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Manager – MCE Secretariat
Department of Industry, Tourism and Resources
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Dear Sir/Madam

Review of the National Gas Pipelines Access Regime

Thank you for the opportunity to present Enertrade's views on the Standing Committee of Officials (SCO) consultation paper on the Productivity Commission's (PC) Review of the National Gas Pipelines Access Regime.

Enertrade has interests in two gas transmission pipelines, the 404 kilometre Cheepie to Barcaldine pipeline in central western Queensland and the 392 kilometre North Queensland Gas Pipeline which supplies Townsville and the surrounding area. The North Queensland gas pipeline provides North Queensland industry, for the first time, with a choice of natural gas.

While the North Queensland pipeline is a recent investment, it would be simplistic to say that it is evidence that an effective gas access regime is in place. Neither does Enertrade contend that the regime has had the effect of stopping all investment. Enertrade holds the view that the current regime has the effect at the margin of distorting investment decisions and is therefore not in the nation's long term economic interests.

The PC recommendations represent a compromise from industry's preferred position. Nonetheless, they go a considerable way towards providing a better balance of consumer and investor interests, reducing the costs of regulation and promoting Australia's long term economic welfare. The PC Report recommendations provide a clear path forward for reform.

In addition to its own submission, Enertrade strongly supports the submission made by the Australian Pipeline Industry Association as a response to the substantive points raised in the SCO consultation paper.

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Gas access reform - momentum and direction

The Council of Australian Government's Energy Market Review (EMR) set the broad direction for energy market reform. In respect of gas, it found that current approaches to economic regulation are creating a perception of uncertainty for investment in new pipelines and recommended an independent review. The EMR Report provided the following guidance:

*'In framing the terms of reference for a review of the Gas Code and in implementing any recommendations that arise from it, governments should ensure that an appropriate balance is achieved between the interests of pipeline companies and the users of those pipelines. It is in everyone's interest to have sufficient incentives for economically viable pipelines to be built. It is also critical that the tentative steps currently being taken towards a more competitive and dynamic industry are encouraged and the momentum and direction of reform is maintained.'*¹

In the Ministerial Council on Energy's response to the EMR Report, Ministers agreed that further reform should be undertaken to streamline and improve the quality of economic regulation across energy markets, to lower the cost and complexity of regulation facing investors and enhance regulatory certainty.

The PC conducted an extensive review of the gas access regime consulting widely with all industry participants. While the PC Report found there was a need for the Gas Code to continue, it found that there are problems with the current regime, principally arising from the considerable costs the regime imposes and its real potential to distort investment and inhibit innovation.

The PC's recommendations, viewed as an integrated package, provide a considered and appropriate response to the problems identified with the current gas access regime. They will establish a regime where regulation is applied only where the case for regulation can be made and will minimise the cost of regulation for investors while maintaining appropriate protections for consumers.

SCO consultation paper

The alternative options proposed in the SCO consultation paper to the Review of the National Gas Pipelines Access Regime do not heed the EMR's warning that it is critical for the momentum and direction of reform to be maintained.

Risk of losing momentum

The approach taken in the consultation paper is to defer consideration of many of the PC's recommendations in the context of the development of an overall energy market framework. This approach raises a number of difficulties including:

¹ Council of Australian Governments Energy Market Review, *Towards a truly national and efficient energy market*, 2002, p 216.



- the PC reforms are an integrated package of reforms which do not lend themselves to separate consideration;
- postponing consideration risks delaying worthwhile reforms indefinitely; and
- a significant proportion of the recommendations are specific to gas access and do not translate easily to the electricity market context.

Enertrade submits that adopting the PC recommendations in full is the most robust and cost effective basis for progressing reform. The PC has presented a comprehensive, balanced and workable reform agenda which was guided by a consultative process where the interests of industry participants were represented and taken into account.

Risk of losing direction

Broadly speaking, the options proposed in the consultation paper would have the effect of:

- introducing a bias towards consumer interests;
- retaining the current heavy-handed approach to regulation; and
- seeking to regulate pipelines that have previously not been subjected to regulation.

Enertrade has interpreted these proposed options as revealing an underlying concern that the PC's recommendations may not sufficiently address perceptions of pipeline market power.

In making its recommendations the PC was cognisant that natural gas transmission and distribution pipelines exhibit 'natural monopoly' characteristics and the potential for market power inhibiting competition.

However, it properly noted that the existence of gas pipelines that exhibit natural monopoly characteristics is insufficient of itself to reach a conclusion that these pipelines have enduring market power which can be misused. The PC pointed to other factors that can constrain market power such as emerging pipeline competition, large end users with significant, countervailing bargaining power and competition from alternative fuel sources.

On balance, the PC found that a gas access regime was still warranted but introduced greater flexibility to take account of emerging competition. The PC identified that:

*'the challenge is to design a gas access regime that encourages and strengthens the development of competition and innovation, and also imposes forms of regulatory intervention only where they are likely to generate net economic benefits.'*²

² Productivity Commission Inquiry Report, *Review of the Gas Access Regime*, 2004, p XXVII.



The PC recommendations go towards meeting that challenge. The direction of reforms proposed by the PC is also consistent with a 'light-handed' approach to regulation originally advocated by the Hilmer Committee and the low cost, low complexity approach supported by the MCE.

The alternative options proposed in the consultation paper risk altering the direction of reform. The alternative objective clauses proposed by SCO introduce uncertainty and complexity by incorporating competing objectives and potentially introduce an inefficient bias in decision-making in favour of users. This raises the prospect of deterring or distorting ongoing investment in gas pipelines.

In respect of the alternative price monitoring model, the proposal attempts to widen the current reach, and consequently cost, of regulation to pipelines that have *some* market power. There is little justification for this approach.

In relation to the scope of access regulation the National Competition Council has made the following statements:

'The National Competition Council works from the presumption that access regulation is intrusive and should be imposed only where it promotes net economic benefits. The Council carefully balances the benefits of access for potential infrastructure users against the costs to existing and potential infrastructure operators. ...In considering these tradeoffs, the Council notes that Part IIIA:

- *is confined to a narrow range of infrastructure with natural monopoly characteristics;*
- *recognises the significance of existing contractual rights;*
- *ensures regulatory and arbitration processes account for the interests of infrastructure owners; and*
- *requires a consideration of whether regulated access is in the public interest.*³

The Australian Competition Tribunal stated:

*'The purpose of coverage of a pipeline is to prevent the consequences of misuse of market power. If the market power is not significant then it cannot be used effectively to prevent an economically efficient pipeline operation or to deter competition in downstream or upstream markets or thwart the interests of users or prospective users.'*⁴

The proposal also effectively introduces an assumption of regulation, albeit an arguably lighter-handed form of regulation. This ignores the fact that the gas market is changing and competition is emerging through pipeline development. It also runs counter to the trend identified by Minister Macfarlane in the Moomba-Sydney pipeline revocation decision:

³ National Competition Council, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*, 2002, p 6-7.

⁴ *In the Application by Epic Energy South Australia Pty Ltd* [2003] ACompT5, paragraph 104.



“the decision to revoke is based on the developing network in south-east Australia which limits the proponent’s ability to exercise market power We are moving away from an assumption of regulation in this sector”⁵

Enertrade endorses the PC’s recommendations as providing a workable, robust and efficient way forward. While Enertrade does not agree with all recommendations made by the PC, it accepts the need for compromise in the interests of certainty and progressing reform. Enertrade considers adoption of the PC reforms, as an integrated package, will result in a more robust and cost-effective regulatory regime that will encourage a more competitive and dynamic industry.

The alternative proposals in the SCO consultation paper introduce the prospect of increased regulation and will work against the evolution of a more competitive and dynamic industry. Further review of, and delays in considering the full package of PC recommendations risk losing worthwhile reforms and creates further uncertainty.

Yours sincerely

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⁵ Macfarlane I, quoted in Productivity Commission Inquiry Report, *Review of the Gas Access Regime*, 2004, p 93.