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Gas Access Regime Inquiry
Productivity Commission
LB2 Collins St West
MELBOURNE VIC 8003

Dear Sir/Madam

SUBMISSION - REVIEW OF THE GAS ACCESS REGIME

Please find enclosed CS Energy's submission on the 'Review of the Gas Access Regime'.

The information contained in this submission is not confidential.

Please contact Mr Ron Roduner if you would like to discuss our submission.

Reliably Yours

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CHIEF EXECUTIVE

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**REVIEW OF THE GAS ACCESS REGIME
PRODUCTIVITY COMMISSION**

**ISSUES PAPER
JULY 2003**

CS ENERGY SUBMISSION

Introduction

CS Energy is the largest gas consumer in the State of Queensland. It purchases and transports gas for use as a fuel in the generation of electricity under the National Electricity Market (NEM) in its Swanbank E Power Station southwest of Brisbane and at its gas fired power station at Mt Isa, the Mica Creek Power Station (MCPS).

CS Energy directly holds a transportation agreement on the Roma to Brisbane Pipeline (RBP) and uses gas at MCPS that is transported by our supplier on the Carpentaria Gas Pipeline (CGP). In addition, CS Energy has entered into arrangements for the proposed PNG Gas Project.

CS Energy expects that its use of gas for electricity generation will increase substantially from 2005 onwards due to the Queensland Gas Electricity Certificate (GEC) regime and the electricity demand growth in Queensland.

CS Energy has supported the development of the emerging coal seam gas industry (GSG) as well as traditional natural gas suppliers. We believe that an efficient gas transmission network is required to increase the efficient utilisation of gas in Australia.

Pipeline infrastructure is for the common good

CS Energy considers that pipeline infrastructure is for the common good hence CS Energy supports consideration for a fundamental rethink of how gas markets are formulated. The Access regime for electricity, has delivered a very competitive market based on open access principles. A rethink in the gas market should be considered to determine if it could deliver similar outcomes. Clear and open access is critical to ensure that transport or pipeline charges (25% of the cost structure to end use customers) do not determine the nature of the competition at a wholesale or retail level. The creation of published spot purchase prices in electricity has facilitated risk control by using primary and secondary market trading.

Pipeline regulation should be pro competitive

Pipeline owners should be restricted from operating in the upstream or downstream (including retail or wholesale) sections of the gas market.

As gas is increasing its market share in electricity generation, pipeline regulation should be pro competitive and should not distort the competitive position of gas-fired generation compared to other generation fuel sources.

CS Energy considers that for balanced interests to exist between pipeline owners and pipeline users, then the principles of open access together with standard terms and conditions should be available to all. CS Energy is concerned that it, and other Gas Users, will not be able to negotiate with equal authority with a gas transmission pipeline owner if there is light handed regulation such as exists now and if there is not a firm set of detailed principles to be followed.

The CS Energy experience in other infrastructure markets indicates that when monopoly infrastructure owners create a contracting structure that does not resemble the actual physical flows then there is allocative inefficiency. This is demonstrated by the differences in approach to electricity transmission between the US and Australia where the US system of physical transfer creates difficulties in transaction creation. This does not occur in Australia. As a principle, pipeline owners should not be able to influence the competitive dynamics between upstream and downstream suppliers and users. It is debateable whether the current contracting structure of unidirectional haul contracts provides the best contract structure for the pipeline users. A market structure review could be used to investigate alternative structures.

Open access principles to apply

Increased gas transmission pipeline infrastructure with full open access principles applied should lead to a more efficient and competitive gas market.

As an investor in potential gas fields and as a User of gas, CS Energy is supportive of the aims of the gas transmission pipeline owners for clarity, certainty, uniformity and simplicity. CS Energy does not consider that the existing market concept and regulatory environment has lead to the most efficient upstream and downstream markets in gas, as pipeline access is not simple nor clear.

CS Energy supports the principles of open access using any delivery/receipt points, and revenue caps for pipeline owners. For an efficient market the Reference Services and Tariffs should be available as a published maximum rate for standard Reference Services. All gas transmission pipelines should be required to offer a minimum of services (a greater range than now exists) with a common basis for determining the Tariff. Access principles should be published and debated prior to pipeline construction.

Giving end gas users effective ability to purchase gas ex field, ex processing plant, delivered or from another intermediary, should assist in increasing competitive pressures. In essence, a mechanism is needed to limit the ability of a gas supplier to only offer “bundled” (delivered) gas to an end user. Transportation costs should be separately identifiable, clear and available to all potential suppliers and users.

Downstream competition either in the wholesale gas market or in the retail gas market would be more effective if there were mechanisms in place, such as mentioned above regarding pipeline access. Existing long-term arrangements by wholesale/retail gas companies and existing gas transmission and distribution network owners has limited the ability of new participants to enter the market.

As a principle, competing entities in supply or end use should not be able to hold positions in the gas pipeline infrastructure otherwise the principles of open access are not followed. Competitive and regulated sectors should not be co mingled. Existing arrangements for gas processing plants and gas transmission pipeline capacity would need to be considered as part of the market redesign. It is best to consider alternative market structures now and make the changes now prior to the development of further gas pipeline infrastructure and the further entrenching of the current principles.

Regulatory considerations

Consistency between states for access principles and transportation services as well as consistency between legislative elements will provide greater certainty for investors in gas development as well as gas transportation.

The development of a new regulatory regime whose aim is to increase competition and market efficiency will face opposition from existing and new participants. Having a clear, cost effective, methodology to address inconsistencies and unexpected outcomes of such new regulations would be beneficial to reducing the regulatory risks associated with any proposed changes.

The regulatory review period for all gas transmission pipelines could have a 3-5 year earnings review with excessive profits returned to existing pipeline users under an established formula. The intent should be such that the gas transmission pipeline owner/operator is not able to exert monopolistic pricing power once this infrastructure is in place.

CS Energy believes that gas suppliers and the gas users need to have input into any proposed Access Principles and Regulated Services before any gas transmission pipeline obtains approval or is constructed. Gas production costs represent a high portion of the costs to customers so gas producers should have the prime say along with the gas users into the access principles and regulated services structure and charges. The unbundling of gas transportation from the gas suppliers will allow the end gas users to aggregate in any manner that suits their needs and not that of the gas supplier or transporter. This is a fundamental principle as it is the end users who pay the cost of gas production and transportation.

The regulations require clarity in defining how pipeline expansions or extensions could be undertaken and what the impact of such expansions or extensions would have under the Reference Service. There should be a regulatory mechanism that allows new gas transmission pipelines (or laterals) to be connected to existing gas transmission pipelines under a regulated charge and without undue technical or commercial interference. Connection point locations should be at the choice of the gas producers and gas users.

Having open and clear charges for minimum levels of service is an essential requirement to ensure that there is an efficient market for any monopoly infrastructure asset. This mechanism has worked well in the electricity market. Having similar regulatory principles between gas transportation and electricity transportation is necessary so that different regulatory regimes do not create artificial cost structures and operating differences so that one energy form is preferred over another.

The current market mechanisms allow the Transportation Provider to obtain additional revenue when Shippers undertake gas trades within the gas transmission pipeline. This

should not be applicable unless there is a clear operational cost impost. A Service Provider should provide service to the pipeline users to input gas and to take it out of the pipeline. A market based on published dispatch criteria for gas suppliers, similar to electricity market dispatch, will give all suppliers equal opportunity to compete in the spot market and allow for long term gas contracts to be struck between gas supplier and gas user. The publishing of market prices provides a basis for the establishment of a secondary hedge market to control the risks of spot price fluctuations.

Since the gas transmission pipeline connects into distribution networks they should be treated in a like manner. In the future, CSG gas fields may connect directly into gas distribution networks and therefore it seems appropriate for the maintenance of a competitive market in natural gas that these two pipelines be regulated in a like manner.

Major Gas Users can spend much more capital in plant than the gas producer and gas transmission pipeline combined. Gas Users need assurance that their long-term capital investments are not held to ransom by parties along the supply chain. The cost of transport is approximately 25% of the total supply cost to gas customers and hence the regulatory structures should not allow the “tail to wag the dog”.

The Ministerial Council on Energy provides a mechanism for the states and commonwealth to provide energy policy for electricity and gas. This is the appropriate mechanism.