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Worsley Alumina Pty Ltd is the manager of the Worsley Joint Venture - Bauxite/Alumina Operation.
Liability and responsibility of the Joint Venturers is several in accordance with the following schedule of participating interests:
Billiton Aluminium (RAA) Pty Ltd 56%, Billiton Aluminium (Worsley) Pty Ltd 30%,
Kobe Alumina Associates (Australia) Pty Ltd 10%, Nissho Iwai Alumina Pty Ltd 4%.

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Worsley Alumina submission to: Gas Access Regime Inquiry

[Productivity Commission, July 2003]

Background

Worsley Alumina Pty Ltd ("Worsley") is a joint venture of BHPBilliton and Kobe Alumina Associates and operates a bauxite mine and alumina refinery near Collie, approximately 200km south of Perth. Worsley has been connected to the Dampier Bunbury Natural Gas Pipeline ("DBNGP") since the construction of that pipeline, which occurred shortly after the refinery commenced operations. Worsley consumes gas transported through the DBNGP under contracts with its gas supplier, Alinta, and directly with the pipeline owner, Epic. Worsley hosts at its refinery a GT-based cogeneration facility owned by South West Cogeneration JV which is also a significant consumer of gas.

Worsley's most recent expansion required additional gas transport capacity and this, in turn, required an expansion of the DBNGP. The negotiations for this overlapped the period of the sale of the DBNGP: Worsley commenced negotiations with Alinta but finalised with Epic. Worsley has participated in the public discussion process with respect to the Regulator's decision on the Proposed Access Arrangement for the DBNGP and has lodged with Epic applications for additional capacity.

Worsley welcomes the opportunity to comment on the Gas Access Regime. Worsley's comments are based on its experience as a user of a covered pipeline and are confined to only a small part of the scope of this Inquiry.

Worsley's comments are predicated on the following understanding. There is a "bargain" between the state and the pipeline owner. The National Third Party Access Code for Natural Gas Pipelines ("Code") is structured to allow parties that operate pipelines in accordance with the Code to be deemed to be not abusing the market power that arises from ownership of a natural monopoly. The acid test that Worsley applies in assessing its experience is this: is the outcome consistent with that one would expect in a truly competitive market?

Issues

Worsley's comments are presented here following the structure of the Review of the Gas Access Regime Issues Paper (July 2003) and the headings are as in that paper.

Benefits and costs of the existing regime

Worsley has three particular interests: that the access regime encourage, or, at least, not discourage competition between gas suppliers; that the pipeline not act as a constraint on Worsley's own capacity expansion plans; and that the gas transport charge be "competitive".

The DBNGP has a gas quality specification that effectively prevents a number of possible gas suppliers entering the market. This specification, and commercial arrangements that depend on it, predate the access regime. The "market power" conferred by the specification accrues to gas suppliers that meet the specification, rather than the pipeline owner. Nonetheless, Worsley contends that in a truly competitive market, with multiple pipelines, pipeline owners would have every incentive to operate to a range of gas specifications, or to as liberal a specification as possible, to maximise the total gas carried by the pipelines. Worsley suggests that the access regime itself require that pipelines operate to a specification appropriate to the gas customers, rather than the suppliers. [Worsley respects that grandfathering of existing provisions may need to apply.]

The economic attractiveness of a capacity expansion that Worsley currently has under consideration is dependent on the availability of gas pipeline capacity. Potential future expansions at Worsley rely on additional pipeline capacity becoming available. Worsley has two applications for additional capacity lodged with Epic. Epic has advised that it is not processing applications for additional capacity and Worsley anticipates that its applications, if processed, will be rejected as "not economic" (at the regulated tariff). In negotiating its last access contract the bulk of the parameters were set by regulation. The variable that decided whether the pipeline expansion was 'economic' for Epic was the contract term. Worsley contends that this should be the only variable that should decide whether a pipeline expansion is 'economic' to provide a reference service at the reference tariff. The access regime does not oblige the pipeline owner to expand capacity. In a truly competitive market one would expect that capacity would become available if economic. A pipeline owner's refusal to supply additional capacity for a reference service at the reference tariff is, prima facie, an abuse of market power. Worsley believes that to evade such an obligation the onus should be on the pipeline owner to demonstrate that such an expansion is 'uneconomic' given the requested contract term. Failure to impose such an obligation on pipeline owners leaves Worsley's future expansion plans hostage to uncertainty as to whether additional pipeline capacity will be available at all, let alone on what terms.

The "bargain" underlying the access regime recognises that the pipeline is a natural monopoly. Competitor pipelines are unlikely to be built and alternative means of gas supply are also unlikely. [Note that environmental considerations may effectively preclude the use of alternative fuels.] Worsley believes that if it arranges its demands so that the reference service is satisfactory then it should be able to rely on capacity being available at the reference tariff. This does not preclude a negotiated settlement on other terms.

Costs

The inordinate time required to achieve the regulator's final decision on the Epic access arrangement is likely largely a consequence of the DBNGP sale process. The Code has contributed to the delay in that it allows wide discretion to the regulator in reconciling objectives and weighing considerations. The length of time required for this decision has had an impact on Worsley's planning of possible future expansions.

The costs of compliance with the Code are relatively minimal for Worsley so long as Worsley seeks a 'reference service' or near equivalent. In Worsley's experience to date this has been all that has been available. Worsley contrasts this with the expected costs of compliance with the state's rail access regime. Under this regime the access charge is negotiated by the rail owner and user between upper and lower limits set by the rail access regulator. Worsley anticipates that it will be extremely difficult to achieve a satisfactory outcome in such circumstances and that it may be necessary to rearrange the way it conducts its rail operations to fit in with the access regime.

Worsley is of the view that, on balance, the Gas Access Regime delivers a net benefit. The provision of a reference tariff for a reference service has the virtue of simplicity and does not preclude a negotiated settlement where additional flexibility is required.

Worsley is of the view that the current Code favours the pipeline owner over the user for the following reasons. There is no requirement on the owner to expand the pipeline in circumstances where a competitive market would do so. Epic has said that if it expands it will be in accordance with its own timetable. Worsley believes that in a competitive market expansion would be in accordance with the users' timetables. In the Epic case the court allowed that the tariff may include an element of monopoly rent. Worsley believes that in a competitive market the tariff would not include an element of monopoly rent.

Objectives

Worsley believes that the objective of preventing the pipeline owner abusing market power needs to be reinforced. Specifically, the Code should not be capable of interpretation to allow the owner to extract monopoly rents.

In a number of instances, eg ss2.24 and 8.10, there are sets of objectives that may be in conflict. Worsley respects that the maximum flexibility arises when the regulator determines the weight to be given to each consideration or objective. Worsley believes, however, that it is desirable and appropriate that the code assign relative, if not absolute, weight to these by, say, ranking the objectives or by recommending which objectives should prevail in which circumstances. For example, s8.11 gives the regulator guidance in the application of 8.10(a)-(k). It could be strengthened by making explicit that the onus is on the pipeline owner to make the case for departing from this guidance. At this point Worsley also recommends that 8.10(j) be modified so that the ICB can not be the price paid for the pipeline lest prospective owners believe that they can afford to pay any amount and still recover that, and a return, through the tariff.

Access regulation and the development of a competitive market for energy services

Commercially negotiated outcomes

Worsley believes that the code as it exists effectively promotes commercially negotiated outcomes. The existence of a reference service at a reference tariff acts as a ‘fallback’ position for both parties. The exploration of alternative outcomes is encouraged when starting from this as a secure base and there is less uncertainty with respect to price when a benchmark price is established.

Worsley offers the following comments with respect to an alternative means of promoting commercially negotiated outcomes. The WA rail access regime sets an upper and a lower limit (total and marginal costs) on the price of access and requires the parties to negotiate between those limits. This pricing method has the theoretical attraction of promoting allocative efficiency but fails in application because it does not recognise the constraints of externalities. For example, the freight rate offered to a wheat farmer may be just low enough to retain the traffic on rail rather than causing the farmer to switch to road transport. Society would be less tolerant of an alumina refinery trucking several millions of tonnes of product per annum to the port – large customers are effectively captive to rail. [The theory, and this application, recognises that rail is a natural monopoly and alternative rail facilities are not a practical proposition.] The access seeker has very little bargaining power and the anticipated outcome is an access rate closer to the top of the range than the bottom. Worsley anticipates that the outcome will contain a large element of monopoly rent. There are overpayment rules that are intended to redistribute excess returns to the users but the framing of these has, in Worsley’s view, been unsatisfactory and they do not properly address how the monopoly rent arises in the first place.

There is a direct analogy with pricing of access to gas pipelines. Whilst a user could theoretically switch to another fuel, even if it could not switch to another pipeline, it is likely effectively constrained to using gas by its environmental licence. The constraint on the pipeline owner then is the price it can charge without driving the user out of the business (or, at least, the business of using gas) rather than the price it requires to keep it in the business of owning pipelines. Worsley believes that the outcome of such a negotiation will see the pipeline owner receiving monopoly rent and will not replicate the outcome of a truly competitive market.

Access regulations and new investment

Extensions/expansions

Worsley believes that, in practical terms, the Code does not allow a user to compel an owner to expand. At the very least, an owner can frustrate by delay any attempts to induce an owner to expand. Worsley recommends that the Code be modified to require an owner to accede to requests for capacity for a reference service at the reference tariff subject to the expansion being economic. The onus should be on the owner to demonstrate that the cost of the expansion cannot be recovered in the life of the pipeline or the term offered by the prospective shipper. Worsley recognises that pipeline owners have legitimate concerns with respect to risk. In a competitive market risk has a price. It should not be open to an owner to simply refuse to accept risk.

Access arrangements and 'light-handed' regulation

Reference tariffs

Worsley believes that a pipeline owner should have the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the service. In a competitive market this revenue stream would not include monopoly rent.

In quantifying this Worsley has regard to the Regulator's Draft Decision: Proposed Access Arrangement Dampier to Bunbury Natural Gas Pipeline. In Worlsey's view the Reference Tariff in this decision allows the owner to recover the efficient costs of delivering the Reference Service taking into account all the factors the Regulator was required to consider in reaching this decision. Worsley accepts that the guidance given by the court in the Epic case specifically allows that the Code permits the inclusion of monopoly rents in the Reference Tariff. Worsley recommends that the Code be altered to exclude the right to earn monopoly rents. It is not clear to Worsley how the Regulator re-weighted the relevant considerations in arriving at his Final Decision. The outcome is consistent, however, with the ascendancy of 8.10(f) and (g) in setting the ICB. Worsley accepts that the declining tariff as specified by the state as part of the sale of the DBNGP resulted in a tariff consistent with that now set by the Regulator. Worsley contends, however, that the tariff as set by the state contained an element of monopoly rent and that this should have been excluded as part of the sale process and should be excluded when the pipeline is a 'covered' pipeline. Worsley recommends that, where necessary, the Code be altered to make explicit that as part of the 'bargain' between the state and the pipeline owner the owner may not abuse its market power so as to earn monopoly rent.