



REVIEW OF THE GAS ACCESS REGIME

**Submission to the
Productivity Commission**

ON

COVERAGE ISSUES

August 2003

1.0 INTRODUCTION

The Goldfields Gas Pipeline (GGP) extends 1380 kms from gasfields in the north-west of Western Australia to Kalgoorlie. Commissioned in 1996, before the introduction of the National Gas Access Regime, it delivers gas to a small number of major mining and processing ventures in the Pilbara, Northern and Eastern Goldfields regions. The gas is used primarily for power generation.

The GGP was constructed pursuant to an Agreement with the State Government, which was ratified by the Goldfields Gas Pipelines Agreement Act 1994 (the State Agreement). When the National Gas Access Regime was introduced, the GGP was included on the list of covered pipelines.

In March 2003, following a protracted and difficult experience with the Western Australian Regulator and the Gas Code process, GGT submitted an application to the NCC seeking revocation of coverage.

The purpose of this submission is to draw upon GGT's experience with the Gas Code processes to highlight some of the shortcomings of the Gas Regime and the Gas Code with respect to the coverage criteria and related issues.

2.0 SCOPE

The Productivity Commission has been asked to take into account the "...Different roles and requirements of transmission and distribution networks". In GGT's view, in the Australian context, the differences between transmission pipelines and distribution systems are so fundamental as to warrant separate treatment.

A distribution system is usually associated with a major urban centre, and can look forward to stable throughput and steady growth. Market reversals in a portion of the interconnected networks will normally be offset by gains elsewhere in the system. Usage patterns within distribution systems tend to fluctuate considerably according to daily, weekly and seasonal usage patterns, but are highly predictable over time. Throughput economies and pipeline sizing is far less important than for transmission lines. Distribution systems are likely to be more stable and longer-lived.

Transmission lines, on the other hand have very different characteristics:-

- they are the link between the depleting gas resource and the market;
- the economics of transmission are extremely sensitive to pipeline size and throughput. This creates the dilemma of whether to risk constructing capacity ahead of the market in the hope of lower unit costs eventually – or building to market requirements and accepting ongoing high costs;
- they are often constructed in remote & inhospitable places;
- their viability (or their profitability) can be dependent on a small number of large industrial loads;
- capacity can be in danger of being stranded on a long-term basis.

Transmission lines in Australia tend to operate at continuously high load factors, but in a wide range of market circumstances. Individual pipelines can have extremely different load profiles.

GGT is strongly of the view that the differences between distribution systems and transmission pipelines warrant separate treatment within the Gas Code.

3.0 OBJECTIVES

GGT believes that it is important that the objectives established for the Gas Code make it clear that application of the regime is reserved for facilities which are regarded as essential, and for circumstances where the benefits anticipated are material in national terms. Coverage should not be treated as a general umbrella applicable to all but a few minor transmission pipelines.

The existing preamble to the Gas Pipelines Access Act and to the Gas Code, sets out the following objectives for the regime:-

The objective of this Code is to establish a framework for third party access in gas pipelines that:

- (a) facilitates the development and operation of a national market for natural gas; and*
- (b) prevents abuse of monopoly power; and*
- (c) promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders; and*
- (d) provides rights of access to natural gas pipelines on conditions that are fair and reasonable for both Service Providers and Users; and*
- (e) provides for resolution of disputes.*

The GGP operates in a market context where the majority of its capacity is devoted to the delivery of gas specifically for the purpose of power generation for major mining and processing activities. Only a small proportion of the gas is used as gas for its inherent qualities. The power generated using GGP gas competes:

- in the Pilbara, with power delivered by company owned high voltage transmission lines from coastal power stations;
- in the Northern Goldfields, with power generated in remote power stations using diesel as a fuel;
- in the Eastern Goldfields, with power delivered by high voltage transmission lines from power stations connected to the State's South West Interconnected System (SWIS).

Therefore, while the GGP on the face of it would appear to have a monopoly in respect to gas transmission services in the regions it traverses, it certainly does not have a monopoly with respect to electricity supply, or for the supply of energy for electricity generation.

GGT believes that the existing preamble has a number of shortcomings as a statement of objectives or "objects" clause. These are discussed below:

1. The focus on natural gas is too narrow

Objective (a) above is focused on facilitating a national market for natural gas. Likewise objective (c) is aimed at promoting a competitive market for natural gas. GGT believes that in market circumstances such as faced by the GGP, these two objectives may be too narrow, and that they could usefully be broadened to focus on energy as opposed to natural gas. GGT also believes that objectives (a) and (c) are very similar and should be combined into a single, energy focused objective.

2. Importance of Promoting Investment is Overlooked

A particular shortcoming of the existing objectives is the absence of any specific attention to the importance of promoting or facilitating investment in new pipelines and/or the expansion of existing pipelines. In a vast country such as Australia, with such poorly developed infrastructure this should, in GGT's view, be the overriding objective of the National Gas Access Regime. It is clear that a preoccupation with tariff reductions on existing pipelines since the introduction of the Code has come at the expense of investment in new capacity.

3. Lack of Consistency with Part IIIA

The Productivity Commission is required by the Terms of Reference for the Review to take into account "... consistency with Part IIIA of the Trade Practices Act 1974, in particular with relation to the objects clause and pricing principles". In its Review of Part IIIA, the Productivity Commission recommended that:-

"The object of this Part is to:

- (a) promote economically efficient use of, and investment in, essential infrastructure services; and*

- (b) *provide a framework and guiding principles to discourage unwarranted divergences in industry-specific access regimes”.*

It is interesting to note that nowhere in the current statement of objectives for the National Gas Access Regime and the Gas Code is there any reference to the regime being limited to “essential services”. GGT believes that this is a major shortcoming, which should be remedied in order to bring the regime in line with the Productivity Commission's recommendation, and the Hilmer vision of a “light handed” regime focused only on “essential services”. It is worth remembering that Hilmer did not support the need for industry-specific regimes.

In its response to the Productivity Commission's recommendation, the Government proposed the following modified objects clause:-

“The object of this Part is to:-

- (a) *promote the economically efficient operation and use of, and investment in, essential infrastructure services, thereby promoting effective competition in upstream and downstream markets; and*
- (b) *provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry”.*

Both of these objects clauses make it clear that the regime relates to “essential” infrastructure services, a criterion which is absent from the current Gas Access Regime and Code objectives. GGT believes that the focus should be confined to essential infrastructure.

4. Lack of any Threshold Test

The previous discussion emphasises the importance of limiting the regime to “essential services”. GGT also believes that in order to ensure that the level of regulatory processes and regulation are kept to a minimum, the statement of objectives should make it clear that application of the regime is reserved for circumstances where the magnitude of the likely benefits is sufficient to warrant regulation. In GGT's view such benefits should be material in national terms. The prospect of even a substantial change in competition in a minor market, should not warrant coverage of a transmission facility.

5. Summary

GGT believes that the shortcomings of the existing objectives can be overcome, and consistency achieved with the Government's proposed objects clause for Part IIIA, with the following set of recast objectives:-

“The objective of this Code is to establish a framework for third party access to gas pipelines that:

- (a) promotes the economically efficient operation and use of, and investment in, essential energy infrastructure services, thereby promoting competition in upstream and downstream markets; and*
- (b) applies only in circumstances where the anticipated benefits are material in national terms;*
- (c) prevents abuse of monopoly power;*
- (d) provides rights of access to essential natural gas pipeline services on conditions that are fair and reasonable for both Service Providers and Users; and*
- (e) provides for resolution of disputes”.*

4.0 COVERAGE CRITERIA

As indicated in the previous section, the Productivity Commission is required by the Terms of Reference for the Review to take into account "... consistency with Part IIIA of the Trade Practices Act 1974". GGT believes that the objective of consistency should extend to consistency between the Declaration criteria embodied in Part IIIA and the criteria for Coverage. In respect of Declaration, the NCC cannot recommend that a service be Declared unless it is satisfied of all of the following matters:-

- “(a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service;*
- (b) that it would be uneconomical for anyone to develop another facility to provide the service;*
- (c) that the facility is of national significance, having regard to:
 - (i) the size of the facility;*
 - (ii) the importance of the facility to constitutional trade or commerce; or**the importance of the facility to the national economy.**
- (d) that access to the service can be provided without undue risk to human health or safety;*
- (e) that access to the service is not already the subject of an effective access regime;*
- (f) that access (or increased access) to the service would not be contrary to the public interest”.*

As far as the present Code Coverage criteria are concerned, the NCC cannot recommend that a pipeline be covered if it is not satisfied of one or more of the following matters:-

- (a) that access (or increased access) to Services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline;*
- (b) that it would be uneconomic for anyone to develop another Pipeline to provide the Services provided by means of the Pipeline;*

- (c) *that access (or increased access) to the Services provided by means of the Pipeline can be provided without undue risk to human health or safety; and*
- (d) *that access (or increased access) to the Services provided by means of the Pipeline would not be contrary to the public interest”.*

GGT offers the following specific comments on Coverage issues:

1. National significance

The principal anomaly in the two sets of criteria reproduced above is the absence of the “national significance” test from the Coverage tests. GGT believes that this is a significant shortcoming in the Code framework, which should be remedied by the inclusion of criterion (c) from the Declaration criteria in the Coverage criteria.

2. Criterion (a)

In its review of Part IIIA, the Productivity Commission has recommended that “... access (or increased access) should promote a substantial increase in competition...”. The Government, in its response to the Productivity Commission recommendations, has expressed a preference for the word “material” in place of “substantial”. GGT believes that in the context envisaged, "substantial" is to be preferred over "material".

It is interesting to refer back to the recommendations of the Hilmer report in this regard. Hilmer proposed that the Minister should be satisfied that:

- “(a) access to the facility in question is essential to permit effective competition in a downstream or upstream activity”.*

The word "essential" does not appear in either the existing criterion (a) for the Gas Access Regime, or in the Productivity Commission’s proposed wording for the Part IIIA Declaration Criterion (a). GGT believes that "essential" should be included to capture the essence of what Hilmer had in mind.

GGT also believes that the rider “whether or not in Australia” is redundant and for reasons of consistency with the Part IIIA Declaration Criteria should be deleted.

GGT, therefore, proposes the following modified set of words for criterion (a):

“that access (or increased access) to Services provided by means of the Pipeline is essential to promote substantial competition in at least one market other than the market for the Services provided by means of the Pipeline”.

3. Criterion (b)

GGT is strongly of the view that criterion (b) should not be limited to the development of “... another Pipeline to provide the Service provided by means of the Pipeline”. As explained earlier, the prime function of the GGP is to transport gas for the purpose of generating electricity for remote mining and processing ventures. Competitive electricity can be provided from a number of alternative services. The GGP is simply one link in one of the alternative supply chains which can deliver electricity to these projects.

Criterion (b) of the Part IIIA Declaration criteria requires:

“(b) that it would be uneconomical for anyone to develop another facility to provide the service;”

Nowhere does it state that the other facility needs to be of the same type as the one providing the service. The key issue being addressed by this criterion is whether the facility being considered for declaration or coverage exhibits monopoly characteristics.

GGT believes that the flexibility provided under the Part IIIA criterion (b) should extend to the Code criterion (b), and that this is important for the sake of consistency. The present restrictive approach introduces the danger of capturing facilities which do not in effect have a monopoly, and of not promoting efficient investment in infrastructure generally.

GGT recommends the following revised wording for criterion (b):-

“(b) that it would be uneconomic for anyone to develop another facility (or facilities) to provide services which compete with those provided by means of the Pipeline;”

4. Criterion (c)

In GGT's view the inclusion of criterion (c) is unnecessary in both the Code criteria and the Part IIIA Declaration criteria. Issues of public health and safety are fundamental to the development and operation of any transmission pipeline or distribution network. These matters are quite adequately addressed in relevant laws and regulations and it should not be the function of an access regime to overlay these in any way. No pipeline would, or could, propose anything which compromised health and safety standards.

5. Criterion (d)

GGT believes that criterion (d) is satisfactory in its present form, but that specific guidance should be given to Regulators to ensure that this criterion is invoked in circumstances where there is a risk that a new greenfields pipeline may not receive investor and/or lender support if faced with the prospect of coverage.

6. Summary

GGT's recommendation for a revision of the Code Coverage criteria is as follows:

- (a) *that the facility is of national significance, having regard to:*
 - (i) *the size of the facility; or*
 - (ii) *the importance of the facility to constitutional trade or commerce; or*
 - (iii) *the importance of the facility to the national economy.*
- (b) *that it would be uneconomic for anyone to develop another facility (or facilities) to provide Services which compete with those provided by means of the Pipeline;*
- (c) *that access (or increased access) to Services provided by means of the Pipeline is essential to promote substantial competition in at least one market other than the market for the Services provided by means of the Pipeline;*
- (d) *that access (or increased access) to the Services provided by means of the Pipeline would not be contrary to the public interest.*

5.0 CONCLUSIONS

GGT's position with respect to Coverage issues can be summarised as follows:

- Differences between pipeline distribution systems and transmission pipelines warrant separate treatment within the Gas Code;
- The existing preamble to the Gas Code should be modified to form a statement of objectives which:
 - has a broader objective than natural gas;
 - emphasises the importance of investment;
 - confines its application to essential infrastructure;
 - confines its application to circumstances of material benefit.
- Existing Coverage criteria should be modified as follows:
 - to include the same national significance test as Part IIIA;
 - to require a "substantial" increase in competition (criterion (a));
 - to delete the rider "whether or not in Australia" from criterion (a)
 - to broaden criterion (b) to allow consideration of equivalent services;
 - to delete criterion (c);