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To whom it may concern

Gas Pipeline Information Disclosure and Arbitration Framework- Draft Initial Rules and Explanatory Note

This submission is provided by Tas Gas Networks (TGN) in response to the Gas Pipeline Information Disclosure and Arbitration Framework - Draft Initial Rules and explanatory note dated June 2017 (Draft Rules). We thank you for the opportunity to respond.

Our response covers two issues that the Gas Market Reform Group (GMRG) may not have had adequate time to consider given the compressed timeframes that have been associated with this review:

- Application of the framework to the unique circumstances of TGN
- How, if the framework is to be applied, changes could be made to make its application to distribution networks more fit for purpose and its exemptions more appropriate to small service providers

In summary:

- The evidence contained below shows that the application of the Gas Pipeline Information and Disclosure and Arbitration Framework to TGN, given its unique market environment, is unlikely to promote the National Gas Objective (NGO). In particular:
    - It is unlikely to provide benefits to current or potential users of its services because TGN operates in a workably competitive market.
    - It is, however, likely to impose administrative and compliance costs on stakeholders and reduce the capacity of TGN to compete with alternative fuels that are not subject to the framework.
- TGN accepts however that, in the constrained timeframes that the GMRG has been provided with to conduct its review and finalise the rules, it might not be feasible to provide broad exemptions from the framework that reflect the market environments in which some pipelines operate. In these circumstances, TGN believe that there are a number of modest changes to the Draft Rules that would reduce the negative impacts the broad application the framework would otherwise have, by providing appropriate exemptions from some elements of it (e.g. Information Disclosure requirements).

NETWORKS

Application of the framework to TGN

We acknowledge the findings of Dr Vertigan's review that there are "some instances" where pipeline operators have market power and have used that market power in a way which results in outcomes that do not promote the NGO.

We note that the conclusions suggest that there are instances where market power either does not exist or is not being exercised. This would not be surprising given the very wide range of market environments in which non-scheme pipelines operate. As currently proposed, however, the rules would apply to all non-scheme pipelines regardless of those circumstances.

We do not consider that Dr Vertigan's general findings are relevant to the TGN gas distribution networks. This is because TGN's market environment and its role in it is unique and, as a result, it does not have market power to exercise.

While TGN is the sole natural gas distributor in Tasmania (and parts of rural Victoria), the relevant market in which we operate is the market for fuel. In Tasmania, natural gas is a fuel of choice and since commencement of our operations 14 years ago, and until today, TGN has had to actively compete with other fuels including LPG, wood and renewable energy. This is demonstrated by the following:

- In respect of the market share of natural gas:
    - In the industrial market – TGN has approximately 12% of the market share in relation to energy demand of major industrial markets in Tasmania[1]
    - In the mass market - TGN has rolled out network past approximately 60,000 premises over 14 years. To date we have connected approximately 12,000 mass market customers which is around 20% of the possible market. Connection numbers are flat at around 500 per annum and loads are, on average, declining. Alternative fuels such as subsidised electricity tariffs, solar, wood and LPG are dominant.
- Every large customer that we have won over those 14 years has had to be persuaded to move from their existing fuel source and absorb the cost associated with the necessary infrastructure to be able to receive natural gas, and the conversion costs of equipment behind the factory gate to enable the use of natural gas. In many cases, these industrial users have also maintained the infrastructure to switch back to alternative fuels and this is used as a negotiating tactic.
- Each of our large industrial customers therefore has an individually negotiated tariff that we specifically tailored to entice them to switch from an alternative fuel. All have a choice in terms of whether they use natural gas or not (i.e. none use natural gas as feedstock).
- The competitive tension exerts considerable pressure on our business to continually strive to provide competitive natural gas pricing in the market place to gain or retain end users. This enables the customer to evaluate a range of energy choices which include LPG, diesel and bio-waste depending the energy requirement.

[1] The typical aggregate annual electricity demand by Tasmanian major industrial users is around 700MW. Compared with approximately 85MW of natural gas supplied by TGN to major users including educational institutions and hotel chains.

   - In the industrial market, we have seen strong competition in recent times due to low oil and LPG prices which has resulted in a number of commercial and industrial users switching back to LPG to supply their businesses required heat load
   - In the mass market, greater consumer choice is driving declining average household gas consumption loads with natural gas appliances being increasingly replaced by more efficient electrical appliances and/or the adoption of new technologies such as solar PV and hot water. For example, TGN's most recent record peak demand day occurred in 2015 despite natural gas connections increasing by 8% since June 2015. These signals suggest TGN operates within a competitive market in the residential sector.
- 34 out of TGN's 36 users are industrial customers who negotiate their gas distribution contracts individually. The other 2 users are natural gas retailers, Tas Gas Retail and Aurora Energy, who are contracted using an industry standard Use of System Agreement.
- All TGN user contracts currently have a provision for either party to seek commercial arbitration and this has not been taken up in the 14 years of operation by any party.

The evidence suggests that TGN already operates in a workably competitive market and does not possess market power.

Changes to Draft Rules including Exemption criteria

1. The word "Shipper" should be replaced with "User". The term "Shipper" in this context is confusing. (Rule 585 and explanatory Notes).
2. The use of "nameplate rating" and "daily capacity" to determine a Category 3 exemption should be replaced with average annual daily usage. Nameplate rating is not a term normally applied to distribution pipelines and is not the most appropriate assessment of the size or economic power of a distribution pipeline. (Definitions and Rules 553 & ,585).
3. The exemptions which are available to a Category 2 pipeline should be available to a Category 3 pipeline. Alternatively, an exemption to sub-rules 554 and 557 should apply to a Category 3 pipeline in addition to the exemptions already drafted. (Rules 585 & 586).
4. The GMRG should develop Guidelines to be considered when determining what constitutes a distribution network for the purposes of assessing an application for a Category 3 exemption. This would enable the AER to ensure small networks can be considered separately where to do so would support the objective set out in Rule 546. (Rule 585):
   TGN recommend that some or all of the following are included for consideration:
   a. the distribution network as described in the operating licence(s) under which the service provider is licensed to provide the services. For instance if a service provider has two networks licensed under separate operating licences they could be considered as two discrete networks;
   b. any discrete distribution network supplied by a single gas off take from a transmission pipeline;
   c. any discrete network;
   d. any geographically separate network.
5. In relation to the GMRG's suggested alternative approach to asset valuation we recommend that the original recommendation made by Dr Michael Vertigan should be adhered to and the revised Rule 569 (2) (a) should not be adopted.

Supporting Commentary on the use of exemptions

Under the current Draft Rules, it is unlikely that TGN will be able to successfully apply for a Category 2 exemption for its Tasmanian operations as in most cases there is more than one user on the network (however the network maybe defined). The use of a "Nameplate Rating" is a less relevant concept for smaller distribution networks and is a more appropriate term for larger transmission pipelines. For TGN, volume measures would be a more relevant indicator given the level of underutilisation is generally high and design capacity often bears little relationship to actual flows.

For example, all of TGN's networks except Hobart have been designed for a daily flow capacity of significantly less than 10 TJ per day. Excluding Hobart, the nameplate capacity of our pipelines range from 2TJ per day through to 6 TJ per day with an average of 4.1 TJ per day.

If a volume measure were to be used for distribution networks we would recommend "average annual daily use". This is a readily available measure of real flows and revenue unrelated to a design capacity which may be meaningless.

TGN has 2 operating licences; one licenses it to operate a transmission pipeline with one large user (single user); and the other licences it to operate 10 discrete distribution networks. All the networks are discrete, geographically separate, and run from their own gas off take on the main transmission Pipeline (owned by Tasmanian Gas Pipeline PTY Ltd (TGP)). On that basis, it would be reasonable for the AER to determine that TGN has 11 networks, one licensed transmission network and 10 licensed distribution networks however for the avoidance of doubt we would prefer that written guidance be issued to assist the AER in that decision.

Under the proposed category 3 exemption TGN would be subject to the Information Disclosure requirements. As already outlined this would be contrary to the continuation of the competitive market which already exists in Tasmania and would be to TGNs substantial detriment. TGN submits that the same exemptions should apply to both category 2 and 3 pipelines or alternatively that exemption to sub rules 554 and 557 should apply to category 3 pipelines in addition to the exemptions already drafted.

It should be noted that TGN has no issues in relation to the requirement to publish our standard contract terms under Rule 554 (2) (a) or to publish information as to gas flows and the technical capacity of our pipelines as required by Rule 553. The former is already available on our website.

Access Requests and Arbitration

TGN accepts that no exemption will include the sub-rules contained in Division 3 and 4 and supports the process of negotiated access requests and the availability of an arbitration framework should those negotiations fail. The option of Commercial Arbitration has always been available under our user contracts.

Asset Valuation

The key principles of the NGO refer to efficient investment and operation of the gas network, which relies on efficient pricing outcomes. To achieve the NGO, the asset valuation approach which produces efficient pricing outcomes should be used. The price that would prevail in a workably competitive market is likely to be the best proxy for this and the asset valuation method should reflect this, notwithstanding the practical challenges this creates.

A historic cost approach is unlikely to achieve this because:

- It uses an asset value which does not necessarily reflect the market value of the assets
- It is not likely to produce pricing outcomes consistent with a workably competitive market

As a result of the above, it is likely to send the wrong price signals which will not promote the efficient investment in the operation and use of gas pipeline assets.

The use of a historic cost approach would result in gas pipelines assets being valued using a different approach to the vast majority of regulated infrastructure in Australia, including covered gas networks. It is difficult to see how this could promote the NGO.

<u>Publication of Pricing Information</u>

TGN's tariffs are not calculated on cost reflective pricing. They are determined through commercial negotiation with users around alternative fuels (i.e. they are based on what the market will bear).

The requirement to publish standing prices and weighted average prices would detract from the market design goal of a workable competitive market as all prices were determined based on the customer's specific requirements through the negotiation process. Such disclosures would be relatively meaningless and potentially misleading.

Summary

TGN has developed a modest market position in a small and competitive market. We have little market power and are currently under threat from increasing gas pricing through increasing commodity and transmission prices. Our customer contracts and pricing are developed in a competitive environment whereby we have to provide a compelling case to incentivise a customer to swap fuels. Application of the framework to TGN will place us at a competitive disadvantage as compared to stronger incumbent fuels such as LPG and Electricity. In the residential market, we have an increasing body of competitors such as solar and battery storage or electricity suppliers assisted by various renewable schemes, some of whom may receive government support to compete against us.

If you have any queries please do not hesitate to contact me.

Yours sincerely

Simon Himson

CEO
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