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**Productivity Commission review of the national access regime: APA Group response to draft report**

The APA Group (APA) welcomes the opportunity to respond to the Productivity Commission's (PC's) draft report for its review of the national access regime.

APA made an earlier submission to this review in response to the PC's Issues Paper. In that submission, APA emphasised the importance of ensuring that the national access regime, and the state and territory regimes established under the national access framework, supports efficient investment, and operates to safeguard the legitimate business interests of existing investors in energy assets.

This submission responds to issues and recommendations raised in the PC's draft report, in particular in relation to investment incentives under regulation, extensions and expansions, and the certification of the electricity and gas access regimes.

Please contact Alexandra Curran  
relation to this submission.

if you would like further information in

Yours sincerely

Peter Bolding  
General Manager  
Regulatory and Strategy



## **1 Introduction**

### **1.1 About APA**

APA plays a pivotal role in Australia's energy sector. APA is Australia's largest natural gas infrastructure business, transporting about half of the nation's natural gas usage through the assets it owns or operates, alongside other energy infrastructure investments in the electricity sector.

APA has extensive experience with regulation under the gas and electricity access regimes. APA's assets are subject to industry-based access regulation as both an access provider (as the owner and operator of electricity and gas transmission and distribution assets) and as an access seeker (for example as the owner of the Emu Downs wind farm).

An overview of APA's history, a summary of assets, and a description of APA's role in the gas market, was provided to the Commission in APA's submission responding to the review Issues Paper.

### **1.2 About this submission**

APA provided an earlier submission to this review addressing a number of issues raised in the Productivity Commission's (PC's) Issues Paper. APA has not sought to repeat its earlier statements to this review here, and therefore this submission should be read in conjunction with APA's earlier submission to find a complete view of APA's response to the national access regime review.

This submission responds to the PC's draft report, in particular in relation to investment incentives under regulation, extensions and expansions, and the certification of the electricity and gas access regimes.

## **2 Response to Productivity Commission draft report**

### **2.1 Support for Productivity Commission findings and recommendations**

APA endorses a number of conclusions and findings of the Productivity Commission's (PC's) draft report. In particular, APA supports:

- The retention of the current national access regime objectives focused on economic efficiency;
- The negotiate/arbitrate foundation of the regime, and rejection of the inclusion of a 'full' regulation option, entailing upfront undertakings alongside negotiate/arbitrate options;
- The retention of limited merits review for decisions made under the regime as a minimum, although full merits review is preferable; and
- The retention of the separate roles of the National Competition Council (NCC), the designated Minister, the Australian Competition and Consumer Commission (ACCC)



and the Australian Competition Tribunal in respect of the different stages and needs of the declaration, regulation and review processes.

APA considers that these conclusions and outcomes should be retained in the PC final report.

## **2.2 Comments on issues raised in Productivity Commission draft report**

### **2.2.1 Regulation and investment**

#### *Provision of spare or speculative capacity*

The PC discusses the impact of regulation of infrastructure investment in chapter 7 of its draft report. APA has previously submitted to this review in relation to investment in regulated infrastructure, particularly incentives to invest at regulated rates of return and the provision of spare capacity.

As a largely non-vertically integrated infrastructure provider, APA has a clear incentive to build additional capacity where there is a market for that capacity. It also has a clear incentive to increase utilisation of its facilities where there is demand.

On the flip-side, APA does not have an incentive to build speculative or spare capacity. The reasons for this are two-fold. First, as APA is generally not a user of its own assets, APA would bear the full demand risk on any speculative or spare capacity built until that capacity was contracted (which may be never). This represents a risk to APA that would not be compensated through regulated tariffs, as well as increasing APA's financing costs (also not compensated through regulated tariffs).

Secondly, APA would bear the risk that when demand was sufficient to justify the speculative capacity investment, it would be available at the regulated tariff. That tariff would not recognise the risk associated with the initial investment. There is also potential for the tariff not to recover the incremental cost of the capacity expansion where the unit cost of the expansion is greater than the average cost of all capacity on the pipeline (this risk is discussed in more detail in APA's initial submission to this review). Therefore, APA is unlikely to be able to recover the full costs of the speculative investment, even where the speculative demand eventuates.

APA notes that the ACCC considers that it already takes account of this type of risk in its decisions.<sup>1</sup> This has not been APA's experience in respect of the AER, which is part of the ACCC. For example, while the National Gas Rules have a mechanism to take account of the additional risk associated with speculative investments, as far as APA is aware, the AER has previously not allowed this mechanism to operate as intended.

As part of APA's recent access arrangement revision proposal for the Victorian Transmission System, APA proposed that its speculative capital expenditure account be subject to a higher rate of return, as allowed under the National Gas Rules (Rule 84(2)). The rationale is that the higher return would recognise the additional risk associated with this type of investment compared with investment to meet immediate (and known)

<sup>1</sup> Productivity Commission 2013, *National Access Regime: draft report*, May, p 233



demand, and setting that return in advance would allow APA to make investments in the knowledge of that return, thereby limiting the risk of truncation of returns.

In its draft decision, the AER did not accept APA's proposal to set a higher up-front rate of return to apply to its speculative investment account. Instead, the AER determined that it would decide on an appropriate rate of return for the speculative investment account at the time the asset in the account is rolled into the asset base – that is, after the investment is made and only once it has proved to be prudent expenditure.<sup>2</sup>

APA considers that this decision in no way provides certainty to service providers when making speculative investments that returns will not be truncated. This is because the investment decision is made at a time of demand uncertainty (and therefore must embed the cost of that risk), however the decision on appropriate returns is made by the regulator with perfect hindsight, when there is no longer any demand risk.

There is a very significant chance that the demand risk at the time of investment will be discounted by the regulator once the investment is proven to be prudent – the counterfactual (where demand does not eventuate) never comes before the regulator. This approach therefore provides no up-front certainty to APA that speculative investments will be compensated appropriately by the regulator, and runs contrary to the ACCC's claims that these risks are considered in their decisions.

#### *Application of the regime to non-vertically integrated infrastructure providers*

As a non-vertically integrated infrastructure provider, APA has clear incentive to provide access to its existing facilities. APA faces high sunk costs in its network of assets and has a clear incentive to maximise throughput so as to earn higher revenues. Further, APA is incentivised to facilitate new entry by customers as well as gas producers as, not only will this increase throughput, but a broader portfolio of customers will more effectively manage APA's counter-party credit and countervailing power risk. That is, APA has no incentive to hinder access and every incentive to facilitate access and grow its business through increased utilisation of its assets.

APA also has a clear incentive to increase the capacity of its facilities (and build new facilities) where there is a willing customer prepared to underwrite the capital investment through foundation shipper commitments. A significant barrier to this incentive is where regulation sets the tariff for that additional capacity below the cost of the extension or expansion. As discussed in APA's earlier submission to this review, this can occur where the unit cost of additional capacity is higher than the cost of existing capacity (often because of a diminished capital base). The regulated tariff generally reflects the average cost of all capacity, which will be lower than the cost of the additional increment of capacity. The reference tariff in these cases cannot underwrite the extension or expansion and it does not proceed.

Therefore, for non-vertically integrated infrastructure providers, access regulation can provide a clear disincentive to invest, while not increasing access to assets as the non-vertically integrated infrastructure provider already has a full incentive to provide access.

<sup>2</sup> Australian Energy Regulator 2012, *Access Arrangement draft decision, APA GasNet Australia (Operations) Pty Ltd 2013-17 Part 2 Attachments*, September, pp163-4



## **2.2.2 Extensions and expansions**

APA does not support the PC's recommendation to include powers for the ACCC to be able to direct an expansion to an infrastructure facility. It is not clear to APA that the widening of the national access regime to include a power for the ACCC to direct expansions as well as extensions is just a 'clarification' of the regime. APA considers that there are clear differences between extensions to a facility and expansions of a facility, and in neither case is it appropriate for the ACCC to be able to direct investment.

Extensions are discrete additions to a facility for a particular purpose, such as a lateral to a specific customer's plant/facility. The costs of constructing and operating an extension to a facility can usually be clearly identified, and its operation can often be separated from other parts of a facility. In this way, an extension to an existing facility can be quarantined both operationally and financially, and is unlikely to impact the core operation of that facility. Because of this, APA believes there is little case to require an infrastructure provider to construct and operate facilities that an access seeker can construct and operate itself. The obligations of the infrastructure provider in respect of third party extension facilities should be limited to providing interconnection with the existing facility.

In contrast, expansions to a facility are by definition integrated within the facility, and operate alongside existing capacity. A requirement to expand a facility would necessarily entail a certain loss of control for the infrastructure provider of the operational and commercial risks associated with that facility, regardless of how that expansion was funded.

Ultimately, where the service provider is not vertically integrated and has every incentive to increase throughput and provide access, the most efficient terms and conditions of that access will be those as determined by the contracting parties rather than by regulatory intervention.

## **2.2.3 Declaration**

### *Criterion (e) – subject to a certified access regime*

APA does not consider that criterion (e), as currently drafted, provides sufficient protection to energy infrastructure providers and access seekers from being subject to dual access regimes. APA considers that the original formulation of this clause, which referred to effective access regimes (regardless of certification) provided appropriate protection to infrastructure providers and access seekers from dual regulation where state and territory governments failed to seek formal certification of their regimes.

Where a certified regime is in place, however, APA considers that it is appropriate for this to be a threshold matter for declaration, such that the NCC and designated Minister need not consider the declaration criteria once certification is confirmed.

## **2.2.4 Certification of the energy access regimes**

As stated by APA in its original submission, certification of state and territory access regimes is important in ensuring that there is consistency between these regimes and the national regime. Certification also protects against declaration under the national access regime.



APA does not support the PC's suggestion that the requirement for certification of the electricity and gas access regimes be removed from the Australian Energy Market Agreement. APA does not consider that this approach will adequately deal with the risk of declaration, which has increased following changes to declaration criterion (e) to refer to certified rather than effective regimes.

Declaration would expose energy infrastructure providers to potentially conflicting regulatory regimes under the national and energy regimes. Alongside declaration (and the requirements of negotiation and arbitration), an infrastructure provider's obligations under the National Gas Law or National Electricity Law would remain in place, requiring that provider to submit access arrangements or revenue proposals, and to comply with those access arrangements and revenue proposals while in force. Obligations under state and territory regimes could conflict with those under the national access regime. For example the requirement for regulated gas transmission network service providers to maintain a queue for the allocation of capacity and to allocate spare capacity as it arises in accordance with that queue could conflict with negotiation/arbitration requirements under the national regime.

While some of this risk would be alleviated by a common decision maker for declaration and coverage under the national and state based regimes, hopefully making a dual declaration/coverage pipeline unlikely, this is not the case in all jurisdictions, for example in Western Australia. Should the declaration criteria and coverage criteria under each regime diverge over time (as could occur as a result of this review) this risk would increase. APA considers that a preferable outcome would be to seek certification of the electricity and gas access regimes, and ensure they remain certified.

Notwithstanding the PC's proposed changes to certification to include a process to revoke certification, APA considers that the costs of maintaining certification under the current regime have been overestimated, in particular in relation to the need to submit each rule change to the NCC for consideration.

The National Gas Law and National Electricity Law, and associated rules under these instruments, cover a wide range of issues, not all of which are related to access. APA considers that it would be possible to identify those parts of the law and rules that are critical to the certified regime, such that only rule changes that impact those parts could be considered by the NCC. There is currently a required consultation process for rule changes, and APA considers that the NCC consideration (where needed) could occur within that framework.