

THE GAS ACCESS REGIME

**QUEENSLAND GOVERNMENT
SUBMISSION TO THE PRODUCTIVITY COMMISSION**

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**Queensland
Government**

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1. EXECUTIVE SUMMARY

The Queensland Government supports the need for a National Gas Access Regime (Regime), which should be clearly defined in a National Third Party Access Code for Gas Pipeline Systems (Code) and in legislation. The current access regime appears to have successfully established a broad framework for regulating access to natural gas pipelines infrastructure, which is generally supported by due process. Similarly, the Code's introduction identifies objectives which, of themselves, remain desirable and uncontroversial. However, while the Regime appears to have been effective in providing a framework for access regulation, there appears to be widespread debate as to the extent to which that framework is, in practice, achieving appropriate outcomes in the industry.

This debate has focused on the potential for the Regime to impose a range of short-term and long-term costs on the community, including:

- (i) regulatory risk, and the perception of regulatory risk, which has the potential to increase the cost of capital to pipeline developers or result in inefficient infrastructure service delivery; and
- (ii) regulatory processes which impose significant delays and financial costs on participants which must ultimately impact on users.

Queensland has a growing gas market, based in large regional industrial and mining centres that are removed from gas supply sources, that is reliant on gas transmission pipelines to access gas supplies. Investment in pipeline infrastructure has encouraged the development of field on field competition between conventional and coal seam gas producers. Further investment in pipelines is proposed to bring offshore gas to the State from either PNG or the Timor Sea. The State still has much to gain from encouragement of investment in the pipeline system given the need for greenfields pipeline infrastructure to sustain the development of these gas markets.

In this context, the Queensland Government is acutely aware of the need for a regulatory environment that encourages investor certainty and is concerned that the current Regime has the potential to deter or delay investment or increase the cost of capital for this important industry.

Based on the experience gained over the past six years of third party access regulation, the key issues of concern to the Queensland Government include:

- the need for sufficient incentives for major expansions and extensions of existing pipelines and construction of new pipelines to be included in the Regime, especially where these allow for the development of 'greenfields' projects or industrial precincts, linkage of existing markets, or innovative offerings by service providers that respond to customer requests for greater levels of service;
- the potential for the regulatory Regime to result in construction of 'fit for purpose' pipelines that do not optimise efficiency in investment; and
- the failure of the first round of regulatory reviews and legal appeals to result in a convergence of views on a number of key issues.

Queensland supports changes to the Regime which increase investor certainty (particularly in relation to the construction of spare capacity) and make the Regime simpler to use. In particular, changes are supported which provide:

- greater clarity of the Code in relation to investment objectives;
- upfront regulatory certainty for new investment (including major expansions or extensions); and
- options for the regulator to adopt less costly forms of regulation.

The Queensland Government notes that a number of key recommendations have already been proposed through the Commission's Review of the National Access Regime and the Council of Australian Governments Energy Markets Review.

The Queensland Government recognises the value in these recommendations to both users and pipeline service providers and encourages the Productivity Commission to give further consideration to these issues.

The Queensland Government also requests the Productivity Commission consider alternative regulatory approaches such as:

1. the extent to which it may be possible to apply price monitoring forms of regulation which may ensure appropriate and efficient price outcomes and transparency while reducing the intrusiveness, complexity and cost of regulation; and
2. concepts, apart from those mentioned above, that may encourage the development of spare capacity to support wholesale gas market competition. One such concept discussed in this submission is a 'hybrid' pipeline whereby a portion of pipeline capacity would be reserved for short-term trading in a wholesale gas market. This portion of the pipeline would operate under a regulatory environment that reflects the risk to the pipeline owner/operator in providing services to this developing wholesale market.

2. INTRODUCTION

The Queensland Government welcomes the Productivity Commission’s review of the Gas Pipeline Access Regime as a timely opportunity to review the framework governing third party access to gas infrastructure in Australia. The experience gained over the past five years of third party access regulation enables each stakeholder to evaluate the objectives, impact, and effectiveness of the framework for consideration by the Commission. This review also enables consideration and, where relevant, incorporation of some of the key recommendations of the Commission’s Review of the National Access Regime and the Council of Australian Government Energy Markets Review.

Queensland is a large state with a dispersed population growing faster than any other Australian state or territory. The State’s gas market also continues to grow rapidly, with gas consumption in Queensland projected to increase between 5-7 percent per annum (ABARE, 2002¹). The rapid growth in the State gas market has been given impetus by Queensland Government initiatives such as the 13% Gas Scheme and the base load gas-fired power station development at Townsville to be supplied from coal seam gas fields in the northern Bowen Basin. This market development has been regionally based around major manufacturing and mineral processing centres at Gladstone, Mt Isa, and Townsville as well as Brisbane. However, these market centres are distant from the State’s major conventional gas fields in South West Queensland which currently supply over 60% of the State’s gas demand.

Queensland’s markets are serviced by four major transmission pipelines:

Major Transmission Pipeline	Date Commissioned	Owner/Operator
Wallumbilla (Roma) to Brisbane	1969	Australian Pipeline Trust and Interstate Pipelines and operated by Australian Pipeline Trust
Wallumbilla to Gladstone	1989	Duke Energy
Ballera to Wallumbilla	1996	Epic Energy
Ballera to Mt Isa	1998	Carpentaria Gas Pipeline Joint Venture - operated by Roverton Pty Ltd.

NB AGL and Petronas Australia hold a significant unit holding in Australian Pipeline Trust – refer <http://www.pipelinetrust.com.au> ; The Carpentaria Gas Pipeline Joint Venture includes AGL (approx. 70%) and the South West Queensland Producers (approx. 30%).

In 1969, with the commissioning of the Roma to Brisbane pipeline, Queensland was serviced by 440 kilometres of gas pipeline. By 2004, this will have risen to 3,600 kilometres. The next step in pipeline growth could require a further increase of more than 50 percent, or a further 1,800 kilometres of pipeline to bring offshore gas to the State’s market.

¹ ABARE (Fainstein M., Harman J., and Dickson A.) August 2002 “*Australian gas supply and demand balance to 2019-20*” p30

The commissioning of three major transmission pipelines between 1989 and 1998 drove gas demand in Queensland from an annual consumption of approximately 22 petajoules in 1990 just after the commissioning of the State's second major transmission pipeline (Wallumbilla to Gladstone) to an expected level in excess of 95 petajoules in 2003.

Market growth throughout the 1990's was met by the development of new conventional gas supplies in South-West Queensland and, more recently, by the development of conventional gas and coal seam gas (CSG) fields in the Surat and Bowen Basin in southern and central Queensland. Contracted CSG production in Queensland commenced in 1997 and, in 2003, is expected to supply approximately 25%-30% of Queensland gas demand. By 2004, it is expected Queensland CSG explorers will be producing approximately 40 petajoules of gas. The viability of Queensland's CSG fields has been enhanced by their close proximity to existing pipeline infrastructure and available pipeline capacity.

The increase in CSG development has spurred field on field competition over the last five years. Proposals to deliver gas from PNG and the Timor Sea have also been progressed through commercial negotiations with significant customers and the potential to deliver gas to Queensland from the North West shelf has been mooted. These projects have the potential to further increase field on field competition, but will also involve the construction of major new gas pipelines.

Investment in transmission pipeline infrastructure with capacity for growth has facilitated field on field competition and further investment will be required to allow the Queensland market to continue to evolve on a competitive basis. The history of Queensland's gas industry development has shown that Queensland has much to gain from encouragement of investment in greenfields pipeline infrastructure and expansion of existing gas pipelines.

In this context, this submission aims to:

- highlight a number of issues of concern to the Queensland Government regarding the Regime;
- state its in-principle support for a number of key recommendations from recent reviews commissioned by COAG; and, where appropriate,
- propose potential solutions for further investigation through the Productivity Commission's Review.

3. ISSUES

3.1 Potential Impacts on Investment

3.1.1 Incentives and Investor Certainty

Queensland agrees with the Commission's stated view that 'the paramount concern is the potential for access regulation to deter investment in essential infrastructure'. Deterring investment can have significant impacts on upstream and downstream competition, and hinder development of an efficient gas market. An access regime should therefore recognise this and accommodate the benefits of erring on the side of encouraging over-investment (as opposed to under-investment) in gas networks.

To encourage investment, the Queensland Government is aware of the need for a regulatory environment that both:

- fosters investor certainty; and
- allows pipeline investors to earn returns commensurate with the risk undertaken.

There is currently widespread concern among investors that the regulatory regime does not provide them with sufficient regulatory certainty. This has the potential to deter and delay investment or increase the cost of capital for the pipeline industry, and may therefore restrict development of upstream and downstream markets.

Practical Example 1

Epic Energy appealed the Draft Decision by the Office of Gas Access Regulation in Western Australia on the Dampier to Bunbury Natural Gas Pipeline (DBNGP) and is currently considering a challenge to the second draft decision by the Office of Gas Access Regulation following the initial decision by the Supreme Court.

Delays in reaching a regulatory decision and disputes regarding that decision over the past 18 months has led to Epic deferring further expansion of the pipeline subject to resolution of existing regulatory issues and associated financial implications. It has been reported that this delay will constrain the ability of the pipeline to meet customer demand or result in potential energy shortages within the market.

The potential for energy shortages brought about by constrained pipeline capacity have reportedly prompted a consortium of major shippers on the DBNGP, Alinta, Wesfarmers and Alcoa World Alumina Australia to enter into discussions regarding their options to purchase the pipeline.

There is also concern that the Regime needs to further encourage greenfields investments and provide the Regulator with additional flexibility in considering the risk attached to such developments, particularly where extra capacity is required to allow markets to grow and mature.

Industry bodies such as the Australian Pipeline Industry Association and the Australian Gas Association have suggested that the Regime lacks incentives for such investment. If there are inadequate incentives to encourage new pipeline infrastructure investment by specialist pipeline infrastructure companies it is likely that new infrastructure will increasingly be developed or procured by other parties in the supply chain. The Productivity Commission may wish to consider the extent to which user and supplier participation is desirable from the perspective of upstream and downstream competition.

Practical Example 2

Specialist pipeline developers withdrew from the construction of the South East Australia Gas (SEAGas) Pipeline.

The pipeline is now being constructed ‘fit for purpose’ by the SEAGas company, a joint venture of International Power, Origin Energy and TXU, to supply gas to each of their parent entities’ power generation facilities in South Australia.

Essentially, a regulator should consider all the economic benefits to the community of a project which may be undertaken by the private sector. This is because where market-based returns (based on project risk) are constrained by a regulated return, projects may become non-commercial, even though they may still be economically viable from the community’s perspective.

There is no question that pipelines have been constructed, as well as bought and sold, since the introduction of the Code. However, an important question remains, are the current returns and regulatory mechanisms under the existing Regime appropriate to ensure the future investment which is required?

3.1.2 ‘Fit for Purpose’ Pipelines

Unwillingness by specialist pipeline service providers to commit to expansions and new pipelines, together with pipeline construction being undertaken or planned by upstream and downstream users (“fit for purpose”) in order to facilitate their businesses may indicate that there is a problem with the Regime. (See Practical Example 2 in previous section).

Investment in gas assets requires a long term view from both the investor and the regulator. A “fit for purpose” pipeline is an efficient result where there is no potential growth in load. Where incremental growth is expected, a “fit for purpose” pipeline may represent inefficient delivery of infrastructure as each expansion of the infrastructure faces a threshold cost level for additional pipeline facilities (compression or looping) and must incur effective duplication costs.

For instance, in the case of looping, such costs are associated with corridor development and laying of pipe. The ultimate consequence of a regime in which only “fit-for-purpose” pipelines are constructed is that it may deter investment by pipeline companies, increase the likelihood that investment, development and operation of pipelines will be facilitated by parties with a position in either the upstream or downstream industry (or their subsidiaries) and stifle the development of wholesale gas trading.

An effective regime will encourage pipeline developments in optimal locations and along optimal routes to maximise the opportunity for users to connect. Therefore, the Regime should recognise that a pipeline may be built in anticipation of new customers and may take a route that allows potential new customers to connect, rather than the most direct route to an existing market.

3.1.3 Upstream and Downstream Competition

The most significant implication of ‘fit for purpose’ pipeline systems is that the cost of increasing capacity can, intentionally or unintentionally, frustrate competition in upstream and downstream markets. This presents a considerable risk for developing and immature markets, like Queensland’s gas market, dampening their development. Conversely, overbuilding networks can have significant advantages since it encourages new entrants to, and facilitates competition in, upstream and downstream markets, albeit at a risk to the investor. This situation is reflective of pipelines currently in operation in Queensland.

There has recently been positive evidence of the development of upstream competition in Queensland, where the rapidly developing coal seam gas industry is providing field on field competition. The development of this industry has directly benefited from the capacity of pipelines such as the Wallumbilla to Gladstone Pipeline which, along with the other recently built greenfields transmission pipelines in Queensland, has the following access characteristics:

- reference tariffs based on estimated returns on equity of between 13% and 16% (post tax nominal)²; and
- review periods of between 20 and 25 years, or when nominal capacity is reached.

These access terms undoubtedly provided the original investors with a level of security/risk which weighed in favour of investment – and, more importantly, in favour of investment in spare capacity which has subsequently enabled upstream competition to emerge.

The access terms approved reflect the Queensland Government’s view that the regulation of greenfields infrastructure development must provide appropriate incentives to build spare capacity to supply market growth in order to encourage upstream and downstream competition.

It is desirable that the Regime provide incentives for innovative offerings by infrastructure owners and the ability to respond to customer requests for greater levels of service. Unless infrastructure owners are allowed to develop and offer service innovation to customers with appropriate cost recovery, the industry will be constrained in its development and ability to meet customer requirements.

² These figures are based on an assessment by the ACCC in 2000 as part of the NCC’s assessment of the Queensland Gas Pipeline Access Regime. The corresponding return on total funds employed are between 9.3% and 10.6%.

Practical Example 3

1. The Wallumbilla to Gladstone (Duke) gas pipeline traverses the Surat Basin coal fields and the rapidly developing Queensland Coal Seam Gas (CSG) industry. At the time of construction of the pipeline, significant spare capacity was included with the expectation of future growth of the Gladstone Industrial Precinct.

If each of the current CSG producers on the pipeline, or their potential customers, had been required to contribute the effective cost of duplication, it is doubtful the coal seam gas industry in Queensland would have reached its current stage of development. Industrial development in Gladstone would also have been severely constrained as projects that are now a reality may have been driven offshore.

2. The Ballera to Wallumbilla (Epic SWQ) pipeline was also built with significant spare capacity. It will be this capacity that facilitates the flow of CSG produced in Queensland to the NSW market, providing new competitive supply outcomes for producers and downstream market participants.

At present, the effect of network investment on up and downstream competition is a contentious debate within the National Electricity Market (NEM). In particular, the Australian Competition and Consumer Commission (ACCC) is reviewing the Regulatory Test. The Regulatory Test effectively decides whether a proposed network investment should be able to earn a regulated revenue stream from the market.

An important aspect of this review will be deciding whether the competition benefits resulting from network investment should be recognised within the test. That is, whether transmission investments should be allowed to earn a regulated revenue stream on the basis of improving competition between generators. The majority of end-users and retailers in the NEM are supportive of such an approach.

In this context, the Productivity Commission may wish to consider whether the upstream and downstream competition effects of building spare capacity within gas pipelines should be further recognised by regulators.

3.2 Transaction Costs

3.2.1 Review Processes

There are significant transaction costs in the administration of the current Regime for participants in terms of both compliance and interaction with the regulator. Proponents complain of a lengthy period covering 18 months to 2 years of submissions and information provision prior to achieving a decision. This is inconsistent with the envisaged time frame of six months provided for in section 2.21 of the Code and creates an industry “on hold” while awaiting decisions.

The delays experienced in regulatory processes have been due to a combination of factors, including:

- the intrusive and information intensive nature of the ‘building block’ form of regulation;
- disputes over information required by regulators;
- the relative infancy of the regulatory regime (with stakeholders and regulators inexperienced with a new regime); and
- in some cases, the complexity of the issues under consideration.

Queensland considers that, over time, movement towards less intrusive forms of regulation should be pursued provided such approaches can significantly reduce the costs of regulation.

Regulatory decisions must be made in a timely manner as delays, disputes and litigation can extend the required timeframes for investment. Timely investment in greenfields pipelines, upgrading of existing pipelines and adequate allocation of funds to operational and maintenance issues are essential for certainty of supply and continued development of the gas industry. Based on industry experience, it appears a period of approximately six years is required from exploration to production of gas. A regulatory decision-making process that takes approximately one third of this time (2 years) has the potential to significantly delay market access to gas.

A lack of clarity in the Code, regarding provisions relating to the collection of information by regulators, has been identified both by industry and the National Gas Pipelines Advisory Committee (NGPAC) as contributing to delays and conflicts in access arrangement reviews.

In the first round of access arrangement reviews, uncertainty regarding the extent of the regulator’s powers to require accounting information from service providers appears to have led to delays in the provision of information for review. The tradeoff between ensuring adequate information flows to the regulator and the cost of collating such information is a fine one. Given Australian Governments’ overwhelming endorsement of energy market reforms, which included the introduction of a national gas code to ensure efficient pipeline operations, monopoly pipeline owners operating within the current policy context should expect to operate within confines of economic regulation. This means pipeline owners should be fully aware of economic concepts of efficient pricing and collate information relevant of their own accord. Collecting such information should evolve to become a natural business process of any monopoly, being comparable to a business collating accounting data for tax or corporate governance requirements.

However, it is important that regulators also recognise the financial and other costs of information collection. Regulators should make appropriate efforts to harmonise their information collection requirements and execute their powers with restraint.

Regulatory convergence and the development of a body of precedents may occur, reducing the cost of compliance in the second round of access arrangements. However, improvements to the current regime will need to be effected in a timely manner if these costs are to be reduced. On this basis, the Queensland Government encourages the Commission to consider more innovative approaches to economic regulation which reduce the cost of regulation benefiting all involved in the gas industry.

3.2.2 Arbitration and Legal Appeals

The current regime has been characterised by a considerable amount of litigation, much of which relates to fundamental regulatory issues such as coverage (See Practical Example 4 below) and the scope of tariff reviews (See Practical Example 1 –section 3.1.1 above).

One of the more concerning aspects of the extent of litigation associated with the current regime is that the ‘Test Cases’ do not appear to have resulted in resolutions, ‘precedents’ or ‘bedding down’ of the Regime in practice – nor does there appear to be an emerging convergence of views on the ‘balance’ between interests under the Gas Access Regime.

Practical Example 4

1. Eastern Australian Pipeline limited (EAPL), a wholly owned subsidiary of the Australian Pipeline Trust (APT), applied in June 2001 for revocation of regulatory coverage of the Moomba to Sydney gas pipeline. This followed the earlier exclusion of coverage of Duke’s Eastern Gas Pipeline (EGP) by the Australian Competition Tribunal. Both pipelines transport gas to Sydney markets. The National Competition Council recommended against the revocation of coverage in a decision which took 18 months to achieve and was criticised by APT as “unjust and flawed”. The matter remains unresolved at this time.
2. The EAPL dispute followed Duke’s protracted legal challenges to effect exclusion of coverage on the EGP. The National Competition Council’s recommendation that the EGP should be covered by the Code was the subject of a successful appeal to the Australian Competition Tribunal.

4. POTENTIAL SOLUTIONS

4.1 Clarity of the Code

4.1.1 Objectives

The lack of clarity in the objectives within the Code may be contributing to a lack of balance between investor incentives and short-term pricing objectives. In its application, the Regime appears to provide insufficient recognition of the need to foster development of the market, which requires investment in greenfields infrastructure and the expansion of existing pipelines.

In its Review of the National Access Regime (NAR), the Productivity Commission argued that regulation is about ensuring access is not denied (either directly or indirectly through pricing) rather than replicating competitive outcomes. The Commission stated “the paramount concern is the potential for access regulation to deter investment in essential infrastructure’. Additionally, “access regulation must recognise the potential cost of a ‘surgical’ approach to rent removal and encourage regulators to focus on the more modest objective of reducing demonstrably large rents from inefficient pricing or denial of access”.

As part of its NAR Review, the Commission recommended that an objectives clause be incorporated in Part IIIA of the *Trade Practices Act (TPA) 1974* emphasising the need to encourage investment. Queensland endorses this recommendation.

Likewise for the Code, Queensland considers it may be beneficial for it to contain clear objectives which recognise the need for investment. Queensland considers that an appropriate objective of the Code may be:

“to promote economically efficient use of, and investment in, essential infrastructure services”.

This was the first of two objectives recommended by the Commission to be incorporated within Part IIIA of the Trade Practices Act 1974. This objective would ensure consistency between the Code and Part IIIA.

4.1.2 Information Collection Powers

The Queensland Government recognises the need for improvements in the amendment processes for the Regime to ensure the regulatory environment remains responsive to changes in the gas market.

The Queensland Government requests that the Productivity Commission consider reviewing the current Code change process.

4.1.3 Coverage Criteria

Queensland agrees with the Commission's view stated in its National Access Regime Review that regulation should be confined to "situations where significant monopoly power is likely to be present". On this basis, the Queensland Government suggests that it may be beneficial for the coverage criteria within the Gas Code to be narrowed. In particular, that section 1.9(a) of the Code could be amended as follows:

*"that access (or increased access) to Services provided by means of the Pipeline would promote **a substantial increase in** competition in at least one market (whether or not in Australia), other than the market for the services provided by the means of the Pipeline."*

This is consistent with the Commission's recommendation in its Review of the National Access Regime that Clause 44G(2)(a) of the *Trade Practices Act 1974* be amended. Such an approach could ensure consistency between the generic regime's declaration criteria under Part IIIA and coverage criteria under the Code.

4.2 Upfront Regulatory Certainty

Upfront regulatory certainty is a precursor to investment in capital intensive assets like gas pipeline systems. As a further incentive for investment and development of the gas markets, major expansions and extensions of existing pipelines should also be able to apply for and be treated in the same way as new investment. Such expansions and extensions should qualify where they allow access for the development of greenfields projects or industrial precincts, or link existing markets.

Significant progress has already been made in identifying areas of the Regime that need refinement in order to provide upfront regulatory certainty and improve the current Gas Access Regime. The Queensland Government notes that a number of key recommendations have already been proposed through the Commission's Review of the National Access Regime and the Council of Australian Governments Energy Markets Review. These include:

- *Binding Rulings*: Code to be amended to enable proponents of new pipelines to seek a binding ruling from the National Energy Regulator (NER) on coverage under the Code prior to construction; and
- *Up-front regulatory agreement*: the proponent of a prospective pipeline can enter into an up-front agreement with the NER prior to construction, locking in a key number of regulatory parameters for extended periods of time.

The Queensland Government recognises the value in these recommendations to both users and pipeline service providers and encourages the Productivity Commission to give further consideration to these issues.

4.3 Alternative Regulatory Options

The Queensland Government requests that the Productivity Commission give consideration to innovative and more light-handed approaches.

4.3.1 Price Monitoring

The National Competition Council (NCC), in its submission to the COAG Energy Market Review, considered an option for pipelines to become subject to price monitoring when there is some doubt over whether they meet the coverage criteria. If such an approach was adopted, it would be necessary to ensure that:

- demands are placed on the pipeline owner to publicly disclose prices, information on available capacity and limited cost information;
- strict demands are placed on the pipeline owner to provide independently audited regulatory accounts (containing full information on cost allocation, asset valuation etc.). This would assist the regulator in overcoming problems associated with information asymmetry; and
- there is a strong degree of predictability in the approach regulators use to determine whether a monopoly is abusing its market power (by way of earning excessive returns, cross-subsidising or would be earning an excessive return if it were not operating inefficiently). Therefore, the triggers for coverage and intrusive regulation would be reasonably predictable. Queensland considers once a body of regulatory determinations under the Code demonstrate a fair degree of consistency across regulatory decisions, then movement towards a price monitoring regime may be warranted.

By emphasising threat, over application, of regulation, a price monitoring regime may reduce the intrusiveness, complexity and cost of regulation while ensuring pipeline tariffs are based on efficient costs.

Ensuring the adequacy of information flowing from pipeline owners to regulators and the public (ie. through regulatory accounts, price and capacity information etc.) would provide the most significant hurdle to implementing such a regime. Queensland also recognises that caution needs to be applied to such approaches given that it is also possible that such an approach may result in inappropriate price outcomes to users, higher regulatory transaction costs or, more costly regulation and additional risks for investors in greenfield developments.

The Queensland Government suggests the Commission give consideration to this issue including whether a price monitoring regime may be a suitable form of regulation to apply to some *existing* covered pipelines. At this stage, the Government does not endorse a price monitoring model per se, but recommends that such light-handed approaches should be robustly considered within the context of this review given their potential benefits.

4.3.2 Hybrid Pipelines

An efficient wholesale trading market offers many advantages to gas users and producers, as well as providing opportunities for pipeline owners to provide expanded market services. However, the current regime appears to encourage asset owners to invest in long term, fully contracted pipelines in order to recover the asset value. This has the potential to stifle the development of an efficient wholesale gas trading market.

For major gas users, a wholesale gas trading market provides the opportunity to source the base portion of their load using a long term supply contract and the 'peaking' portion of their load in a traded market. This means that users do not have to pay on an ongoing basis for capacity that is used intermittently. A wholesale gas market also provides the user the opportunity to sell excess contracted volumes, thereby lowering take-or-pay risk.

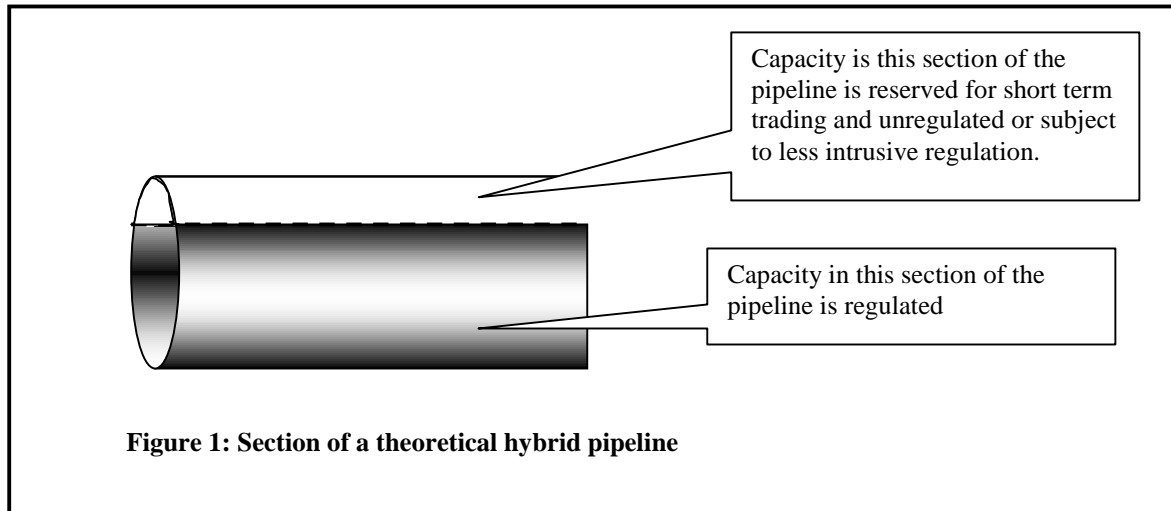
For producers, it provides the opportunity to trade excess production capacity. More importantly, for new producers (particularly CSG producers), it provides the opportunity to enter the market in a small way, trading produced volumes into the wholesale market as the production wells are drilled. In this way, cash flow is obtained earlier in the project, without a long term supply contract and associated obligations. Consequently, the development of a wholesale spot market has the potential to support new entrants to the gas supply market and enhance their financial viability at the early stages of production. By supporting the viability of new gas producers at the start-up stage, a spot market has the potential to increase the number of competitors in the upstream supply industry.

The Queensland Government requests the Productivity Commission examine ways in which the Regime could assist in providing a regulatory environment that encourages the development of an efficient wholesale gas market. The following concepts are offered to promote discussion on this subject.

Capacity Reserved for Short Term Trading

An efficient wholesale gas market requires access to pipeline capacity. This submission has already discussed the advantages of allowing 'greenfield' pipeline developments the ability to build with spare capacity. However, it may be possible to develop a regulatory mechanism which encourages pipeline owners to nominate a portion of pipeline capacity that would be permanently reserved for spot and short term trading, while allowing the pipeline owner to be appropriately rewarded for the risk of non-contracted capacity.

This concept could be described as a hybrid pipeline, with a separate regulatory approach taken for two 'virtual' segments of the physical pipeline capacity. The portion not reserved for short-term trading would be covered by the Gas Code and regulated like other significant monopoly infrastructure. However, the portion which the pipeline owner has explicitly reserved solely for short-term trading would be 'entrepreneurial' and unregulated or would operate under a regulatory regime providing much greater flexibility and opportunity to match short term gas market supply/demand requirements.



Operational Systems to Facilitate Gas Trading

In order to facilitate the trading of capacity reserved for short term trading under a system described above, as well as trading excess capacity, consideration could be given to the introduction of a system similar to that in operation in the US gas market under Federal Energy Regulatory Commission (FERC) Order 637. FERC 637 mandates that excess capacity on all pipelines must be communicated via the internet, with daily posting of transactions and capacity.

Currently, many Australian pipeline operators communicate with their contracted customers via websites. Encouraging the expansion of this existing use of internet based technology to a system similar to that required under FERC 637 could provide many advantages including enhanced public access to trading capacity information and the provision of clear and transparent pricing.

5. EFFECTIVENESS OF QUEENSLAND'S GAS ACCESS REGIME

Queensland has previously expressed its concern with the recommendation of the NCC to not certify Queensland's Gas Access Regime. The NCC's recommendation is primarily based on its views regarding:

- (i) the inclusion of transitional provisions which protect the access terms described in section 3.1.3 ["Upstream and downstream competition"] for the main transmission pipelines; and
- (ii) the regulatory process (undertaken prior to the introduction of the Code) for approving the reference tariffs.

As discussed in section 3.1.3 ["Upstream and downstream competition"] the access terms approved by the Regulator in Queensland provided investors with an incentive to build new infrastructure with spare capacity. This spare capacity is facilitating the emergence of field on field competition. The competitive market outcome, together with evidence that demand for gas is growing by 5% to 7% per annum (indicating transmission capacity continues to be contracted under the Queensland Gas Access Regime) illustrates in real terms the effectiveness of the regime.

It should be noted the tariffs for three of the pipelines have been found by the ACCC³ to be in the range of reasonable outcomes. The tariffs for the fourth pipeline (the Roma to Brisbane pipeline) are scheduled to be reviewed by the ACCC within three years.

The NCC's recommendation in relation to the certification of Queensland's regime ignores the benefits of establishing long-term access arrangements to support the development of new pipelines and the markets they serve. This is a principle which has been recognised by:

- the ACCC, within its Draft Greenfields Guideline for Natural Gas Transmission Pipelines;
- the Productivity Commission, in its review of the generic National Access Regime under Part IIIA of the *Trade Practices Act 1974*; and
- the Council of Australian Governments in the Review of Energy Markets.

In its Draft Greenfields Guideline, the ACCC explicitly recognises the use of access arrangements of an extended duration to manage uncertainty faced by greenfields pipelines. The Guideline states that:

“The ACCC considers that a longer period provides a greater incentive to the service provider to improve its performance and build its markets and the opportunity to reap more of the project’s blue sky potential.”⁴

The Productivity Commission in its review of the generic National Access Regime under Part IIIA of the *Trade Practices Act 1974* recommended that steps be taken to “refine mechanisms...to facilitate efficient investment within the Part IIIA regime in particular and access regimes generally”. The Council of Australian Government Energy Market Review also recognised the requirement to provide incentives for long term efficient investment in greenfields pipelines and proposed that a 15 year economic regulation free period could be offered to pipeline service providers to offer greater certainty for investment. Alternatively, the review proposed that upfront regulatory agreements with the regulator could be developed.

These proposals all seek to provide certainty to investors in greenfields pipelines. In this regard, Queensland's Gas Access Regime is consistent with these approaches and recognises the benefits of a differential approach to investment in greenfields pipelines. The NCC's refusal to certify a demonstrably successful Queensland Gas Access Regime threatens to add to perceptions of regulatory risk held by investors.

³ ACCC (2000), Queensland Gas Pipeline Access Regime: Assessment of tender processes and tender outcomes, a report to the National Competition Council.

⁴ ACCC (2002), Draft Greenfields Guideline for Natural Gas Transmission Pipelines, p.30.

6. CONCLUSION

The existing National Gas Access Regime appears to have successfully established a broad framework for regulating access to natural gas pipelines infrastructure, incorporating information provisions and ring fencing obligations. However, there also appears to be widespread debate as to the extent to which the application of the Regime is, in practice, achieving appropriate outcomes in the industry.

As a State that will require significant further investment in pipeline infrastructure, particularly in gas transmission, Queensland recognises the need to improve the Regime before the next round of Access Arrangement reviews and capitalise on the lessons learned from the first round. This submission, while not indicating the Government commitment to any specific solutions or recommendations at this stage, suggests a number of alternative options for investigation by the Productivity Commission. The alternative options are aimed at ensuring the regulatory regime supports the development of the gas market and increasing competition in the upstream and downstream gas industries.