



**Productivity Commission Review of  
Gas Access Regime  
Submission on Issues Paper**

**VENCORP  
1 September 2003**

## Summary

This submission is provided by VENCorp in response to the Productivity Commission's Issues Paper released in July 2003 on their review of the Gas Access Regime under Terms of Reference set by the Treasurer 13 June 2003.

VENCorp is a service provider of a major covered pipeline under the Code. We support the approach of the regime and application of it by the Code for regulation of essential and significant gas infrastructure.

While we believe that there are some areas of the Code that would benefit from improvements, we have found the underlying framework provided by the regime and implemented via the Code to be generally effective and practical in its application to date.

The submission briefly explains VENCorp's role in the Victorian energy industry and, in responding to matters raised in the Issues Paper, provides specific suggestions on the need for improvements mainly in the following key areas :

- better definition of the objectives and principles embodied in the Code, particularly where these are applied to the minimum requirements of an Access Arrangement of each covered pipeline;
- process improvements to make its application more efficient and lead to greater certainty with regard to regulatory outcomes;
- better recognition of the dependencies of competitive reforms in downstream markets (in particular, full retail competition) on the transportation arrangements and access to the services by third parties;
- more direct attention by the Code on the impacts and consequences of the third party access regime in gas on the long term reliability of overall energy supply. In particular, this review of the Code should recognise the role of gas transportation services to the efficient operation of NEM and reliability of electricity supply in light of the expectations of growing dependence on gas fired power generation for peaking services in electricity supply. Governments are keenly aware of this critical dependency, and the regime could be improved to better reflect the growing importance of an encompassing approach to energy supply.

## Table Of Contents

<b>1</b>	<b><u>Introduction</u></b> .....	<b>1</b>
<b>2</b>	<b><u>Background</u></b> .....	<b>2</b>
<b>3</b>	<b><u>Suggested Improvements to the Code</u></b> .....	<b>3</b>
	<u>3.1 Benefits And Costs Of The Existing Regime</u> .....	4
	<u>3.2 Objectives</u> .....	5
	<u>3.3 Access Regulation And The Development Of A Competitive Market For Energy Services</u> .....	5
	<u>3.4 Access Regulation And New Investment</u> .....	6
	<u>3.4.1 Investment</u> .....	6
	<u>3.4.2 Information Gathering</u> .....	7
	<u>3.5 Access Arrangements and 'Light-handed' Regulation</u> .....	8
	<u>3.5.1 Scope for Earlier Merits Review of Decisions</u> .....	8
	<u>3.5.2 Reference Tariffs</u> .....	8
	<u>3.5.3 More 'Light-Handed' Regulation</u> .....	10
	<u>3.6 Other improvements – implications for electricity?</u> .....	15
<b>4</b>	<b><u>Conclusion</u></b> .....	<b>16</b>



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## 1 Introduction

VENCorp appreciates the opportunity offered by the Productivity Commission to provide input to its review of the gas access regime, and hopes that the following views and suggestions assist the Commission with its considerations.

Our submission is based on our practical experience with application of the Code over six years, including establishment of an Access Arrangement and then renewal for the subsequent regulatory period and as a service provider of a covered main transmission pipeline which is critical to energy supply in the state of Victoria.

As a practitioner of the Code<sup>1</sup> with a very significant role in gas transportation, VENCorp fully supports the approach of the regime and the application of it by the Code for regulation of essential and significant gas infrastructure.

### **Regime is not fundamentally flawed**

VENCorp has found the underlying framework associated with provision of third party access to transmission services under the Code to be generally effective and practical in its application to date. While there are some areas of the Code that would benefit from improvements, it has achieved its intended purpose of ensuring effective and efficient third party access to significant energy infrastructure involved in the transportation of gas in the state of Victoria reasonably well.

### **Regulatory Stability is Needed for Now**

The original commitment by governments in 1997<sup>2</sup> was to establish a national regulatory framework which would achieve a uniform national approach to third party access to essential gas transmission infrastructure. VENCorp agrees that it is appropriate and opportune to now review the Code and the framework under which it operates, now that substantial practical experience is available and following on from the findings of the Parer Energy Market Review for CoAG and the Productivity Commission's previous work on the National Access Regime. However, we strongly support the previous finding of the Commission, with regard to its review of the National Access Regime, that the overall framework is effective as "a useful piece of economic regulation, but with some deficiencies"<sup>3</sup>.

VENCorp believes that this review should be undertaken with the aim of improving the effectiveness of the Code in delivering the objectives and applying the core principles of the regulatory framework, consistent with the aim specified by the Treasurer in the Terms of Reference<sup>4</sup>.

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<sup>1</sup> National Third Party Access Code for Natural Gas Pipelines

<sup>2</sup> refer Intergovernmental Agreement of 7 November 1997

<sup>3</sup> Productivity Commission issues paper, Box 1; p9

<sup>4</sup> Terms of Reference of this review, section III

Any substantive dismantling of the provisions of the Code may put the significant benefits already obtained under the regime at risk and may well end up creating much greater damage from the resulting regulatory upheaval these changes would entail.

The energy industry in Australia has experienced and dealt with some large regulatory changes imposed on it over the last five to ten years. The importance of regulatory stability to future investment and the current economic state should be given strong recognition by the Commission during its considerations in the course of this review. Further large regulatory shocks may harm both investment in the network infrastructure and the associated markets for gas which rely upon this infrastructure.

VENCorp therefore encourages the Productivity Commission to consider the need for a more efficient and effective process for incremental development of the Code to allow it to evolve to meet the changing needs of the industry, such that change occurs in a timely manner and precludes the need for major reviews every five years.

### **Better Recognition of Requirements for Electricity**

In addition, there is an important area where we believe that the Code and the regime itself may benefit from further consideration and development for the future.

It is clear that the reliability of electricity supply and the smooth operation of the National Electricity Market ('NEM') are increasingly dependent on gas fired power generation in the future. Therefore, the regime covering third party access to the gas transportation infrastructure which services those users will play a critical role.

The important dependencies between these two energy industries need to be carefully considered in changes to the Code. This view is fully consistent with the findings of the CoAG Energy Market Review.

We therefore believe that it is important to the long term security of overall energy supplies to take into account the potential consequences for electricity when reviewing the Code.

## **2 Background**

### **VENCorp's Statutory Basis**

VENCorp is a statutory body established under the Victorian Gas Industry Act 1994 in December 1997, with responsibilities including the operation of the main gas transmission system in Victoria, the Principal Transmission System ('PTS'), and operation/administration of the Victorian wholesale gas spot market.

The PTS is a covered pipeline under the Code, and was originally covered under the Code which was implemented under state law in Victoria prior to the Code itself coming into effect nationally.

In accordance with the Code, GasNet and VENCorp each have an approved Access Arrangement which has been in place since the Code was first introduced, and have recently renewed these Access Arrangements<sup>5</sup> following expiry of the first regulatory period.

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<sup>5</sup> the current regulatory period is from 1 January 2003 – 31 December 2007

## Joint Service Provision

The PTS is owned by GasNet Australia and operated by VENCorp. GasNet and VENCorp are joint service providers under the Code, sharing the provision of services which together create the third party access regime for the PTS. The services are split between them in accordance with statute and, as provided for by the Code, are defined in each party's Access Arrangements.

The liabilities and obligations between GasNet and VENCorp are defined by contract<sup>6</sup> and the MSO Rules which govern the operation of the PTS under a competitive wholesale market for gas.

The services, terms and conditions that are provided collectively by VENCorp and GasNet are essentially the same as for any open access gas pipeline system, requiring scheduling, balancing, metering and allocation of quantities, and commercial settlement.

## Market Carriage

The PTS is operated as a market carriage pipeline under the Code. It encompasses a market driven approach which is flexible, responsive, and whereby capacity management and balancing are market based and market driven, utilising a daily spot market to value gas and establish prices.

## Environment

The PTS is the main high pressure gas transmission system which provides the transportation of gas in Victoria. The PTS services the transportation needs of the most significant domestic gas market in Australia. The demand is over 200PJ per annum, servicing a significant mix of end users ranging from industrial, commercial, gas fired generation, to residential. The penetration of gas in Victoria is far greater than in other states as yet. Unlike the situation elsewhere in Australia, about 40% or more of the gas transported on the PTS in winter months is for residential usage. Over 1.4 million residential customers are reliant upon the PTS for transportation of gas to the distribution networks which service their households.

The PTS is therefore an essential and significant piece of infrastructure relating to energy supplies (both gas *and electricity*) for the state of Victoria, and more widely as others states become more firmly interconnected to Victoria by interconnecting electricity and gas transmission lines.

## 3 Suggested Improvements to the Code

VENCorp has found the Code's implementation of the underlying framework for provision of third party access to be generally effective and practical to apply. Our suggestions on potential improvements to the Code are focussed on improving its effectiveness in achieving the objectives and intent. They are based on our practical experience with application of the Code over six years as a service provider of a covered main transmission pipeline which is a significant and essential piece of gas transmission infrastructure, including subsequent renewal of our Access Arrangement for a subsequent regulatory period.

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<sup>6</sup> the Service Envelope Agreement between GasNet Australia and VENCorp

The material in this submission has been structured as responses which address the specific questions raised in the Commission's issues paper (as relevant) in the order of that paper, to assist the Commission with its considerations on these matters.

### 3.1 Benefits And Costs Of The Existing Regime

1. *How has the Gas Access Regime affected upstream and downstream industries?*
2. *To what extent has the Regime promoted competition in these markets?*
3. *To what extent does the Regime facilitate the development of a national market for natural gas and energy in general?*
10. *Are these costs likely to be significantly greater than the costs associated with unregulated commercial negotiations between pipeline owners/operators and users?*
15. *What and how significant an effect does the Regime have on investment in upstream and downstream markets? Does it encourage efficient investment in these markets?*
16. *Taking account of both benefits and costs, does the Regime provide a net benefit to Australia?*
17. *To what extent does the Regime balance the interests of different parties, such as pipeline owners, end-users and gas producers?*

The deficiencies and problems with the Code often attract the focus of attention. An important point to note is that the Code is a piece of access regulation, and while it is essential to support a number of very important competition reforms, it cannot of itself guarantee their success. While the problems do need to be addressed, the benefits provided over the last five years by the national framework for open third party access to significant gas pipelines and the Code itself have not yet been adequately recognised and often do not get the attention they deserve. In this respect, one criticism of the public appraisal to date has been that it tends to be popularised and driven by headlines. This review will be very helpful in properly assessing the true extent of the benefits achieved by implementing a national regime and Code.

VENCorp has not found the costs of compliance with the Code to be exorbitant. We believe that costs involved in challenges to the Code should be discounted from any consideration of the costs of compliance, as this is a separate issue. Costs for ongoing maintenance of our approved access arrangement are not excessive given the nature and importance of the roles that VENCorp undertakes and the services it is required to provide for third party access to the PTS. We found that the costs for major renewal of our access arrangement at the end of the regulatory period were higher than we would have preferred, due in the main to significant uncertainties which arose from areas of the Code which are not well defined or that are in need of development to match and better reflect the evolving needs of the industry.

VENCorp is keen to see that all of its costs are minimised and we believe that there is scope for greater efficiency and cost reduction by streamlining the processes involved in the Code and addressing specific areas in the elements of the minimum requirements of each access arrangement with better definition of requirements and guiding principles.

The regime admirably sets out to provide a framework under which the interests of all parties are able to be balanced in an equitable manner. However, the current implementation in the Code could benefit from adopting a broader view which takes better account of the consequences of the access regime for gas transportation on other parties and areas, such as:



- taking a much bigger focus on the impacts and consequences to end users, who may not be the direct “users” of services provided under any Access Arrangement, but are the ones who fund the bottom line; and
- taking account of the clear dependencies of the electricity market and the reliability of energy supply on the effective functioning of the access regime in gas.

### 3.2 Objectives

*18. Are improvements needed to the objectives specified in the preamble to the Gas Pipelines Access Act in order to ensure uniform third party access arrangements are implemented and applied on a consistent, national basis?*

This review should be undertaken with the aim of improving the effectiveness of the Code in delivering the objectives of the regulatory framework, consistent with the aim specified by the Treasurer in the Terms of Reference<sup>7</sup>. This requires a strengthening of the definition of the core principles which give effect to the objectives.

Examples of this are:

- better definition of the principles for minimum requirements in section 3 of the Code to improve clarity of purpose and process, which is addressed further in section 3.5 of this submission; and
- better definition of the principles to be applied in development of practical incentives, where it would be helpful for the Code to provide more guidance on the framework under which applicants and regulators establish suitable incentive structures which work more effectively in producing truly efficient outcomes.

### 3.3 Access Regulation And The Development Of A Competitive Market For Energy Services

*33. Are changes required to the Gas Code to better facilitate its effectiveness in promoting competition in upstream and downstream markets?*

*34. Does capacity trading facilitate upstream and downstream competition? Or is there scope for misuse of market power by upstream or downstream industries?*

*35. To what extent, if any, does the Regime's impact on pipeline investment hinder the development of competition in upstream and downstream markets?*

*36. To what extent does the Gas Access Regime promote retail contestability on a consistent and timely basis?*

*37. What changes to the Regime might better facilitate its effectiveness in promoting retail contestability on a consistent and timely basis?*

The Issues Paper focuses on the areas of commercially negotiated outcomes and facilitation of the development of upstream and downstream markets (which includes the more specific aspects of retail contestability).

<sup>7</sup> Terms of Reference of this review, section III

It would be of considerable value for the Code to provide much clearer directions on the principles that need to be addressed by arrangements for covered pipelines to achieve the desired objectives.

VENCORP believes that the current regime is essential for the facilitation and promotion of competitive markets in natural gas, and Victoria provides an example of how the regime can facilitate the implementation of broad competition reforms in gas. The Code would benefit from improved recognition of the requirements for facilitating competitive reforms in both the upstream and downstream industries.

For example, Victoria and New South Wales have each invested a large amount of time, resources and money in developing and implementing full retail competition in accordance with national competition policy under both market and contract carriage access regimes (respectively). The arrangements for open third party access on transmission as well as distribution pipeline systems can significantly impact on the efficiency and effectiveness of the development of full retail competition and the manner by which it is implemented, and revisions to the Code should attend this aspect.

However, access to cost-competitive supplies is a pre-requisite of the entry of new retailers into downstream markets and enhancement of retail competition. Retail competition is more likely to be influenced by limitations on "access" to cost competitive supplies rather than the transport regime.

The Code is a piece of access regulation, and while it is essential to support a number of very important competition reforms, it does not of itself undertake them or guarantee their success. The Code is currently focussed on providing flexibility for negotiation of access to the assets and services for transportation, with processes for resolution of disputes on such should they arise. The Commission will need to remain mindful of the important limitations of the Code in this respect during its consideration of the advantages or otherwise to other markets, especially those upstream and downstream.

### 3.4 Access Regulation And New Investment

#### 3.4.1 Investment

38. Has the Gas Access Regime led to a level of investment in gas pipelines that is inefficient? ....

39. Does the Code create an incentive to delay investment and/or build smaller pipelines than optimal so as to minimise the possibility of pipeline investment being subject to access regulation? ....

In Victoria, there has been significant recent and ongoing investment in new gas supply and gas pipeline development since the Code has been in effect. This is described in Box 1. It is apparent that substantial investment is proceeding in Victoria whilst the Code is in effect.

The Code is not solely responsible for this investment activity, and this may perhaps be the salient point. The Code is a piece of access regulation relating to pipelines, and as such should at best facilitate *economic* investment decisions and at least not hinder them, but cannot create or drive them of itself, especially in other markets.

**Completed Pipeline Developments:**

- Installation of compressors in 1999 to provide a potential three-fold increase in the Moomba-Melbourne pipeline capacity to up to 92TJ/day, dependent on compressor availability and system conditions in NSW.
- The South-West Pipeline, completed in May 1999.
- Connection of the Western Transmission System to the Principal Transmission System 2000
- The Eastern Gas Pipeline (Longford – Sydney) 2000
- Longford – Bell Bay (Tasmania) pipeline
- Vic Hub, drawing supplies from the Gippsland and Bass basins and supplying Melbourne, Sydney and Tasmania. Jan 2003

**Planned pipeline developments:**

- Interconnection with South Australia via SEAGas fully operational by Jan 2004

**Completed Supply-Storage Developments:**

- Development of the Underground Storage facility at Iona is operational with a storage holding capacity of 10PJ and a maximum daily injection capability of about 260TJ per day

**Planned supply developments :**

- Patricia Baleen field in the Gippsland basin, with contracted supplies of 60PJ (currently under EES) 2003
- Minerva fields in Otway basin expected by Jan 2004, over 100TJ/d
- Yolla field in Bass Strait expected 2<sup>nd</sup> half of 2004 over 60 TJ/d
- Kipper field in Bass Strait, with expected start up within the next 5 years
- Thylacine/Geographe fields in Otway basin expected 2006, over 200 TJ/d

*Box 1 Planned and completed investment in gas supply and transmission pipelines in Victoria*

### 3.4.2 Information Gathering

*54. Do the information gathering requirements of the Code significantly hinder investment? If so, what changes would ensure an appropriate balance between the interests of access seekers and providers, while not significantly discouraging infrastructure investment?*

The regulated revenue approved under the Access Arrangement for a covered pipeline which comprises significant infrastructure can be substantial<sup>8</sup>. It is appropriate, therefore, that a high level of diligence and scrutiny be applied by the regulator to the claims during the approval process.

This becomes more important if changes contemplated in regard to binding obligations on the regulator are introduced, as the essential feature of these proposals is to further limit the long term regulatory risk to the service providers in terms of their revenue stream in order to achieve the objective. The direction seems to be to develop reforms which reduce the risk to investors to facilitate future investment.

Where the regulated revenues involved are substantial, there should be stringent requirements on information disclosure to allow the community to be assured that the regulator's decision is sound and valid and therefore that the costs are for efficient investment (a Code principle).

<sup>8</sup> The regulated costs involved in the provision of the PTS equates to over \$½ billion for each regulatory period, excluding any consideration of the regulated costs for provision of distribution services

There is scope for refinement of the information gathering processes so that smaller covered pipelines do not have impractical costs imposed upon them for the purpose of regulation of their costs.

### 3.5 Access Arrangements and 'Light-handed' Regulation

#### 3.5.1 Scope for Earlier Merits Review of Decisions

*58. Do you think there is scope to improve the effectiveness and timeliness of the access arrangement process providing for an appeal on the merits of a regulator's decision earlier in the process? What are the advantages and disadvantages of doing so?*

VENCorp is concerned at the potential increased costs arising from the suggestion that merits based appeals be applied *during* the process of consideration by the regulator. We understand that the objective is to assist with streamlining the process by avoiding dispute after the final decision is made, but are very concerned that this may extend the already lengthy process of the regulator even further and thereby impose far more costs in the normal processes prior to any appeal of the final decision.

There is an important trade off in this suggestion in regard to timing and thereby costs. Currently, appeal from regulator's decisions are permitted on errors in law. Allowing appeals on a merits basis throughout the process may just serve to increase the overall length of the consideration phase and the costs involved without providing sufficient corresponding benefits.

#### 3.5.2 Reference Tariffs

*59. Are the reference tariff objectives specified in the Code appropriate? If not, what improvements could be made?*

*60. Do the multiple objectives assigned to reference tariffs, and the discretion regulators have to make tradeoffs between them, lead to any problems? For example, has there been unnecessary uncertainty or inconsistency?*

*62. Is the level of prescription provided in the Code on reference tariffs appropriate? If not, should it be increased or decreased and why?*

*63. What, if any, improvements should be made in determining reference tariffs? Are clearer reference tariff principles required in the Code?*

*65. Should changes be made to the review procedures available for reference tariff decisions?*

The Code requires service providers to take a complete view of the implications of their tariffs. In particular, the Code requires a balanced and pragmatic view of any proposed tariff structure:

## **(a) General Principles**

8.1 Reference Tariff and Reference Tariff Policy should be designed with a view to achieving the following objectives:

- (a) providing the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering that Service;
- (b) replicating the outcome of a competitive market;
- (c) ensuring the safe and reliable operation of the Pipeline;
- (d) not distorting investment decisions in Pipeline transportation systems or in upstream and downstream industries;
- (e) efficiency in the level and structure of the Reference Tariff; and
- (f) providing an incentive to the Service Provider to reduce costs and to develop the market for Reference and other Services.

To the extent that any of these objectives conflict in their application to a particular Reference Tariff determination, the Relevant Regulator may determine the manner in which they can best be reconciled or which of them should prevail.

*Box 2 Section 8.1 of the Code*

## **(b) Allocation of costs between services**

"to the maximum extent that it is commercially and technically reasonable, the portion of total revenue... that a reference tariff should be designed to recover should include:

- (a) all of the total revenue that reflects costs incurred that are directly attributable to the reference service; and
- (b) a share of the total revenue that reflects costs incurred that are attributable to providing the ref service jointly with other services, with this share to be determined in accordance with the methodology that meets the objectives in section 8.1 and is otherwise fair and reasonable."

*Box 3 Section 8.38 of the Code*

## **(c) Allocation of costs between users**

"...a reference tariff should to the maximum extent that is technically and commercially reasonable, be designed so that a particular user's share of the portion of total revenue to be recovered from sales of a reference service is consistent with the principles described in section 8.38".

*Box 4 Section 8.42 of the Code*

## **(d) Conclusions**

Thus, it is clear that the Code currently requires a balance between the competing objectives of ensuring competition, (s8.1(b)), avoiding distorting investment decisions in pipeline transportation decisions in upstream or downstream industries (s8.1(d)), and that to the maximum extent that is technically and commercially reasonable (s8.42) the allocation is consistent with the principles of section 8.38.

It would be helpful to include more definition of the principles to be employed by the regulator when making decisions on the right balance to strike between competing objectives. However, we recognise that the level of prescription in this

area is itself a difficult balance to strike whilst still allowing scope to give meaningful effect to the principles embodied in the Code.

The tariffs are benchmark settings under the Code. However, the Code would benefit from a greater recognition that consideration of the proposed tariff structure and settings needs to be meaningful and practical, cognisant of the intended application, and ensures that the process itself isn't more expensive than the benefits it tries to achieve.

The resultant set of principles should assist the regulator in reaching any decisions on the right balance between competing elements of incentives to providers to offer access to the services, cost reflectivity, facilitation of entry to related markets (upstream and downstream), facilitation of competition and ensuring simplicity.

### 3.5.3 More 'Light-Handed' Regulation

#### (a) Elements of Access Arrangements

68. *Could a more light-handed approach continue to balance effectively the interests of all parties and provide a fully competitive, open and transparent third party access service on a non-discriminatory and economically efficient basis?*
70. *Are the current minimum requirements for access arrangements appropriate and effective?*
71. *What changes to the current minimum requirements would improve the prospects that the Code enables pipeline and/or network owners and operators to provide a fully competitive, open and transparent third party access service on a non-discriminatory and economically efficient basis?*

An Access Arrangement is a statement of the policies and the basic terms and conditions which apply to third parties that wish to utilise the relevant covered pipeline. The aim of the Code is to promote flexibility for commercial negotiation of the third party access, and the minimum requirements stipulated in the Code are relevant where a dispute over access arises, as this is only where they are binding.

We suggest that it may be more appropriate to have certain minimum requirements which are binding at all times, not just in a dispute over access. In most cases, service providers accept these minimum requirements up front in their Access Arrangements, so that this suggestion would probably have minimal impact on most providers and should therefore be pursued in the Code.

The Code requires that Access Arrangements include:

- services policy
- reference tariffs
- terms and conditions
- capacity management policy
- queuing policy
- trading policy (contract carriage only)
- extensions/expansions policy
- a review date.

The Code would benefit in some areas from greater definition of the objectives and requirements to be achieved in each area. This development will ensure that there is consistency and objectiveness of application, and just as importantly, increase clarity for applicants/service providers which will help them understand their requirements and possibly avoid need for disputation of a regulator's decision.

This would help to streamline the processes of regulatory approval. In addition, such clarity could provide much greater benefit to users so that they fully understand their rights and know what is required of the service provider, and are thus assured that the tariffs set by the regulator are value for money.

- For example, the requirements for definition of services could be improved, both in terms of definition of the minimum requirements and to improve processes in its application for joint service provision.
- The capacity management policy is simply a requirement for identification by the service provider as to whether the covered pipeline is either contract carriage or market carriage. Access to spare capacity is covered by the queuing policy. The trading policy (for trading of capacity) applies only to contract carriage pipelines. It may be more beneficial to co-join these policies and restate the requirements more generally in terms of the principles and objectives to be achieved in regard to capacity management. Both schemes of carriage need to be covered.
- Finally, there is no adequate definition of the requirements for balancing arrangements, which are currently left to the individuals to determine.

**(b) Service Provision – Joint Service Providers**

VENCorp and GasNet are joint service providers under the Code for provision of services on the PTS. GasNet owns the assets and VENCorp operates them. Services are allocated between the parties in accordance with relevant statute, and this is provided for by the Code. Each service provider is required under the Code to have its own approved Access Arrangement in place.

Joint service provision is a valid and effective manner of delineating service provision. The key requirements are that services are well defined, clearly delineated, and that the corresponding consideration of services and the associated tariffs are aligned and result in a consistent and efficient outcome.

It would be expected that joint service providers would be separate commercial organisations in most cases. This is the case in Victoria. This ensures ring fencing between operating the market and asset maintenance. It also requires the use of separate Access Arrangements, as each service provider can have very different strategic and commercial objectives and must have the right to commercial confidentiality from the other as in any normal commercial situation. The commercial incentives of each can be significantly different, and this will be highlighted by the differing services that each provides. However, there are direct linkages between them under the regime in the services that each provides for third party access to the assets.

This necessarily implies that joint application by the joint service providers, under a single Access Arrangement, and joint consideration by the regulator of the Access Arrangements of each, is problematic in practice. However, consideration

of the related Access Arrangements of joint service providers at the same time is critical. Consideration should also be given to establishing a minimum set of requirements which the Access Arrangements of all joint service providers must *collectively* meet.

The Code also provides that the joint service providers agree on the allocation of services between them under contract. It is silent on what should happen where this becomes unachievable. We feel that the Code would benefit from providing a better framework to encourage and facilitate agreement by joint service providers.

**(c) Service Provision – Definition of Services**

VENCorp believes that the minimum requirements for regulation of services is as important as regulation of prices/revenues under the Code. The services policy determines the minimum level of service that a user can rely upon under an access dispute.

The regulator has the power to make binding and enforceable decisions where relevant, subject to reasonable rights of appeal. However, where the regulator is required to impose requirements which *in their opinion* are required, the Code should ensure that this process is linked back to more concrete objectives.

It seems to us to be reasonable to require more definition of the minimum requirements that a service provider must provide in return for the (often substantial) regulated revenues. This is consistent with intent of Code, and its practical application would benefit from a more clarification to avoid uncertainties and assist with:

- the process of application to regulator and renewal of access arrangements for covered pipelines;
- the regulator's process of consideration of these applications;
- user's understanding of their rights and assurance to them of value for money.

**(d) Balancing Services**

There is no definition by the Code of the requirements for balancing arrangements, which are currently left to the individuals to determine. There has been some discussion of the desirability of common balancing arrangements and that the Code should be extended to cover this aspect.

Whether this is a matter of direct relevance to the provision of third party access on the relevant assets (and therefore the Code) is an open question. Most of the concerns expressed to date are competition issues, not access matters, and thereby not suitable for the Code.

In addition, the suggestion of the need for a common design for balancing arrangements is questioned. The need for a "standard market design" is not apparent, and would not serve the interests of the nation at this time:

- ***One shoe does not fit all***

Covered pipelines currently have different balancing arrangements. This is not a consequence of market carriage versus contract carriage, and applies equally to various covered pipelines operating under contract



carriage schemes. The different approaches to balancing appear to be perfectly legitimate and may well be more efficient at this time<sup>4</sup>. The variations are primarily driven by the physical realities involved in transportation and supply on each particular pipeline and the level of competitive reform in each area. For example, Victoria has a clear and strong need for urgent focus on within day balancing. Other pipelines do not, and daily and even longer term balancing arrangements are practical (and efficient) on these pipelines.

Imposing a standardised balancing approach which addresses the requirements of the Victorian system and its end users for within day balancing onto other pipelines which have no such inherent requirements would not be rational at this time.

Similarly, the amount of retail competition applicable in the relevant area varies from pipeline to pipeline. Imposing requirements to facilitate the needs of full retail competition on pipelines in areas which are not implementing full retail competition is unnecessary.

- ***The key is ensure that arrangements are compatible***

The core driver should be to ensure that the differences of the arrangements for each covered pipeline do not impede competition between them and the trading of gas across them. This does not require that the same design be applied to every pipeline.

The key requirements to meet this objective are:

- that the markets are competitive, and to what extent competition is realised in each market;
- the basic incentives and signals in each market are correctly formulated ; and
- the degree of flexibility (and freedom) provided in each market to allow participants to develop effective ways of trading across them.

***(e) Capacity management:***

The Code does not yet recognise well<sup>9</sup>:

- that capacity constraints should provide price signals to the markets for gas, and the secondary market for pipeline capacity is not well developed in Australia;
- the increasing volatility of the energy market, where shippers now demand contracts for firm service for periods as short as one year.

To some extent, these are also competition issues. However, some aspects of these matters are also important to the provision of access to third parties.

The increasing volatility is becoming more relevant with the growing reliance upon gas fired power generation to provide peaking supply in the electricity market. Peaking gas fired power generators bring exactly the kind of conditions that are

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<sup>9</sup> Max Kimber, in an article for Australian Gas Journal in June 2000

most problematic to address in pipeline operation and capacity management, and therefore the ability to offer access to the pipeline under the Code.

The Victorian market carriage regime is aimed at creating market-based price incentives for the management of constraints to directly addresses these issues. Schemes on other contract carriage pipeline aim to do likewise in one manner or another. But there is no real means of assessment of their usefulness or merits in this regard where the Code is silent on the requirements.

The existing elements relating to Capacity Management Policy, Trading Policy and Queuing Policy in the Code are, in reality, all addressing what is critical to obtaining access to the services on all transmission pipelines. In view of this, it may be better to wrap them all up into a single element relating to management of capacity on transmission pipelines and how users are able to obtain access to capacity on those transmission pipelines. The approach should be to define the essential requirements and principles which the capacity management policy is required to address. This statement of essential deliverables should be such that it is suitable for common application to contract carriage and market carriage transmission pipelines – the only difference between the two approaches is the manner by which these underlying objectives are satisfied.

The following principles ought to be included in the minimum requirements of the resultant capacity management regime:

- the arrangements should be such that capacity constraints provide price signals to the market and facilitate the development of efficient, market-driven approaches to the services of balancing and capacity management ;
- the arrangements should facilitate the development of secondary markets for trading of pipeline capacity;
- the arrangements should not preclude the long term contracting of gas by suppliers with their customers and the producers from whom they source gas, in the related downstream and upstream markets respectively;
- the arrangements should promote efficient use of the system by facilitating:
  - the development of firm capacity to support future investment in the pipelines;
  - effective access to spare and un-utilised capacity on a firm basis;
  - flexible and responsive access at short notice to un-utilised capacity on an interruptible basis; and
  - the requirements on access provision to service the increasing volatility of the energy markets, recognising the emerging growth in volatile gas usage as fuel for peaking gas fired power generation.

### 3.6 Other improvements – implications for electricity?

*78. Are there other necessary changes to the Gas Access Regime, its objectives and its application, to ensure uniform third party access arrangements are implemented and applied on a consistent, national basis?*

Particular focus should be applied to the need to ensure that the Code, which is currently (and understandably) “gas-centric”, better facilitates the requirements for reliable electricity supply and the National Electricity Market (‘NEM’).

The arrangements in the emerging national electricity market are different to the arrangements typically adopted around Australia for transporting and marketing of gas, including the spot market developed for gas transport in Victoria.

While each energy industry is highly inter-dependent and inter-linked at commercial and operational levels, the regulatory frameworks which govern them are independent and currently give no credible recognition of the strong dependencies between them. Each has its own Code and set of objectives which are not strongly aligned.

Typically, transportation arrangements for main gas transmission have been based on long term contracts, booking capacity for shipping requirements well in advance, locking in daily shipping orders with nominations before the day, and non-market based penalties for imbalances or over-runs. This is becoming increasingly unrealistic for serving the requirements of gas fired power generators in the NEM, particularly those required for peaking. Their operation has direct impact on the effectiveness of the ability of service providers to provide third party access to the pipelines.

Arrangements typically rely on a pipeline system which provides a large amount of spare un-utilised capacity (at least in an intra day profile sense) on the pipeline, thereby allowing the operator to use the linepack of the pipeline and the divergence between supply/demand profiles for managing the intra day swings for spike loads. Overseas (e.g. USA, France) the existence of large gas storages near load centres is also used for managing the spike loads. This is not necessarily the most efficient solution for Australia, and around the world the issue of managing rapidly varying demands created from gas fired power generators on transmission pipeline systems is becoming an increasingly recognised problem.

The arrangements for gas transportation need to be aligned with the needs for power generators operating in the NEM, including the peaking power generators. Victoria, like other places (e.g. PJM ) is developing a Demand Side Management response for addressing the supply/demand solution at the peak times in summer, and this is also likely to impact on the requirements for gas transportation as well as the electricity supply. Flexibility and responsiveness is the key in order to achieve satisfactory results.

As it is currently written, the operation of the Code does not adequately provide for consideration of the impacts it can have on investment in electricity supplies and the fully competitive market in operation of the NEM. It is clear that the reliability of electricity and the operation of the NEM are going to be increasingly dependent on gas fired power generation in the future, and the regime covering third party access to the gas transportation infrastructure which services those users will play a critical role.

There are growing dependencies of electricity supplies on gas and governments have already taken initiatives for a broader view of requirements for energy supply and the need for better alignment of gas and electricity arrangements. Access to the pipelines to ship gas from producer to the generators may become a critical issue very quickly if

not attended properly. This review should not be undertaken in complete isolation from the effects it may have on the NEM and therefore on the future security of electricity supply. This view is fully consistent with the findings of the CoAG Energy Market Review.

VENCorp believes that it is important to the long term security of overall energy supplies to take into account the potential consequences for electricity when reviewing the Code.

Alignment of the arrangements for gas and electricity offers many advantages, from synergy of operations, reduction in complexity across the two areas, and efficiencies for large retailers who operate in both (e.g. trading, retail customer systems). The arrangements for each energy industry should not be developed in isolation and the needs of peaking gas fired generation should not be ignored or de-prioritised.

Further, the alignment of arrangements (i.e. in terms of flexibility, responsiveness, and pricing) between gas and electricity would also assist in facilitating the development of the all necessary products for diversifiable risk. To the extent that there is non-alignment, it creates a potential for raising the costs for operating in both gas and electricity, in terms of systems and infrastructure for dealing with the differences in market arrangements and in usefully diversifying the risks.

This need for better alignment between the energy industries is especially important in terms of the requirements for Full Retail Contestability. However, again, alignment may not necessarily require identical trading arrangements or systems (and given the physical differences in gas and electricity transportation, alignment to this extent is unlikely to be possible), but should at least provide for consistent interfacing arrangements such that participants wishing to perform similar transactions in both the electricity and gas markets do not need substantially different business systems to do so.

## **4 Conclusion**

VENCorp supports the approach undertaken under the regime for access regulation and the application of it by the Code for regulation of essential and significant gas infrastructure. We have found it to be generally effective and practical in its application to date.

There are some aspects of the Code that would benefit from improvements, and this submission has made a number of suggestions in this regard. In particular, the Code would benefit from:

- better definition of the objectives and principles embodied in the Code, particularly where these are applied to the minimum requirements of an Access Arrangement of each covered pipeline;
- process improvements to make its application more efficient and lead to greater certainty with regard to regulatory outcomes;
- better recognition of the dependencies of competitive reforms in downstream markets (in particular, full retail competition) on the transportation arrangements and access to the services by third parties;
- more direct attention by the Code on the impacts and consequences of the third party access regime in gas on the long term reliability of overall energy

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supply. In particular, this review of the Code should recognise the role of gas transportation services to the efficient operation of NEM and reliability of electricity supply in light of the expectations of growing dependence on gas fired power generation for peaking services in electricity supply. Governments are keenly aware of this critical dependency, and the regime could be improved to better reflect the growing importance of an encompassing approach to energy supply.

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