

**QUEENSLAND MAJOR GAS USERS GROUP
RESPONSE TO:
Regulatory Impact Statement
Gas Access Regime – The Coverage Test**

30 November 2005

BACKGROUND

The Queensland Major Gas Users Group (QMGUG) supports the development of a competitive gas market including the efficient use of gas transportation systems in Queensland and in the interconnected gas market of Australia.

QMGUG submitted responses to the Productivity Commission. It submitted a formal response to the Ministerial Council on Energy on 14 September 2005.

QMGUG has as members 95% of the gas users of Queensland, who purchase more than 125 PJ per annum, forecast to increase to above 150 PJ per annum in the next two years. The group has been meeting since 2001 on an informal basis. It is in the process of formalizing its structure into an incorporated association.

QMGUG members are in a unique position relative to gas users of the southern States. Queensland has gas fired generation units, open cycle and combined cycle that compete in the National Electricity Market. Queensland has large industrial processes that consume large amounts of gas, e.g., Incitec-Pivot, Comalco Aluminium Refinery and BP Bulwer facility. Further in northwest Queensland over 30 PJ per annum of gas is used in electricity generation at Mt Isa for Xstrata and CS Energy, at BHPB's Cannington Mine and Southern Cross Fertilizer's Phosphate Hill Mine and at Zinifex's Century Zinc Mine.

The QMGUG members rely on four major, interconnected, gas transportation pipelines: Roma to Brisbane Pipeline (RBP); Queensland Gas Pipeline (QGP); Southwest Qld Gas Pipeline (SWQP); and Carpentaria Gas Pipeline (CGP).

Some members use the newly constructed Moranbah Gas Pipeline (MGP). There are two proposals to connect this pipeline from Moranbah, 140 Kilometer southwest of Townsville to the Gladstone area and the QGP, and all others Queensland gas pipelines. QMGUG considers it likely that this will occur even with coverage required.

QMGUG members purchase gas from local Queensland gas fields, conventional and coal seam methane.

The proposed Papua New Guinea Gas Project and the Australian Gas Pipeline (AGP) have identified two gas transportation routes within Queensland and onwards to connect at Moomba. Four of the potential customers of the PNG Gas Project have been identified and are members of the QMGUG.

QMGUG expects that a Project Sanction decision does not require the pipeline portion to be uncovered. QMGUG considers that without coverage there will be a deleterious impact on the cost of delivered gas-to-gas customers; and, in the future, it would be more difficult for local gas producers and gas customers to efficiently utilise this pipeline at an efficient cost. QMGUG recommends that the proposed Australian Gas Pipeline be evaluated by the ACCC in regards to its proposed pipeline services and tariffs as applied to the PNG Gas Project and future access for local gas producers and gas customers before it is granted a 15-year holiday.

The issues and concerns raised by the QMGUG require serious consideration.

ABARE has forecast that natural gas consumption will grow at about 3.7 per cent per annum to 1828 PJ in 2019-20. QMGUG Members suggest that this growth will not occur unless there is a competitive gas market, including incentives to stimulate gas production competition and to minimise the cost of gas transportation and increase the efficiency of gas transportation services. Coal fired electricity generation is more cost effective. QMGUG suggests that unless the non-efficient gas pipeline costs are reduced and more flexible services are provided much of this growth will not occur.

QMGUG contends that the removal of coverage, increasing the threshold for coverage and allowing greenfield gas pipelines a 15-year holiday on pricing and lowering the transparency and access principle service provisions will lead to a higher cost, less efficient gas market.

The PC has recommended a number of changes to the gas regulatory regime to improve the certainty for investors in pipelines and minimise the costs of regulation, while protecting customers from the misuse of market power.

QMGUG has raised its concerns in its papers submitted to the PC and the MCE. QMGUG strongly disagrees with the proposed actions that will provide gas pipelines with an ability to charge monopoly prices. If a gas pipeline can show that there is a competitive gas pipeline or alternate source of gas delivery and that it is facing market competition only then should it be allowed to apply to remove cover.

This paper is a further effort to identify the areas required to protect customers from the misuse of market power of the gas transportation pipeline.

QMGUG considers that the MCE RIS paper does not show that there will be adequate protection of gas customers from the misuse of market power of the gas transportation pipeline.

PROBLEM

The PC's assessment found that, on balance, the Gas Access Regime is likely to be distorting investment in favour of less risky projects, including altering the nature and timing of pipeline investments. It is therefore likely that the current regulatory regime is generating an inefficient and sub-optimal investment environment. The PC stated that the likely distortion to investment is due to the combination of the current coverage test and the potential for regulatory error, regulatory risk and asymmetric truncation. The PC evaluated the coverage test as part of its overall assessment of the gas access regime.

While the PC did not explicitly provide persuasive arguments for or against the proposition that the current coverage threshold is reducing investment, on balance it considered that the coverage test for the Gas Access Regime sets too low a threshold for regulation and recommended that the coverage threshold be raised.

QMGUG suggests that a fundamental bias has been fostered from strong representation of the gas pipeline industry.

OBJECTIVE

The objective of government action is to ensure that regulation is only applied in circumstances where the benefits of it clearly outweigh the costs, thereby achieving an improvement in economic efficiency within the gas market for the benefit of the community as a whole.

QMGUG suggests that coverage was introduced because there was strong evidence of monopoly pricing and lack of efficient services. No review has shown that a gas pipeline has charged optimal tariffs nor provided optimal services. New gas pipelines have been built in a coverage regime and these pipelines have begun to apply competitive pressures on some existing gas pipelines. Until price derogations are removed in Queensland and gas pipelines are required to be covered until competition is in place the majority of gas transportation pipelines will continue to act in a monopolistic manner.

OPTIONS

QMGUG response is:

Option 2 appears to be the better solution proposed but it will not eliminate the concerns raised by the PC, where it said: "...the likely distortion to investment is due to the combination of the current coverage test and the potential for regulatory error, regulatory risk and asymmetric truncation". As the RIS states: "It is not possible to assess how the National Competition Council (NCC) will interpret and apply the amended criterion in practice, but it is likely that the amendment will have the effect of raising the threshold."

QMGUG prefers Option 1, Status Quo, from these two choices.

QMGUG recommendation is to have all gas transportation pipelines have coverage as the default regime for all existing and new gas transportation pipelines.

There are three examples of gas pipeline inefficiency even with coverage:

The Spring Gully Pipeline was built to by-pass the QGP;

The Braemar Gas Pipeline is being built to overcome the inefficiency of the RBP; and

The Ballera connection between the SWQP and CGP remains a bottleneck.

Removal of coverage to minimise regulatory costs to the gas transportation owners will not lead to a more efficient gas transportation system. The gas customers, and gas producers, will continue to be at a disadvantage in negotiating more effective, less costly gas transportation services.

In Queensland alone if the price derogations were not in place and an economic return was required to calculate pipeline tariffs it is QMGUG's contention that there would be significant reductions in gas transportation costs. If the average gas transportation were reduced only by \$0.10 GJ this would save the gas customers \$12.5 million per year. The regulatory cost to comply with coverage is nowhere near this level. The economic returns on these Queensland gas pipelines, protected by price derogations, would remain above an efficient level. All reviews have been distorted by the inability of the NCC/ACCC and gas customers to address the price derogations imposed by the Queensland government.

Gas pipelines have been and are being proposed even with the current coverage regime. There is no evidence that greater investment, interconnection and competition will take place between gas pipelines without coverage. There is no evidence that no coverage will facilitate improved reliability of supply and lower long-term prices for the benefit of consumers and the wider community.

There is no evidence that if coverage and the regulatory uncertainty had not been in place that more new gas pipelines would have been built. Even with the regulatory uncertainty and coverage requirements in place, new gas pipelines have been built: SeaGas, BassLink, East Coast Pipeline, Moranbah, extensions to the EAPL, expansion of the Roma to Brisbane Pipeline, Peat/Scotia Gas Pipeline, Braemar Pipeline, Spring Gully Pipeline, interconnection pipeline between the SWQP and the CGP.

Even if the Government has already agreed to raise the declaration threshold for the National Access Regime the QMGUG suggests that this declaration should be reversed. QMGUG contends that only if a gas pipeline owner could demonstrate that the benefits of coverage do not clearly outweigh the costs to gas customers then it can seek to obtain relief from coverage.

There is nothing to suggest that if the proposed PNG Gas Project and Australian Gas Pipeline do not eventuate that the expected demand, in Queensland alone, could not be satisfied with local gas sources and existing, covered gas transportation pipelines. There

is nothing to suggest that without coverage that the delivered gas prices to gas customers would be less due to the removal of coverage.