and expected where the experience suggests that there is a problem that needs to be addressed.

[76] The indirect costs of ring fencing measures may, depending on the circumstances, include such things: an increase in the overall cost base for delivered electricity and so provide pressure for price increases; a reduction in the intensity of competition in the related markets; and a reduction in investment in both the regulated and related markets, including a reduction in the uptake of new technologies.

[77] More specifically, it is proposed that any revised ring-fencing arrangements would be settled one year prior to the scheduled completion and implementation date for the covered network's next price review. This would provide ample time for the outcome of any revisions to ring-fencing arrangements (such as a revised Cost Allocation Method) to be factored into the new prices.

8. Transitional measures and implementation

8.1 Introduction

There are two factors that will affect the transition of newly covered networks into the regime.

- Firstly, it is intended for covered networks to determine their pricing methodology and prices through a transparent, consultative process with customers and the public. It is envisaged that such a review would take in the order of nine months.
- Secondly, the ERA will be required to make decisions shortly after a network has been covered that will affect pricing, namely:
  - the approval of ring-fencing measures, which will include a Cost Allocation Method, and
  - in the case of the Alinta and Horizon networks, a determination of the cost of capital for those covered networks.

  It is envisaged that these ERA processes may take six months after coverage of the networks.

8.2 Proposed transitional measures

So that the regime can commence as intended from the outset, the Public Utilities Office is proposing a transitional process is established that requires initial prices be set, then updated following the decisions of the ERA. These initial prices would then remain in use until the completion of the first review of prices is undertaken.

More specifically, the following process and timeline is proposed:

- 20 business days after commencement of the regime: the covered NSP is required to publish:
  - An interim User Access Guide
  - An interim standard contract containing standing terms and conditions applicable to the network service; and
  - Interim versions of relevant service and access information (i.e. classification of the network, technical constraints etc.);
- Three months after the commencement of the regime: the covered NSP is required to:
  - publish its Interim Tariff Methodology and Interim Access Tariffs, including the assumptions underpinning prices as well as the method adopted, are to be developed by the covered network within three months of coverage commencing. The Interim Access Tariffs are required to only include the forecasts of costs for the period until the completion of the first full review of prices (two years after regime commencement);
  - submit its proposed ring fencing arrangements to the ERA; and

- Final versions (subject to ongoing updating obligations) of its User Access Guide, standard contract and service and access information.

- Six months after the commencement of the regime: the ERA is expected to have approved (or determined alternative) ring-fencing arrangements and provided its views on the cost of capital for the initially covered networks.
- Nine months after commencement of the regime: the Interim Access Tariffs are to be updated to reflect the ERA's determination on the cost of capital and approved ring-fencing measures. It is expected that the covered NSP will also commence its first full review of its pricing methods, tariff setting methodology and prices for the covered network at this time.
- 18 months after coverage: the covered NSP is required to have completed and have put into effect its first review of its pricing methodology and price list.

After the transitional period described above is completed:

- a covered network will be required to review its prices at intervals or not more than five years; and
- 15 months prior to the implementation of the above review, the covered network will be required to propose any revised ring-fencing arrangements to the ERA, which the ERA will be required to determine on within three months (the one year window is intended to permit the effect of a change in ring-fencing arrangements to feed into the next price review).

8.3 Powers for the ERA

A Bill is proposed to be introduced into Parliament in the first half of 2019. The Public Utilities Office will manage the preparation, publication and commencement of each piece of delegated legislation necessary to enable the new framework to start on the intended go-live date of 1 January 2020. This delegated legislation will likely include the Rules (see separate consultation paper), a PNAC incorporating the detailed design discussed in this Consultation Paper, supporting regulations, and likely other instruments.

Once the Bill has passed Parliament and taken effect as an Act, the Public Utilities Office will seek to formalise the proposed roles for the ERA and ensure that it has the appropriate powers to undertake these roles. In addition, funding regulations will be implemented to enable the ERA's recovery of the ongoing costs of administering its functions from industry.

The Public Utilities Office is investigating whether any of the above transitional measures can be undertaken before the regime commences.

Appendix A – Specification of the Pilbara networks Light Regulation Regime

A.1 The form of regulation process

1. The existing ENAC coverage process and test will not change.

2. The Horizon Power and Alinta DEWAP coastal networks will be prescribed from the outset to be subject to light regulation under the PNAC. To give effect to this Alinta's network will be prescribed to be covered.[78]

3. The light regulation regime is defined in the rest of this Appendix. The defining characteristic of the regime is the removal of some or all of the up-front access arrangement approval process.

4. The Minister for Energy, when deciding that a Pilbara network is to be covered, will also make a decision on the form of regulation (full or light) to be applied.

5. In making a form of regulation decision for a Pilbara network, the Minister must have regard to:

    a. the Pilbara electricity objective;

    b. the form of regulation factors, which are to be based upon those in section 2F of the National Electricity Law; and

    c. the effect of either full or light regulation on the likely costs that may be incurred by:

        i. an efficient service provider; and

        ii. efficient users and efficient prospective users; and

        iii. end users.

6. In a form of regulation decision, as in a coverage decision, the Minister can dismiss vexatious or frivolous applications.

7. Uncovered Pilbara networks can opt in to the light handed access regime at any time, except perhaps after a coverage application has been made. There will likely be no pre-requisites for opting in, other than being a non-covered Pilbara network.

8. Opted-in networks are deemed to be covered while they are opted in. Except as noted below, opted-in networks cannot be subject to a coverage decision or a form of regulation decision.

9. The existing ENAC coverage revocation process will continue unchanged - any covered network[79] can apply to have coverage revoked. On revocation, regulation ceases.

[78] Horizon's NWIS network is already covered: Horizon Coverage Decision, see footnote 11.
[79] This does not include opt-in networks. They do not need to apply for revocation – they can just opt out again.

10. A network which opted in to light regulation can opt back out again on 12 months' notice.[80] Applications and access disputes in progress for the network will continue despite the opting out. Existing access contracts will be preserved. The Minister can extend this 12 month period if a coverage application has been made but not yet resolved, and there's a reasonable prospect that coverage will be granted.

11. If a Pilbara network is light regulated, an access seeker can apply to have it fully regulated, but this cannot be done:

    a. if the network was light regulated after a coverage and form of regulation decision — for at least five years, or earlier if there has been a material change in circumstances, or the Minister determines that light regulation is failing, for example due to the NSP's behaviour in access negotiations and arbitrations;

    b. if the network is light regulated because it opted in — for at least 10 years, or earlier if, perhaps, the NSP has committed a serious or recurring breach of its obligations under the PNAC (e.g. a court or the arbitrator finds that the NSP has not been negotiating in good faith or has been hindering access).

12. A full regulated Pilbara network can apply to be light regulated at any time.

13. If a network changes from light to full regulation while there is an application or access dispute in progress, each applicant can elect whether its application or dispute will continue under the light regime, or transition into the full regime. Existing access contracts will be preserved.

14. If a network changes from full to light regulation while there is an application or access dispute in progress, each applicant can elect whether its application or dispute will continue under the full regime, or transition into the light regime. Existing access contracts will be preserved.

A.2 Pilbara electricity objective

15. The objective of the Pilbara is as follows:

> To promote efficient investment in, and efficient operation and use of electricity services for the long-term interests of consumers of electricity with respect to price, quality, safety, reliability and security of supply of electricity, and the reliability, safety and security in the Pilbara.
>
> For the purposes of applying this objective:
>
> - customers include those who use electricity for residential, commercial and industrial purposes, with this latter class of use including the use of electricity for the resource extraction and processing, and

[80] The Public Utilities Office will monitor this 12 month period and may propose and consult on changes if it is causing difficulties.

- the consideration of the long-term interests of a consumer or class of consumers requires regard to be had to the purpose for which that consumer or class of consumers uses the electricity, and the benefits that are thereby associated with that use, including but not limited to any wider economic benefits that may be generated.

A.3 Pricing arrangements

A.3.1 Revenue and pricing principles

16. The following revenue and pricing principles are to apply:

    a. The NSP should be given a reasonable opportunity to recover at least the efficient costs it incurs in providing covered network services and complying with regulatory obligations.

    b. The NSP should be provided with effective incentives to promote economic efficiency with respect to the covered services it provides. This includes efficient investment in the network, efficient provision of network services, and efficient use of the network.

    c. the tariff for a network service should allow for a return commensurate with the regulatory and commercial risks involved in providing the service;

    d. Regard should be had to the economic costs and risks of the potential for:

        i. under and over investment by a covered network service provider, and

        ii. under and over utilisation of the network with which a covered network service provider provides covered services

A.3.2 Pricing rules

17. The covered network must specify the period over which the prices that it is setting are proposed to remain in place until they are reviewed, which must not be more than five years. The covered network may set out the circumstances under which an earlier review may take place.

18. Prices for standard services are to be calculated by:

    a. Firstly, calculating the target revenue for the provision of regulated services in aggregate, applying the target revenue rules; and

    b. Secondly, deriving prices that are expected to deliver that target revenue by applying the price setting rules.

19. The target revenue rules are as follows:

    a. Target revenue must be set equal to the forecast cost of providing the covered network services in aggregate for the nominated pricing period, which must be done by applying the building block cost of service approach.

b. Costs must be allocated between covered services and any other activities undertaken by the covered network or any related entity by applying the Cost Allocation Method that has been approved by the ERA as part of the ring fencing arrangements.

c. The cost of capital used in the building block cost of service approach is to be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the covered network provider in respect of covered network services. The cost of capital for a covered network is to be determined on a pre tax basis.

    i. The ERA will be required to determine the costs of capital applicable to the each of the initially covered networks within six months of the commencement of the new regime. Each covered network (and the arbitrator, if a dispute occurs) must apply the cost of capital determined by the ERA for that covered network when calculating prices for the first full pricing period, which is expected to be the five years commencing 1 July 2021.

    ii. When undertaking this exercise, the ERA must apply the methods and values set out in its prevailing rate of return guideline prepared under the National Gas Rules to the extent that the methods or values would be unaffected by a consideration of the nature of the specific activity for which the cost of capital is being estimated.

        (This would require the use of the standard CAPM and estimation of a WACC, and to determine the risk free rate, market risk premium and rate of utilisation rate of imputation tax credits using the methods and values set out in the gas network rate of return guideline. Thus, the equity beta, leverage assumption, debt risk premium and rate of distribution of imputation tax credits would be permitted to differ from the guideline methods and values as appropriate to reflect the nature of the regulated activities undertaken by the particular covered pipeline).

d. The RAB at any point in time must be established by commencing with a RAB at the time of coverage or the commencement of the regime (initial RAB), adding capital expenditure and deducting depreciation and disposals. In undertaking this calculation:

    i. the initial RAB is to be derived by applying the initial RAB principles below;

    ii. an assessment of the prudence and/or efficiency of past capital expenditure may be undertaken, but must only extend to capital expenditure undertaken in the most recent five complete years as at the time of the commencement of the price review or access dispute; and

    iii. the adjustment for depreciation is to be consistent with the calculation of depreciation that was, or is proposed to be, included in the derivation of target revenue.

20. The initial RAB principles are as follows:

    a. The initial RAB of a covered network can be the subject of an access dispute by an access seeker unless it has been prescribed in law or rules or subject to a prior determination by an arbitrator, in which case the prescribed or determined initial RAB is to be applied.

    b. Where an initial RAB is to be determined, it must be determined at an amount that is objectively reasonable value at the time of coverage or commencement of the regime, and in determining this amount regard must be had to:

        i. the depreciated optimised replacement cost of the assets required to provide covered services;

        ii. the original cost of the assets and the extent to which those costs have been recovered in the past;

        iii. the desirability of avoiding material changes in network prices, and

        iv. any other methodology, factor or indicator that is relevant to the objective for the initial RAB.

21. The price setting rules are as follows:

    a. Prices should, to the extent practicable, be subsidy free, meaning that:

        i. The revenue that is expected in respect of a customer or group of customers recovers at least the cost that would be avoided by not providing the covered service to that customer or group of customers; and

        ii. The revenue that is expected in respect of a customer or group of customers does not exceed the stand-alone cost of provision to that customer or group of customers.

    b. A price should, to the extent practicable, signal the impact on future investment costs of additional usage by those end-use customers assigned to that price.

    c. The expected shortfall in recovery of target revenue that is expected if prices were set to comply with paragraph 21.b should be recovered through an adjustment to prices, where this adjustment, to the extent practicable:

        i. reflects an allocation of the shortfall across customers (subject to any adjustment required for prices to be subsidy-free); and

        ii. involves the use of charging parameters.

        that are expected to cause the least distortion to the use of the covered network compared to prices set to comply with paragraph 21.b.

d. When considering the tariff-setting methodology or changes to it, regard should be had to:

   i. the desirability of prices that are transparent, that promote stability and certainty for stakeholders, and regard to the impact of the change in price on end-use customers; and

   ii. transactions costs caused for retailers, consumers and other stakeholders.

e. So to avoid unfair discrimination:

   i. the price that is paid by different access seekers should reflect the characteristics of the final customers that are served by the access seeker (associated final customers);

   ii. the price that is paid by different access seekers should vary only to the extent that is justified in terms of the cost of provision to the associated final customers (i.e. from application of the principles above), or with references to differences in the economic characteristics of the associated final customers (i.e. from application of the residual cost recovery principle); and

   iii. the price that is paid by different access seekers should include an appropriate share of the residual costs to be recovered from the associated final customers.

f. When deriving the price for the standard service, all customers should be assumed to be a consumer of the standard service and to pay the standard price.

22. All forecasts used when calculating target revenue or prices must:

    a. Be arrived at on a reasonable basis; and

    b. Must represent the best forecast or estimate possible in the circumstances.

A.4 Transparency requirements

23. The disclosure obligations will be modelled generally on Part 23 NGR, including the following. The details will be further refined and consulted upon during the implementation stage.

A.4.1 Disclosure standards

24. All published information must:

    a. not be false or misleading in a material particular;

    b. in relation to information of a technical nature, be prepared, published and maintained in accordance with the practices, methods and acts that would reasonably be expected from an experienced and competent person engaged in the ownership, operation or control of a network in Australia acting with all due skill, diligence, prudence and foresight; and

c. in relation to a forecast or estimate, be supported by a statement of the basis of the forecast or estimate and:

   i. be arrived at on a reasonable basis; and

   ii. represent the best forecast or estimate possible in the circumstances; and

d. be reviewed periodically for accuracy, currency and completeness; and

e. promote the Pilbara electricity objective.

25. Where a service provider becomes aware that information required to be published by it does not comply with the access information standard or the PNAC, the service provider must publish information that does comply as soon as practicable after the service provider becomes aware of the non-compliance.

A.4.2 Upfront disclosure of access terms, principles and policies

26. A User Access Guide is to be published on an NSP's website no later than 20 business days after the application date for the covered network. The information included with the access request specified in a user access guide must be no more than is reasonably required to enable the NSP to make an access offer. The access guide must contain the following information for each of the NSPs covered networks:

    a. identify the network service provider for the covered network and, where there is more than one service provider for the covered network, identify the network service provider responsible for dealing with preliminary enquiries and access requests;

    b. set out the contact details for an officer of the network service provider to whom preliminary enquiries and access requests can be sent;

    c. describe the process for making an access request, the information to be included with the access request and response times;

    d. describe and delineate the roles and responsibilities of the NSP and ISO regarding the processing and modelling of access applications;

    e. describe the arrangements for undertaking further investigations;

    f. explain how the network service provider will deal with and use any confidential information exchanged between the service provider and the prospective user;

    g. describe the process for preparing an access offer and for requesting negotiations in relation to an access offer;

    h. include a statement of the obligation to negotiate in good faith and the right to refer an access dispute to arbitration; and

    i. describe the arrangements for the exchange of information during negotiations.

27. A requirement for the covered network to publish six months prior to the completion of the first ongoing review of prices a Network Development Policy. This policy is required to describe the covered network's proposed:

    a. planning standards for the network;

    b. principles for deriving the capital contribution that may be sought from a customer; and

    c. principles for determining the extent of capital expenditure that would be included in the RAB and recovered through prices.

28. A requirement to publish no later than 20 business days after the application date for the covered network a standard contract containing standing terms and conditions applicable to the network service.

29. The following service and access information:

    a. Network information no later than 20 business days after the application date for the covered network and any updates within 20 days of a change:

        i. Classification of network (Tx or Dx)

        ii. Schematic maps

        iii. Technical constraints

        iv. Relevant policies

A.4.3 Publication of prices and pricing methodology and periodic review and consultation

Interim initial prices

30. An Interim Access Tariff methodology and Interim Access Tariffs, including the assumptions underpinning prices as well as the method adopted, are to be published by the NSP within three months of coverage commencing. The Interim Access Tariffs are required to only include the forecasts of costs for the period until the completion of the first full review of prices.

31. The Interim Access Tariffs are to be updated within three months of the ERA's determination on the cost of capital, the proposed ring-fencing measures (including a cost allocation method), and where relevant, an approved initial RAB.

Ongoing periodic review of prices

32. A covered network is required to undertake a forward-looking review of prices within 18 months of coverage commencing and then at intervals of no longer than five years. In undertaking the review the NSP is required to:

    a. consult with customers and the public;

b. disclose information that explains and justifies its proposed pricing methodology and prices, which would include forecasts of expenditure and service usage over the proposed pricing period having regard to the covered network's relevant policies, including its Network Development Policy and its Cost Allocation Method; and

c. demonstrate how prices meet the revenue and pricing principles.

A.4.4 Annual and ongoing disclosure requirements

33. Financial information is to be published annually no later than four months after the EOFY of the NSP for the covered network. The information is to be in the form and contain the information specified in financial reporting guidelines to be developed by the ERA. The information is to be certified in the manner provided for in the financial reporting guidelines.

34. Service usage information (monthly kilowatt hours and peak demand megawatts) are to be published each month after the application date for the covered network, by the last business day of the month for the prior month.

35. Reference tariffs, being Access Tariffs provided to any party will be deemed Reference Tariffs, and required to be offered to any other party, are to be published no later than 20 business days after the Access Tariffs are offered to any party requesting them and thereafter, to be available on the NSPs website at all times.

Financial reporting guidelines

36. The ERA must publish and maintain financial reporting guidelines within six months of the PNAC commencing. The guidelines must:

    a. provide for the publication of financial information such as:

        i. financial statements;

        ii. information on the methods, principles and inputs used to calculate the RAB, depreciation allowances, allocation of costs; and

        iii. financial performance metrics.

    b. specify the level of detail of information required, which must be at the level of detail reasonably required given the objective of the regime and to provide a true and fair statement of the financial performance of the covered network and prices;

    c. specify any accounting or audit standards that apply to the reported information; and

    d. provide for the manner in which the financial information and price information is to be certified as being true and fair.

37. The ERA may from time to time amend the financial reporting guidelines.

A.5 Negotiating framework[81]

A.5.1 Access requests

38. A prospective user may request the network service provider for a covered network to provide access to a network service.

39. A prospective user may make a preliminary enquiry before making an access request. A network service provider must: – not require a prospective user to make a preliminary enquiry before making an access request; and – if requested by the prospective user, carry out further investigations on the basis of the preliminary enquiry and before the prospective user makes an access request.

40. An access request must be in writing and must include the information reasonably required to be provided by the prospective user for the network service provider to prepare an access offer in relation to the access sought or to determine whether the service provider needs to undertake further investigations in relation to the access request.

41. If an access request is incomplete, the network service provider must notify the prospective user within five business days after the access request is received, specifying the information required to complete the access request.

42. The network service provider must notify the prospective user if the service provider needs to undertake further investigations in relation to the prospective user's access request. The notice must be given within 10 business days after receipt of the access request or, if applicable, after receipt of the further information requested.

43. A network service provider must: – only undertake further investigations in relation to an access request when and to the extent reasonably necessary; and – carry out further investigations expeditiously.

44. A network service provider and a prospective user must negotiate in good faith about the terms and conditions on which further investigations will be carried out, including the basis for determining reasonable costs of the further investigations to be paid by the prospective user and any reasonable extension to the time period to enable the further investigations to be completed.

45. A prospective user may amend the details of the access sought in an access request with the consent of the network service provider. The network service provider must not unreasonably withhold its consent and may give its consent subject to reaching agreement on a reasonable extension to the period for making an access offer.

[81] The following framework is adapted directly from NGR Part 23, ss 559-561. Minor adjustments may be made during detailed implementation, but the intention is to follow the Part 23 model as closely as possible.

A.5.2 Access offers

46. The network service provider for a covered network in receipt of an access request must prepare and make an access offer that complies with relevant rules and within the period determined as discussed below.

47. The period for making an access offer ends at the time agreed by the prospective user and the network service provider or if no time is agreed between them:

    a. 20 business days after receiving the access request or if applicable, the further information requested; and

    b. if the network service provider is required to carry out further investigations in relation to the access request, 60 business days after receiving the access request or if applicable, after receiving the further information requested.

48. An access offer is to:

    a. set out the price and other terms and conditions on which the network service provider offers to make the network service or services requested in the access request available to the prospective user;

    b. contain the details of any works to be undertaken by the network service provider and prospective user and any applicable technical and performance specifications; and

    c. be in a form capable of acceptance by the prospective user so as to constitute a new access contract or form part of an existing access contract.

49. A network service provider is not required to make an access offer in relation to a network service if:

    a. the access request has been withdrawn;

    b. the network service provider has concluded that it is not technically feasible or consistent with the safe and reliable operation of the network to provide the network service requested by the prospective user, having used all reasonable efforts to accommodate the reasonable requirements of the prospective user; or

    c. the provision of the network service requested by the prospective user would require the extension of the network service provider's covered network. If a network service provider does not make an access offer for the reason specified above, the service provider must give the prospective user written reasons explaining why the requested network service cannot be provided.

A.5.3 Negotiations

50. A prospective user who has made an access request for a network service on a covered network may by notice to the network service provider request negotiations in relation to any aspect of access to a network service including:

    a. whether access can be granted; and

b. the price and other terms and conditions of an access offer.

51. A prospective user or user seeking access to a network service on a covered network, and the service provider for the covered network, must negotiate in good faith with each other about whether access can be granted and, if so, the prices and terms for access.

52. Negotiations are to follow the below requirements:

    a. Each party to negotiations must seek to accommodate all reasonable requirements of the other party (or parties) to the negotiations regarding the timetable for negotiations.

    b. The parties to negotiations must use reasonable endeavours to identify any other person who may become a party to an access dispute relating to the network service the subject of the negotiations.

    c. If an access request is for more than one network service, the prospective user may by notice to the network service provider require negotiations in relation to those network services take place as part of the same negotiation process.

    d. A prospective user may at any time by notice to the network service provider bring negotiations to an end, whether or not the prospective user also refers or has referred a related access dispute to arbitration.

    e. A party to negotiations must only use or reproduce confidential information of another party for the purpose for which it was disclosed and must not disclose the confidential information except in limited situations such as:

        i. to the arbitrator in the course of an arbitration;

        ii. with the consent of the other party;

        iii. to a professional or other adviser of the party who agrees with the party to maintain the confidentiality of the confidential information; or

        iv. if the disclosure is in accordance with an order made or a subpoena issued by a court of competent jurisdiction.

53. In negotiations, each party to the negotiations must, in requesting or providing access negotiation information, do so in a manner and at a time consistent with the duty of the party to negotiate in good faith.

54. A prospective user who is party to negotiations may from time to time by notice request a network service provider who is party to the negotiations to provide access offer information in relation to any aspect of the matters being negotiated.

55. A network service provider given a notice in such circumstances must comply with the request within 15 business days of the notice or any longer period agreed by the prospective user.

A.6 Dispute resolution

56. The dispute resolution regime will generally be adapted from Part 23 of the NGL, with modifications as discussed in this consultation paper.[82]

A.6.1 Scope of the arbitration regime

57. An access dispute is any dispute or disagreement between an access seeker and an NSP in connection with an access application, including (but not limited to) the application process, any terms and prices for a network service, the availability of network capacity and the need for and nature of any network augmentation or extension.[83]

58. The regime applies to access disputes not contractual disputes. Once an access contract has been entered into, disputes under the contract will be dealt with by whatever means the parties have agreed.

59. The arbitrator, and perhaps the ERA as scheme administrator, can dismiss a dispute as frivolous or vexatious.

A.6.2 Access dispute notice

60. Either party may commence an access dispute by giving an access dispute notice to the other party and to the ERA, as scheme administrator.

61. An access dispute notice must be accompanied by the fee (if any) set by the scheme administrator from time to time and specified on its website.

62. An access seeker may withdraw the access dispute notice at any time before the final access determination.

63. The NSP may only withdraw an access dispute notice with the other parties' consent.

A.6.3 Identity of arbitrator

64. The ERA will not act as arbitrator.

65. The scheme administrator must give the parties an opportunity to agree on an arbitrator from the pool, and failing agreement must appoint a pool arbitrator having regard to the parties' submissions.

66. The parties may agree to adopt an arbitral panel, chaired by a legally qualified pool arbitrator and comprising up to two additional expert members agreed by the parties.

67. An arbitrator will not be liable for anything done or omitted to be done in good faith in his or her capacity as arbitrator, and may require the parties to sign a suitable release and indemnity before proceeding.

[82] NGL ss 563-584
[83] See definition of "access dispute" in Access Code s 1.3; see NGR rule 563(1).

A.6.4 Expedition, informality and efficiency

68. The arbitrator must resolve disputes with as little formality and technicality, and as much expedition, and as inexpensively, as the requirements of the PNAC, and a proper hearing and determination of the dispute, permit.[84]

69. The parties must do all things necessary for the proper and expeditious conduct of the arbitration, and must not seek to delay or frustrate proceedings.

A.6.5 Hearings to be in private

70. The arbitration will be conducted in private, i.e. only the parties to the proceedings may attend.

A.6.6 Parties to an access dispute

71. The parties to an access dispute will generally be the access seeker and the NSP.

72. The arbitrator may permit a third party to join the proceedings if there is a compelling case for their inclusion, and the benefits of doing so clearly outweigh the time, cost and other disadvantages of their joining.

73. Before permitting this, the arbitrator must:

    a. give due weight to need to resolve access disputes quickly and cheaply;

    b. consider what complexities may arise regarding the management of confidential information if the third party were to join; and

    c. consider whether there may be other means for the third party's issue to be heard, without them having to become a party to the dispute.

A.6.7 Mediation

74. The arbitrator, and perhaps the ERA as scheme administrator, will normally require the parties to mediate, conciliate or engage in another alternative dispute resolution process for the purpose of resolving the access dispute unless, in the arbitrator's or ERA's opinion, doing so does not have a reasonable prospect of resolving the dispute.

75. The parties are to agree on a mediator and where agreement cannot be reached the scheme administrator will appoint one.

A.6.8 Expert input

76. The parties may lead expert evidence in the normal way, and may agree that the arbitrator is to appoint an independent expert.

77. The parties may choose to adopt an arbitral panel instead of a single arbitrator, to allow expert members to supplement the pool arbitrator.

[84] Access Code, Appendix 5, clause A5.3.

78. The Public Utilities Office is considering a proposal for the arbitrator to be able to refer matters to the ERA for broader consultation.

A.6.9 Arbitrator's decision

79. The arbitrator's award will be binding on the parties. However, the access seeker may elect whether or not to proceed with access on the awarded terms.

80. If an access seeker is largely successful in its claim, i.e. the awarded terms are substantially the same as it was seeking, there may be costs consequences if it does not proceed to an access contract.

A.6.10 Decisions as precedents

81. Arbitrators' decisions will be published, redacted to preserve the parties' confidential information.

82. The arbitrator must have regard to relevant items in past decisions and, where there is a relevant precedent, must make an explicit decision whether to follow or depart from it.

83. In making this decision, the arbitrator must have regard to the desirability of promoting predictability in regulatory outcomes.

A.6.11 Expedited process for queuing disputes

84. The Pilbara arbitration regime will adapt and develop the ENAC's concept[85] of an expedited "queuing dispute". This is a dispute on an interim or procedural matter, the speedy resolution of which may permit the access seeker's application to be further progressed and an access offer made, without the parties having to resort to a full-scale dispute.

A.6.12 Principles the arbitrator must have regard to

85. The arbitrator when determining access disputes:

    a. must apply the Pilbara electricity objective, revenue and pricing principles and pricing rules;

    b. have regard to the operational and technical requirements necessary for the safe and reliable operation of the network; and

    c. have regard to any previous access determination that addresses the same, or similar matters, to those which are currently in dispute.

A.6.13 Costs

86. The parties to an access dispute referred to arbitration must bear their own costs.

87. Parties to an access dispute will normally pay an equal share of the following costs:

[85] Access Code ss 10.13 and 10.14

a. the fees and expenses of the arbitrator;

b. the fees and expenses of any expert retained by the arbitrator;

c. the costs of room hire; and

d. the cost of any additional input agreed by the parties to be necessary to the conduct of the arbitration.

88. The arbitrator may, however, make a different order as to costs having regard to any relevant matters including (but not limited to) whether the conduct of that party unreasonably prolonged or escalated the dispute or otherwise increased the costs of resolving the dispute.

A.6.14 Scheme administrator

89. The ERA is to be the scheme administrator.

90. The role of the scheme administrator includes:

a. establishing a pool of senior legally-qualified persons suitable to act as arbitrators;

b. publication of non-binding guides, including an arbitration guide;

c. referring access disputes to arbitration and appointing the arbitrator if the parties cannot agree;

d. correcting minor errors in access determinations;

e. publishing information about access determinations;

f. perhaps, dismissing frivolous or vexatious claims before referring them to arbitration; and

g. perhaps, referring matters to mediation or other alternative dispute resolution.

A.7 Ring fencing

91. NSPs must propose ring-fencing arrangements or revised ring fencing arrangements to the ERA:

a. within three months after coverage commences

b. not less than 15 months prior to the date upon which the covered network's next scheduled review of its prices is scheduled to be completed and put into effect, and

c. within three months of the occurrence of an event that is likely to have a material effect on the operation of the ring-fencing arrangements (the covered network must notify the ERA that such an event has occurred within one week of that event occurring).

i. Examples of an event that may have a material effect on the operation of the ring-fencing arrangements include a corporate restructure or a major transaction.

92. The ERA must either approve the proposed ring-fencing arrangements, or determine alterative ring-fencing arrangements, within three months of the receipt of the proposed ring-fencing or amended ring-fencing arrangements.

93. The ring-fencing arrangements must comprise:

    a. a Cost Allocation Method; and

    b. Competition Protection Measures.

94. The Cost Allocation Method is the method by which the revenues, expenses and asset values associated with the regulated activity are to the established from an entity that provides the regulated activity in combination with other activities, and must comply with the following:

    a. any asset values, and operating costs, that are directly attributable to the regulated activity or to the other activities must be allocated to the activity to which they are directly attributable; and

    b. any asset values and operating costs that are not directly attributable must be allocated to the regulated activity in accordance with an appropriate allocator, which:

        i. unless unable to be delivered without undue cost or effort or the cost is immaterial, is causation based; and

        ii. otherwise reflects a reasonable and well-accepted allocation approach

95. The Competition Protection Measures are measures to ameliorate the harms that may flow from the regulated activities being provided by an entity that also operates in a related market. The ERA must assess whether the proposed Competition Protection Measures are reasonable, having regard to:

    a. the efficacy of the proposed Competition Protection Measures in addressing the harms in the context of the particular provider; and

    b. the cost associated with implementing and maintaining those or different measures in the context of the particular provider.

96. The harms referred to in paragraph 95 include the potential for the vertically integrated entity to:

    a. restrict competition in the related market;

    b. raise the cost incurred by competitors in the related market;

    c. reduce the perceived or actual quality of the services provided by competitors in the related market; and/or

d. otherwise provide the related party with an unfair advantage over competitors in the related market.

97. The categories of measures that could be applied, where appropriate, to address the harms listed above, include:

a. measures to ensure that confidential information received by the regulated business, or that is generated by the regulated business, is quarantined in a manner that avoids the harms;

b. measures to segregate defined categories of staff between the regulated activity and other activities;

c. measures physically to separate defined categories of staff associated with the regulated activity from staff that undertake different activities;

d. obligations with respect to the remuneration arrangements for staff;

e. separate branding of regulated activity and other activities; and/or

f. obligations with respect to discrimination between a related entity and a competitor in the conduct of the regulated activity.