

13 April 2017

Dr Michael Vertigan AC
Chair,
Gas Market Reform Group
c/o Australian Energy Market Commission
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Sydney South NSW 1235
via email: gas@environment.gov.au

Gas Pipeline Information Disclosure and Arbitration Framework: Response to Implementation Options Paper

Dear Dr Vertigan,

Energy Networks Australia welcomes the opportunity to make a submission to the Gas Market Reform Group's *Implementation Options Paper – Gas Pipeline Information Disclosure and Arbitration Framework* (Options Paper) released last month.

Energy Networks Australia is the national industry body representing businesses operating Australia's electricity transmission and distribution and gas distribution networks. Member businesses provide energy to virtually every household and business in Australia.

Gas network businesses recognise the benefits of effective measures to support commercially focused negotiations between shippers and the operators of gas transmission pipelines with the objective of providing for reasonable and transparent pipeline access.

Need for exemptions regime for non-scheme distribution networks

Energy Networks Australia notes the request for views in the Option Paper on the benefits of an exemptions framework being provided for 'non-scheme' gas distribution networks. An exemptions framework for a number of small regional gas networks, in our view, will be critical to avoiding unnecessary costs and uncertainty affecting gas consumers.

Since the commencement of the gas access regime in 1997 a limited number of small regional gas distribution networks have applied for revocation of coverage under the regime based on Section 102 of the *National Gas Law*. These networks include the:

- Wagga Wagga gas distribution system;
- South West Slopes natural gas distribution system;
- Temora natural gas distribution system;
- Mildura distribution system;
- Roma and Dalby distribution systems; and
- Alice Springs gas distribution system

The clear basis for these revocations has been that regulation of third party access beyond existing gas law obligations is of no net public benefit, due to their limited size, the presence of strong inter-

fuel competition sufficiently incentivising non-discriminatory open access terms and the potential high regulatory costs with limited or no countervailing benefits.

The Options Paper states that smaller regional distribution pipelines are:

- likely to have significant market power; and
- are also have significantly fewer shippers or prospective shippers seeking access and less prospect of competition given limited gas consumption.

We do not agree with the first point. Rather, it is generally accepted that natural gas networks are not in a position to exercise any market power that they otherwise might have for the following reasons:

- natural gas is a fuel of choice;
- there are readily available substitutes for all natural gas applications, particularly from electricity and to a lesser extent liquefied petroleum gas (LPG);
- the cost of switching away from natural gas to either electricity or LPG are low; and
- natural gas has no clear competitive advantage over electricity, such that gas businesses are required to compete to retain and attract new customer connections.

With regard to the second point, as the Option Paper notes, regional areas serviced by small distribution pipelines commonly have limited demand and are often not in a position to use their market power because they may only be negotiating with one shipper. In this scenario, both the distribution pipeline and the shipper have comparable negotiating power and the commercial negotiation should reflect this. Relatively low levels of retail gas competition serve to strengthen the negotiating power of gas retailers with distribution companies. For instance, the AEMC noted in its Retail Competition Review that:

Rivalry appears lower in the retail gas market [in South East Queensland] than the electricity market, with just two gas retailers competing. Switching rates are lower than for electricity, with fewer gas options to choose from. Additional retailers have not entered the gas market primarily due to the small size of the market, with low penetration of gas pipelines to households and small businesses and a low level of average gas demand. Competition is not expected to increase over the next few years for this reason, coupled with issues securing competitively priced gas in the wholesale market.¹

This is common across smaller gas distribution networks operated by our members, where the small size of the market and difficulty in contracting required volumes of natural gas has limited retailer entry into these markets.

ENA further notes that the concerns raised by stakeholders during the GMRG's review about market power being exercised to the detriment of consumers and efficient market outcomes were raised solely in relation to transmission pipelines.

Given the lack of market power, limited shippers and customers using the smaller distribution pipelines defined as non-scheme pipelines, the costs and resources associated with the arbitration process are unlikely to be commensurate with the value of services or contracts being considered. Therefore, the costs associated with arbitration are likely to outweigh the benefits, and as noted by the Major Energy Users in its submission to the draft Amendment Bill, the cost associated with small users on distribution pipelines of utilising the proposed provisions will likely exceed any benefit they might individually gain through reduced pipeline tariffs.

¹ AEMC (2014), *Retail Competition Review, Final Report*, 22 August 2014, Sydney



Given these circumstances there is a need for a clear exemptions framework for small gas distribution network providers. An exemptions approach would also be consistent with international practice of comparable arbitration frameworks applying to major transmission infrastructure, as outlined in the Options Paper.

Proposed arbitration framework not 'fit for purpose'

The preferred arbitration framework as set out in the Options Paper appears to have the potential to lead to repeated, complex and costly disputation.

Under the gas access regime, the coverage test is specifically intended to avoid intrusive and costly asset-based regulation applying to circumstances where it is not warranted. A broadly applicable arbitration framework that appears to risk repeated individual asset-specific cost-based assessment processes occurring over time does not appear to be consistent with a cost-effective or flexible approach.

As an example, the option discussed of establishing and updating actual Regulatory Asset Bases and past depreciation on an asset specific basis appears to simply mirror traditional 'cost of service' regulation in a way that risks undermining the agreed policy goal of a simple, efficient commercially-focused arbitration approach.

It appears the rationale for the new commercial arbitration framework is based on a lack of confidence in the existing 'no-coverage', 'light regulation', and 'full regulation' regulatory menu. The solution to this, however, is not the provision of an arbitration scheme that shares many features with that recently replaced in Part XIC of the *Telecommunications Act*. This telecommunications regime - prior to its replacement - fostered multiple, complex, overlapping access disputes, each involving significant direct and indirect costs to consumers, infrastructure owners, access seekers, and governments.

ENA urges the GMRG to ensure that any arbitration framework is designed with a focus on creating commercial incentives for dispute avoidance or settlement, rather than relying on an intrusive and costly establishment of historical costs or on highly contentious and artificial assumptions around hypothesised past cost recovery arrangements for discrete pipeline assets.

Implementing the information and arbitration rules framework

The Options Paper proposes implementation of the new information and arbitration framework through an initial set of Rules made by the South Australian Energy Minister.

As a core regulatory design principle, ENA supports detailed rules development occurring by the AEMC within the intended rule-making framework. This avoids one-off Ministerial rule making processes potentially applying an inconsistent interpretation of the rule-making test, and provides for the rule change proposal to be more fully assessed, including recognition and accommodation of interlinkages between different elements of the rules framework.

ENA understands the need for timely implementation of these reforms, but considers that wherever possible implementation should occur through normal rule making processes.



Should you have any additional queries, please feel free to contact Garth Crawford, Energy Network Australia's Executive Director – Economic Regulation on (02) 6272 1555 or gcrawford@energynetworks.com.au.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'John Bradley', is positioned above the printed name.

John Bradley
Chief Executive Officer

