

**EASTERN GAS PIPELINE (LONGFORD TO SYDNEY) –
APPLICATION FOR COVERAGE
UNDER THE NATIONAL GAS ACCESS REGIME**

**Issues Paper
January 2000**

National Competition Council

Contents

<i>Background</i>	2
<i>1 The Council's Process</i>	6
<i>2 Coverage Issues</i>	7

Background

On 7 January 2000, the National Competition Council (the Council) received an application for coverage of the Eastern Gas Pipeline (the EGP), which runs from Longford in Victoria to Horsley Park in Sydney, NSW under the *Gas Pipelines Access (Victoria) Act 1998*, and *Gas Pipelines Access (NSW) Act 1998*.

The application was made by AGL Energy Sales and Marketing Limited (AGL).

The pipeline is presently under construction, and is expected to be completed and ready for operation by no later than September 2000.

The pipeline is jointly owned by Duke Eastern Gas Pipeline Pty Ltd, DEI Eastern Gas Pipeline Pty Ltd and Duke Australia Operations Pty Ltd (collectively referred to in this Issues Paper as Duke), and it is anticipated that upon construction, the pipeline will be operated by Duke Australia Operations Pty Ltd.

The Council is seeking submissions from interested parties to help it determine what recommendation to make to the relevant Minister concerning coverage.

Legislative Framework

The *Gas Pipelines Access (Victoria) Act 1998* and the *Gas Pipelines Access (NSW) Act 1998* (the Gas Access Acts) apply the *National Third Party Access Code for Natural Gas Pipeline Systems* (the National Code) to gas pipelines in Victoria and NSW respectively. In the case of interstate pipelines the access regimes of both States may apply.

The National Code is a central element of National Competition Policy (NCP) reforms aimed at promoting free and fair trade in gas. It permits parties to negotiate access to the transport capacity in natural gas transmission pipelines and distribution networks on reasonable terms and conditions approved by an independent regulator. The National Code sets out the rights and obligations of service providers, pipeline users and access seekers. It includes coverage rules, the operation and content of access arrangements, ring fencing arrangements, information parameters, dispute resolution and pricing principles.

Interested parties can find the National Code on the website of the Registrar of the National Code at:

<http://www.coderegistrar.sa.gov.au>.

Coverage of a Pipeline

Section 1.3 of the National Code provides that any party may apply to the Council requesting that a particular pipeline be covered under the National Code. The Council must deal with the application according to the provisions of sections 1.2 to 1.12, and make a recommendation to the relevant

Minister on whether coverage should be granted. It is up to the relevant Minister to decide whether the pipeline should be covered or not.¹

In deciding whether to recommend coverage, the Council must consider the criteria for coverage set out in Section 1.9 of the National Code (discussed in Section 2 of this paper). The Minister must also consider these criteria when deciding whether to grant coverage.

If coverage is granted, the owner and operator are required to meet certain obligations under the Gas Access Acts and the National Code. The owner and operator are required to submit an access arrangement to the regulator (the ACCC) for approval, and to consider access requests by third parties. The access arrangement must set out the terms and conditions and the tariffs on which the owner or operator will provide access to spare capacity.

The NSW and Victorian Gas Access Acts include a process for administrative (merits based) appeals against a decision to grant coverage. The process is set out in the Gas Pipelines Access Law (or GPAL), which is incorporated into the NSW and Victorian Gas Access Acts.

The Pipeline

The EGP is described in AGL's application as:

The Eastern Gas Pipeline licenced under Pipeline Licence No 175 (Pipelines Act 1967 (Vic)) and Pipeline Licence No 26 (Pipelines Act 1967 (NSW)) from Longford in Victoria to Horsley Park in New South Wales including lateral pipelines to Port Kembla and Smithfield, compressor stations and other appurtenances ("the EGP"). Construction on the pipeline commenced on 6 August 1999 and Duke plans to place the pipeline in service by no later than September 2000.

AGL's application relates to the whole of the pipeline.

The EGP is a 792 kilometre pipeline between Longford and Horsley Park and will have a capacity of 110 PJ/year at 100 per cent load with maximum compression.² The EGP will be able to supply natural gas to towns on the eastern seaboard of Australia south of Wollongong.³ Gas from the EGP will provide an alternative source of gas in the Sydney market to gas supplied by the Moomba to Sydney pipeline, in which the AGL group of companies have a significant interest.

The route of the pipeline is illustrated at Annex 1.

¹ If the Minister decides to grant coverage, the Minister may decide to grant coverage to a greater or lesser extent than requested by the applicant, if having regard to the part of the pipeline that is necessary to provide services that prospective users may seek, the Minister considers it appropriate.

² For sake of comparison, total gas use in NSW in the 1996-97 financial year was 104.6 PJ (source: *Energy in NSW 1998*, NSW Department of Energy).

³ Source: (with modifications) ACCC Issues Paper on the Access Undertaking submitted by Duke, p. 2.

Undertaking lodged by Duke

On 18 November 1999, Duke lodged a voluntary undertaking with the ACCC under Part IIIA of the *Trade Practices Act 1974*. The undertaking sets out the terms and conditions, and indicative tariffs on which Duke proposes to offer access to the EGP. If the undertaking were to be approved by the ACCC, then it would govern access to the EGP for third parties.

According to Duke's undertaking, by lodging the undertaking, it is seeking an alternative to being covered by the National Code. Duke states in its application for approval of its undertaking that:⁴

The Undertaking aims to comply with the objectives of the National Third Party Access Code For Natural Gas Pipeline Systems and its enabling legislation, yet offer pro-competitive alternatives to some of its prescriptive and inhibiting provisions which have a negative effect on market development, such as:

- *simplistic application of cost service tariffs*
- *short tariff review period*
- *maintenance of the facility owner's revenue streams*
- *application of high incremental tariffs for capacity enhancement*
- *cross-subsidies to finance discounts*
- *differentiation of shipper classes*

The ACCC has released an issues paper and invited submissions from interested parties. A copy of the proposed undertaking and the ACCC's Issues Paper may be found at the ACCC's website at <http://www.accc.gov.au>.

The ACCC notes in its Issues Paper that, "Some parties may consider the lodgement of a Part IIIA Undertaking rather than an access arrangement under the Code as being an issue in itself", before seeking comment on, "To what extent should the elements of the undertaking ... be consistent with the Code". Parties may wish to comment on that issue in their submissions to the Council.

Submissions

To assist interested parties in preparing submissions to the Council on the application, this issues paper:

- outlines the procedures the Council will follow in considering this application; and
- raises issues on which the Council seeks public comment.

Written submissions should be sent to Mr. Luke Berry, National Competition Council, GPO Box 250B, Melbourne VIC 3001 (or e-mailed to luke.berry@ncc.gov.au) by **Friday, 11 February 2000**. Due to time constraints imposed by the National Code, the Council may not be able to consider submissions received after this date.

⁴ Eastern Gas Pipeline Access Undertaking.

It would be appreciated if respondents could supply a copy of their submission in both electronic and print form.

Unless confidentiality is requested, submissions will be treated as public documents and made available to interested parties on payment of an administration fee. Where possible, a submission should have individual sections marked as confidential so that the remainder of the document can be made publicly available. If sections of a submission are confidential, two copies should be provided – one with the confidential sections omitted and the other with the confidential sections included.

If the Council considers that a submission does not warrant confidential treatment, it will advise the person who has prepared the submission. The person will then have the choice of either withdrawing the claim for confidentiality or withdrawing the confidential parts of the submission.

Should you have any queries, please contact Ms Angela Houpis (administrative matters) on 03 9285 7089 or Mr. Luke Berry (all other matters) on 03 9285 7782.

1 The Council's Process

The procedure for seeking coverage of a pipeline is set out in sections 1.2 – 1.19 of the National Code. The National Code can be viewed at <http://www.coderegistrar.sa.gov.au>.

In summary, the procedure is as follows:

1. Any person may apply to the Council for coverage of a pipeline.
2. If the Council considers that the application has been made on trivial or vexatious grounds, it may reject the application. Otherwise the Council must, within 14 days of receipt of the application, inform the service provider and other interested parties, and will call for submissions by advertising the application in a national daily newspaper.

The Council advertised this application in *The Age* and the *Sydney Morning Herald* on Friday, 21 January 2000, and in *The Australian Financial Review* on 22-23 January 2000.

3. The Council will consider all submissions received on or before close of business, **Friday 11 February 2000**.
4. The Council must prepare a draft recommendation within 14 days of the close of the consultation period, and circulate it to the applicant, the service provider, each person who made a submission, and any other person who requests a copy. For this application, a draft recommendation will be released by 25 February 2000.
5. Parties will have a further 14 days to make submissions to the Council after the release of the draft recommendation.
6. The Council must consider any further submissions and make a final recommendation on coverage to the Relevant Minister within 28 days of the release of its draft recommendation.

For this application, the Council's final recommendation must be sent to the relevant Minister by 24 March 2000.

7. The Council must recommend that coverage be granted if it is satisfied that the pipeline meets all of the criteria set out in section 1.9 of the National Code (see below), but must recommend against coverage if it is satisfied one or more of the criteria is not met.
8. The Minister must make a decision on coverage after considering the criteria in section 1.9. The Minister has 21 days to decide the matter.
9. The Minister's decision may be appealed to the Relevant Appeals Body under the process specified in the National Code and GPAL.

2 Coverage Issues

This section discusses the criteria in section 1.9 of the National Code against which the application must be assessed, and raises issues on which the Council seeks public comment.

In addition, the section summarises some of the views put by the applicant in support of its application. The application is available from the Council's website at <http://www.ncc.gov.au>, or on request from the Council.

The questions are for guidance only. Parties making submissions to the Council should not feel bound to respond only to the issues suggested, or to answer every question posed, and are free to comment on any issue they consider relevant to the Council's deliberations.

The Coverage Criteria

Under section 1.9 of the National Code, the Council cannot recommend coverage unless it considers the pipeline in question meets all of the criteria set out in section 1.9 of the National Code. However, if the Council is satisfied that the pipeline does meet all of the criteria, then it must recommend coverage.

The Council may recommend coverage either to the extent sought, or to a greater or lesser extent than sought in the application, but cannot recommend coverage to a greater extent of a pipeline than is owned or operated by the same service provider or group of service providers.⁵

The criteria in section 1.9 are:

- that access (or increased access) to services provided by means of the pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the pipeline;
- that it would be uneconomic for anyone to develop another pipeline to provide the services provided by means of the pipeline;
- that access (or increased access) to the services provided by means of the pipeline can be provided without undue risk to human health or safety; and
- that access (or increased access) to the services provided by means of the pipeline would not be contrary to the public interest.

⁵ Taking account of any part of the pipeline that is necessary to provide services that potential users may seek access to (section 1.29).

Criterion (a) that access (or increased access) to services provided by means of the pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the pipeline.

Background

This criterion mirrors the criteria set out in:

- section 44G(2)(a) of the Trade Practices Act (TPA), relating to declaration of a service for access under Part IIIA of the Act; and
- clause 6(3)(a)(ii) of the Competition Principles Agreement (CPA) relating to assessments of the effectiveness of a State or Territory access regime.

The rationale for this criterion is that access regulation is only warranted where there are, or will be, tangible benefits (for example, reduced prices or improved quality) which flow through to at least one market apart from the market for the services of the particular gas pipeline. For example, providing access may promote competition in upstream (gas production) and/or downstream (energy retail) markets.

In effect, the Council must be satisfied that access would actually promote more competitive *outcomes* – such as lower prices – in another market. This might be unlikely, for example, where the other market is a monopoly (price benefits are unlikely to be passed on to consumers), or where the other market is already highly competitive. A related consideration is whether effective competition is already provided by another source. For example, it could be relevant to consider the extent of competition from other significant energy sources, such as electricity or LPG.

The Council must also consider whether access charges are a sufficiently significant input into the other market to have a material effect on competition in that other market.

In general, while a trivial increase in competition would not be sufficient, the Council considers access would not need to substantially promote competition in order to satisfy this test.

The Application

AGL's application argued that:

The gas market in New South Wales and the Australian Capital Territory can only experience real competition when there is upstream competition amongst producers. The EGP will allow natural gas "basin on basin" competition between the South Australian Cooper Basin producers and the Gippsland Basin producers, and hence facilitate competition in the end [use] gas markets.

AGL's argument alludes to the fact that, at present, the Sydney market is almost entirely supplied by gas from the Cooper Basin. The Eastern Gas Pipeline will transport gas from the Bass Strait to the Sydney market.

AGL's application also argued that access to the Eastern Gas Pipeline would promote competition "in the retail gas markets of New South Wales and the Australian Capital Territory".

The Council seeks comments on:

- *Will access to the EGP promote competition in another market or markets? What markets?*
- *Is there already significant competition in those other markets?*
- *Do other sources of energy, such as electricity or LPG, provide competition for natural gas in the markets in which natural gas transported in the EGP is likely to compete?*
- *Are you interested in seeking access to the services of the EGP now or in the foreseeable future? Are you aware of any other party seeking access now or in the foreseeable future?*
- *Would efficiency and/or prices in another market be improved as a result of access to the services of the EGP? How?*

Criterion (b) that it would be uneconomic for anyone to develop another pipeline to provide the services provided by means of the pipeline.

Background

This criterion reflects the criteria set out in:

- section 44G(2)(b) of the TPA, relating to declaration of a service for access under Part IIIA of the Act; and
- clause 6(3)(a)(i) of the CPA relating to assessments of the effectiveness of a State or Territory access regime.

The rationale for this criterion is that access regulation should be limited to infrastructure where it is not viable to build competing facilities. As such, access regulation should normally be confined to infrastructure with entrenched monopoly power, and usually to infrastructure exhibiting *natural monopoly*

characteristics – that is, where a single facility can meet market demand at less cost than two or more facilities. Such a facility is normally characterised by large up-front production costs relative to operating costs, resulting in pervasive economies of scale – as output increases, sunk costs are spread over more units of output, resulting in declining average production costs over a wide range of output.

The Council must consider whether natural monopoly characteristics or other restrictions currently inhibit the construction of competing pipelines. Examples of other restrictions might include environmental or planning regulations.

In considering whether it is economic to build another pipeline, the Council adopts a social test rather than a private test. While a private test would consider whether it is viable for an individual to invest in a new facility, a social test considers whether building a new facility represents an efficient use of resources from the viewpoint of the community.

The Application

The application argued that:

It is the nature of major pipelines serving a large market such as New South Wales that they constitute a natural monopoly, as evidenced by the pipelines which are presently covered by the Code. This natural monopoly occurs because of the economies of scale which result in reducing marginal cost.

The application also argued that because there is at present significant uncommitted capacity in the EGP, other parties would find it uneconomic to build another pipeline. The application contended that it might be difficult to obtain planning approval for the construction of another pipeline along the route of the Eastern Gas Pipeline for environmental reasons.

The Council seeks comments on:

- *Would it be uneconomic to build another facility to provide the services sought by third parties?*
- *Are any factors likely to emerge in the foreseeable future that will affect this situation?*

Criterion (c) that access (or increased access) to the services provided by means of the pipeline can be provided without undue risk to human health or safety.

Background

This criterion reflects the criteria in:

- section 44G(2)(d) of the TPA, relating to declaration of a service for access under Part IIIA of the Act; and
- clause 6(3)(a)(iii) of the CPA relating to assessments of the effectiveness of a State or Territory access regime.

The rationale for this criterion is that the National Code should not be applied to pipelines where access might pose an undue risk to human health or safety.

The Application

The application contended that, with appropriate safeguards, access could be provided with minimal risk to human health and safety.

The Council seeks comments on:

- *Whether access to the EGP poses or would pose a risk to human health or safety?*
- *If there are any such risks, what are they? Can these risks be addressed in a satisfactory manner while still providing access?*

Criterion (d) that access (or increased access) to the services provided by means of the pipeline would not be contrary to the public interest.

Background

This criterion closely mirrors the criteria in section 44G(2)(f) of the TPA, relating to declaration of a service for access under Part IIIA of the Act.

One matter of public interest is whether any benefits of access, such as cheaper prices and more efficient use of resources, are outweighed by regulatory or compliance costs. Other matters of public interest include environment considerations, regional development, and equity.

The Application

One issue of particular importance in this case is the fact that Duke has lodged an undertaking with the ACCC setting out the terms and conditions, and tariffs, on which Duke proposes to provide access. However, if the Eastern Gas Pipeline were covered by the National Code, Duke would be required to submit an access arrangement in accordance with the National Code to the ACCC covering the same matters.

Duke may take the view that its undertaking does as much to promote competition as an access arrangement lodged under the National Code, and is preferable due to the limitations of the National Code. On the other hand, AGL may be concerned that by lodging an undertaking, Duke is bypassing the requirements of the National Code in relation to access arrangements. AGL's application argued that in view of the potential for the EGP to promote competition in the NSW and ACT gas markets, "the public interest lies in the application of the National Code principles to third party access to this pipeline to ensure consistency of price setting and certainty for users of pipelines".

The Council must consider whether the wording of this criterion permits the Council to take into account the undertaking process commenced by Duke. This is because the criterion asks the Council to assess whether 'access would be contrary to the public interest'.

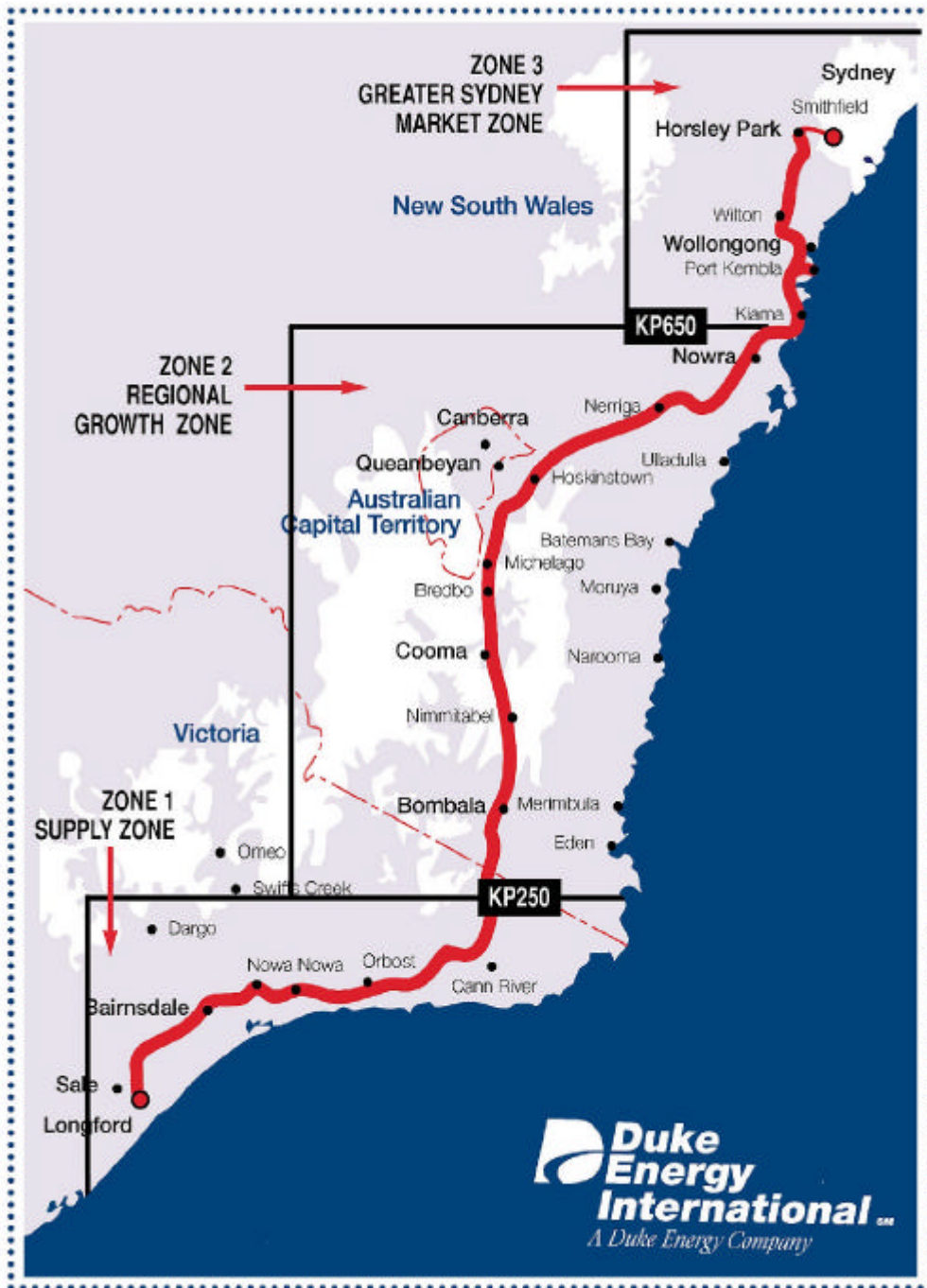
If the Council is permitted to take the undertaking process, then the Council must consider the weight to give to undertaking process in assessing the public interest. The Council must also what factors are encompassed by the public interest.

The Council seeks comments on:

- *can the Council take into account the undertaking lodged by Duke?;*
- *what factors are relevant to the public interest?;*
- *what weight should be given to the undertaking lodged by Duke with the ACCC?; and*
- *what other matters may be of relevance to the public interest in considering this application?*

Annex 1: Route of Eastern Gas Pipeline

EASTERN GAS PIPELINE **SUPPLY ZONES**



Source: Eastern Gas Pipeline Undertaking, Duke Energy International