

MAJOR ENERGY USERS INC

**Submission**

Ministerial Council on Energy

Standing Committee of Officials

**Response to the MCE Consultation on the  
Productivity Commission's Review of the  
National Gas Pipelines Access Regime**

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## **EXECUTIVE SUMMARY**

The Major Energy Users (MEU) Inc., comprising some 20 major gas users operating in NSW, Victoria South Australia and Queensland, welcomes the opportunity to provide comments on the MCE proposed response to the Productivity Commission's Review of the Gas Access Regime.

The MEU, like all major consumer groups, retains its considerable disquiet with the Productivity Commissions Review of the Gas Access Regime, as it considers the Report to lack balance and quality.

The MEU's analysis of ABARE's gas consumption growth data to 2019/20 shows that only 2 sectors really matter in the current growth forecast: gas for fixed power generation and for alumina smelting. In the period 2009/10, 64 % of the forecast growth is for power generation and alumina smelting, whilst for growth through to 2019/20, these 2 sectors make up over 50%.

The MEU's analysis shows, for the two sectors concerned, that most of the forecast gas consumption will be met by existing expansions of the relevant pipelines or from proposed pipelines being progressed under the existing regime. Post 2010, there is only one project identified that would require a greenfields pipeline to serve the needs of these two dominant sectors.

The upshot of the analysis is that only a fraction of new pipeline investments required for identified projects will be contingent upon the proposed code changes arising from the MCE SCO papers.

The MEU considers that its analysis undermines the basic thesis (espoused in the SCO papers) in linking the growth in gas consumption to 2019/20 to the need to tilt the incentives in favour of pipeline owners (in order to encourage pipeline investments). The incentives even include the offering of a no price regulation holiday for greenfields pipelines. The MEU considers this to be a poor outcome for public policy formulation.

The MEU:-

1. Supports the new objects clause, provided the following words are included: 'for the long term interests of consumers';
2. Supports the coverage test to be aligned with Part III A of the TPA and for the coverage recommendation body to be the AEMC;
3. Supports the alternative model for the light-handed form of regulation conditional upon adequate information disclosures and the signing off of relevant information by a CEO of the pipeline company;
4. Opposes Measure 2 (price regulation holiday) for greenfields pipelines, as there is no evidence that the current regime cannot deal constructively with all pipeline proposals. Moreover, there are significant concerns with a truncated, non-transparent and vague

Ministerial process, which cannot be regarded to be in the public interest; and

5. Supports the establishment of an independent expert panel, as suggested by MCE SCO, and MEU also recommends
  - a. That the expert panel should include a representative who has direct experience of the energy market from a consumer perspective
  - b. The addition of terms of reference to the expert panel to include
    - i. an assessment of the increasing concentration of the electricity supply industry,
    - ii. the exercise of market power, and
    - iii. the adequacy of existing competition laws.

# Major Energy Users Comments On The Ministerial Council On Energy's Proposed Response To The Productivity Commission Review Of The Gas Access Regime

## 1. Introduction

The Major Energy Users (MEU) Inc. welcomes the opportunity to provide its comments. The MEU comprises some 20 major gas users in New South Wales, Victoria and South Australia. These companies also have major operations in Queensland and Tasmania.

As presented by our representative at the public forum on this issue on 23 November 2005, the MEU is disappointed that the MCE SCO response did not explicitly alert Ministers to the very considerable disquiet every major consumer group had with the **balance** and **quality** of the Productivity Commission (PC) Report. This disquiet was also shared by other stakeholders, including upstream producers and even by regulators. The criticisms were serious and objective and Ministers should be alerted to them. Sound public policy making should be based on rigorous and objective analysis. The PC Report could not provide any evidence that there has been investment deterrence as a result of the Gas Access Regime, and had to revert to an intuitive approach because the actuality of investment did not support its thesis.

The MCE SCO papers would also benefit from the use of more up-to-date data. The figures SCO used on gas consumption are based on a previous ABARE Report. Current ABARE projections are more **modest**. For example, gas consumption is projected at 1747 PJ in 2019/20, compared with 1828 PJ in the previous ABARE report and the share of natural gas in Australia's primary energy consumption is 23.7%, not the 24.2% figure used.

A more disconcerting comment on the MCE SCO papers concerns its linkage of projected gas consumption with the requirement for:-

“significant investment in gas infrastructure, including pipelines.... (as stated in the SCO papers) and with the PC's ‘finding that’...the design and application of the gas regulatory regime has the potential to deter investment in the future”- -

The conclusion drawn from this statement would appear to be that because gas consumption is projected to grow strongly, many gas pipelines will be required and therefore the incentives in the gas access regime should be tilted in greater favour of pipeline owners in order that these gas pipelines are built. This conclusion is even more tenuous in the light of the recent ABARE projections of more modest gas consumption to 2019/20. This thesis is examined in the next section.

## **2. Some Basic Analysis to Inform Sound Public Policy Formulation**

Examination of the ABARE projections shows that only two sectors have a significant impact on the current growth forecasts of gas consumption: **these are gas fired power generation and alumina smelting.**

In the period to 2009/10, 64% of the forecasted growth of gas consumption will be for power generation and alumina smelting. Given that we are now in 2005 (and closing on 2006) it should be noted that the vast majority of any material project that uses gas is likely to already be in the planning/evaluation process, no doubt based on the status quo. For growth through to 2019/20, power generation and alumina smelting make up over 50% of forecast gas consumption in Australia.

In the case of gas fired power generation, only two states have significant needs for additional gas consumption: Western Australia and Queensland, and through to 2009/10, they make up 77% of forecast gas fired power growth and through to 2019/20, 70%.

Examining each sector individually:

### **a) Alumina Smelting:**

Alumina smelting growth is based on the specific projects identified by ABARE. In the period through to 2009/10, ABARE assumes gas used in alumina production will grow by 128 PJ, i.e. 40% of total growth. Of the 5.95 million tonnes of alumina growth identified, 2.85 million tonnes (about 50%) is forecast to be in South West Western Australia. The relevant refineries are already connected to the Dampier Bunbury Pipeline and take gas off it. That is, only **expansions** of the pipeline capacity are required, **not extensions**.

Of other alumina expansions, 1.7 million tonnes is from Gove and the rest is from Gladstone. Both these alumina operations have signed with the proposed PNG Pipeline as their future source of gas. Presumably construction of the PNG pipeline is to go ahead if the status quo is maintained, and as we are not aware that current regulation would help or hinder its development, we offer no view here other than to comment that all of the reports about its commitment to proceed are entirely related to the amount of gas expected to be drawn by consumers.

**Post 2010, the only project identified that would require a Greenfield pipeline is the Aurukun Greenfield Refinery in Queensland, totalling an output of 1.40 million tonnes of alumina in the early 2010's.**

The upshot of this analysis is that, of the alumina projects totally 10.15 million tonnes and 161 PJ, only 1.4 million tonnes (or 14% of all

forecast alumina production) could possibly be contingent on the proposed code changes arising from the MCE SCO papers.

b) **Gas Fired Power Generation**

Growth in gas demand for power generation to 2009/10 is forecast to be 75 PJ (with demand in WA being 35.5 PJ or 47% of all forecast gas needs for power, and demand in Queensland being 22.4 PJ or 30% of all forecast gas needs for power). Thus demand for gas for power generation is mostly focused on WA and Queensland as between them they account for nearly 80% of all forecast gas needed for power generation.

For Western Australia, demand in the South West is likely to be served via an **expansion** of the Dampier Bunbury Pipeline (following the trend of the recently announced gas fired power station), and if it is elsewhere the alternative fuel is likely to be diesel. It should be noted that this shows again that gas pipelines to mines, such as to Telfer & the smaller Nifty mine, have been built under the current regime, as and when required.

For Queensland, it would seem that the current regime has not deterred significant power projects being developed based on coal bed methane (CBM) and new pipelines (such as for the Enertrade power station and 300km pipeline from the Mooranbah field) have been constructed as needed. Further it should be noted that the gas access regime has not stopped new projects from being progressed such as the AGL 300 MW Townsville project, based on using gas from the proposed PNG pipeline.

**The above analysis does undermine the basic thesis in linking the growth in gas consumption to 2019/20 to the need to tilt the incentives in favour of pipeline owners (to encourage pipeline investments), even to the extent of requiring no price regulation! This is a very poor outcome for public policy formulation.**

**The MEU strongly recommends that the MCE carefully consider our analysis, which provides the correct context and background for consideration of proposed code changes, especially those relating to greenfields pipelines.**

### **3. Comments: Final Position on Productivity Commission's Recommendations**

The MEU appreciates that the MCE SCO has made many amendments to the PC Recommendations and consequently, made the relevant recommendations more balanced.

However, of the five major issues covered in the proposed MCE response, the most significant concerns the proposed changes to the treatment of greenfields projects. In the MEU's view, this is deeply flawed, especially in the light of our analysis challenging the basic assertion linking future gas consumption to the need to provide greater regulatory certainty to greenfields pipelines by not having any price regulation!

#### **3.1 Objects Clause for the Regime**

The MEU supports SCO's proposal that an objects clause mirroring that already contained in the NEL for the electricity sector would be more appropriate (than the one recommended by the PC) namely:-

“The objective of the gas access regime is to promote efficient investment in, and efficient operation and use of natural gas pipeline services for the long term interest of consumers of natural gas with respect to price, quality, reliability, safety and security of natural gas”. --

The MEU agrees with SCO's reasons for the “refinements” to the PC recommendations. In addition, we consider that as the preamble to the code is to be deleted (and therefore with it the provisions which explicitly state that the objective of the Code is to inter alia, promote the interests of consumers through preventing the abuse of monopoly power and provide access that is fair and reasonable for users) users would require a compensating explicit requirement that the regime's objective is in the long term interests of consumers.

**The MEU considers that removal of the preamble to the Code is unacceptable to consumers, unless the new objects clause includes the words ‘for the long term interests of consumers’. Removing these words will unfairly tilt the regime in favour of asset owners.**

#### **3.2 Coverage Test and Administration**

The MEU agrees with SCO that:-

- the coverage test for gas transmission and distribution pipelines should be aligned with the coverage test in part III A of the TPA 1974.

- the AEMC will be the coverage recommendation body (taking over the role currently performed by the NCC) and the criteria and procedural requirements for coverage assessments will be included in the New National Gas Law.

**The issue of expertise (and timely coverage assessments) in gas matters is very important and in view of the establishment of the AEMC as a “rules making body”, and “expert energy institution”, the responsibility for coverage issues should be vested in the new organisation.**

### **3.3 Light-handed Form of Regulation (price monitoring)**

The MEU strongly supports the SCO’s alternative model for light-handed regulation.

The MCE proposal is essentially a model in which the coverage test is applied to all pipelines and covered pipelines are either price monitored or price regulated. The AEMC will determine coverage applications, develop the criteria for applications and develop the criteria for application by the AER which will make the decision as to the form of control applied to covered pipelines.

The PC model is not a form of light-handed regulation, with its combination of binding arbitration in the case of disputes. It has the strong probability of increasing complexity of the coverage process if both coverage and the form of regulation are decided simultaneously. More important, if the degree of market power is such as to require a pipeline to be covered, then it will be inappropriate for the pipeline to be considered for light-handed regulation.

The MEU’s support for the alternative model is **conditional** upon:-

- the development of the appropriate rules by the AEMC to govern the AER’s assessment of the regulatory option and the cost-benefit assessment, the development of requirements for adequate information disclosures, including to provide an ability to pierce corporate veils and trust vehicles and to ensure that related party transactions are robust and at ‘arms-length’; and
- the requirement that financial and other regulatory information provided by the pipeline is signed off by the Chief Executive Officer (as this would reduce the potential for ‘errors and omissions’).

### **3.4 Greenfields Projects**

The MCE SCO is proposing two measures to create greater certainty of regulatory outcome for greenfields pipelines, in order to enhance the environment for more pipeline investments.

In Measure 1 (binding no coverage ruling) pipeline proponents can apply to the AEMC for an upfront coverage assessment, with a binding 15 year no coverage ruling if the AEMC determines accordingly.

In Measure 2 (price regulation holiday) the pipeline proponents can apply to the relevant Minister for a 15 year price regulation holiday without seeking a coverage assessment. If a price regulation holiday is granted, an access arrangement covering non-price items will be submitted for approval by the AER. The criteria applying to the relevant Minister's decision do not require reference to market power of the pipeline nor to the publication of proposed pricing schedule.

The MEU does not agree with the sentiment that the current gas access regime has created regulatory uncertainty and has deterred investments. The MEU also disagrees that, as a result, there is a need to create greater certainty for pipeline investors including commitments to long-term pricing arrangements.

As argued in our analysis in Section 2, above, we do not find that the more modest growth scenario in gas consumption (compared to an earlier ABARE report used by SCO) necessarily equates to a need to tilt incentives in favour of pipeline investors in order to bring forth investments in pipelines. The very implication of the need to tilt the balance implies that there have been a significant number of experiences where a needed pipeline development has not proceeded. In fact neither the PC nor SCO has been able to point to an example where a needed pipeline has not been constructed. The ACCC (in its review of greenfield pipelines) identified that there has been massive investment in gas pipelines since the introduction of the gas access regime.

The tilting of incentives in favour of pipeline investors, and therefore the proposal for a price regulation holiday (Measure 2) cannot be sustained from the facts or from our analysis.

The MEU does **not** accept the statement:-

“The MCE notes the concerns that the cost associated with regulatory compliance could affect investment, and also that regulation (or its possibility) could complicate the negotiation of foundation contract arrangements, and possibly create incentives for pipelines to be undersized or deferred.” (Page 15)

The claim that pipeline owners will undersize pipelines ignores the reality that owners will not permit such inefficiencies and that service providers and foundation customers do have the ability and incentive to negotiate arrangements that serve their joint interests.

As has been pointed out previously, “transmission pipelines can be expanded in a number of cost effective ways” has been clearly stated by the CEO of APT:

“We can and will expand the capacity of several of our pipelines. We can do that in one of three cost effective ways – by looping, or by adding compression or by adding spur lines. (Jim McDonald, CEO APT, Open Briefing ASX 9 March 2001)”<sup>1</sup>

The MEU points to the new SEAGas pipeline where the capacity has been designed to carry over 80% of the current SA gas market in its own right. This effectively duplicates the capacity of the older MAPS pipeline from Moomba to Adelaide. SEAGas is hardly an undersized gas pipeline.

The MEU notes that the AEMC coverage criteria (Measure 1) including the upfront 15 year no coverage ruling criteria, has yet to be developed. The MEU looks forward to commenting on the AEMC criteria, in the light of its analysis concerning gas consumption growth and the need to tilt incentives in favour of asset owners.

The MEU has **significant** concerns with the **Measure 2** (price regulation holiday) by SCO:

We consider that this is an unnecessary measure: there is no evidence provided (either by the PC or SCO) to enable the statement that:-

“.....a binding ruling may not be a sufficiently timely process to provide regulatory certainty for some gas pipeline projects. This may be due to their size and/or complexity or the needs of the market to be supplied or timing constraints on finalising contractual and financial arrangements. To ensure that the regulatory regime does not inhibit such pipelines proceeding to financial close the MCE has decided to implement a 15 year price regulation holiday for proposed gas pipelines.....” (Page 15)

The MEU considers:-

- The proposed Ministerial process (for transmission pipelines involving only 28 days) is too truncated, non-transparent, and does not involve a public consultation mechanism to assist the Minister in arriving at a decision representing the public interest.
- The criteria for Ministerial approval are not specific enough e.g. can a price regulation holiday be approved if the pipeline has significant market power or even some market power, or should there be a long-term price schedule commitment?

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<sup>1</sup> BHP Billiton Submission on the Review of the Gas Access Regime. 29 August 2003, Page 68.

- At any time during the 15 year price regulation holiday period, **both** service providers and existing and potential users should have the **right** to apply for a coverage assessment (not just service providers only!).
- Whilst Measure 2 would require the pipeline
  - “to be required to make public a policy that ..... would offer non-discriminatory pricing for similar reference - services..... “(Page 16),

this requirement is too limited and should include non-price discrimination.

- The availability of Measure 2 is likely to render Measure 1 (binding no coverage ruling) redundant, as it is probable that the Ministerial process (with all its advantages for pipeline owners) would be preferred by pipeline proponents. All projects will be considered to be urgent and requiring “regulatory certainty”. Measure 2 will simply undermine the Measure 1 process.
- The AEMC should be asked to develop rules to enable a truncated AEMC process to deal with ‘urgent’ proposals. At a recent public forum the NCC proffered its view that a fast-track process could be completed in a period of 3 to 6 months. This option would obviate most of the concerns we have with issues of transparency, public consultation and still provide sufficient time to enable **efficient** determinations without the need for reverting to “urgent” proposals.

#### **4 Development of a National Approach to Energy Access: Experts Panel**

The MEU supports SCO's proposal for a panel of experts to provide the MCE with advice on the issues identified and the steps required to develop and implement a seamless, national approach to energy access.

The MEU considers that a 'helicopter shot' of the various reform programmes underway and proposed need to be undertaken on an integrated basis, i.e. a strategic vision or an implementation plan as required.

An important term of reference (in addition to those highlighted in the MCE SCO papers) is the need for assessment and advice on whether the range of reform programmes underway and proposed will likely deliver the outcomes envisaged by the MCE when it launched the present reforms. For example, a key question in the minds of consumers, concerns whether the current and prospective concentration of the electricity supply industry – with both vertical and horizontal reaggregation occurring – will deliver benefits to consumers and whether changes are needed to existing competition laws. Much of the existing programmes are limited to regulation of networks and access issues.

MEU also considers that the formation of an expert panel should recognise the importance of including a person who not only understands the gas transport and delivery processes but understands the importance of gas delivery and usage of gas by consumers. Unfortunately in the creation of expert panels it is often overlooked that there is a need for understanding of the consumers views in relation to using the services provided. Such an approach actively recognises that gas transportation is only a means of permitting the connection of the gas producer and the gas consumer – that pipelines are not an end in themselves.