11 February 2000

Mr Luke Berry
National Competition Council
GPO Box 250B
Melbourne Victoria 3001

Dear Mr Berry

Eastern Gas Pipeline - Application for Coverage – Issues Paper

I am pleased to provide to you Energy Australia's submission on the above issues paper.

Energy Australia has been at the forefront of the development of competition in NSW for electricity and is now supplying gas to 8 major customers in the NSW gas retail market. This has been achieved by overcoming the many hurdles faced by new entrants created, possibly by unintended consequences of the regulatory structure and/or incumbent behaviour.

Energy Australia believes that the best interest of gas market participants would best be served by the promotion of competition not only in the upstream and downstream markets but also in pipeline on pipeline competition.

Therefore Energy Australia's supports the acceptance of the Undertaking recently submitted to the ACCC by Duke Energy as opposed to coverage of the pipeline by the National Gas Access Code.

While some interested parties may have an issue with the undertaking lodged under Part IIIA of the Trade Practices Act, Energy Australia considers this approach as preferable. The concept of pipeline on pipeline competition and commercial risk appears not to have been considered in the development of the National Gas Access Code. Furthermore Energy Australia considers the approach taken by the Code in the lodging of an access arrangement is more appropriate to infrastructure with entrenched monopoly power that exhibits natural monopoly characteristics such as the existing pipelines in NSW.

I trust this submission is of assistance to the Council in its deliberations. If you require any further information please do not hesitate to contact me on 02 9269 4913 or Brian Steffen, Manager Retail Regulatory Affairs on 02 9269 4867.

Yours sincerely

Nick Saphin
General Manager Retail & Marketing

4 February 2000

Mr Mark Pearson
General Manager
Regulatory Affairs – Gas
Australian Competition and Consumer Commission
PO Box 1199
Dickson ACT 2602

Dear Mr Pearson

Duke Energy International Access Undertaking – Issues Paper

I am pleased to provide to you Energy Australia's submission on the above issues paper.

Energy Australia has been at the forefront of the development of competition in NSW for electricity and is now supplying gas to 8 major customers in the NSW gas retail market. This has been achieved by overcoming the many hurdles faced by new entrants created, possibly by unintended consequences of the regulatory structure and/or incumbent behaviour.

I firmly believe that the Commission's acceptance of the undertaking as proposed by Duke Energy can help reduce the barriers to competition in the NSW gas retail market by providing an alternate source of competitively priced gas. The Duke proposal will encourage competition both upstream and downstream and stimulate the growth of the NSW gas market.

The Commission's acceptance of the proposed undertaking will also result in benefits to end use customers through lower prices and the environment through greater utilisation of gas as fuel source resulting in major greenhouse gas reductions.

While some interested parties may have an issue with the undertaking lodged under Part IIIA, Energy Australia considers this approach as preferable. The concept of pipeline on pipeline competition and commercial risk appears not to have been considered in the development of the National Gas Access Code. Furthermore Energy Australia considers the approach taken by the code in the lodging of an access arrangement is more appropriate to infrastructure with entrenched monopoly power that exhibits natural monopoly characteristics such as the existing pipelines in NSW.

I trust this submission is of assistance to the Commission in its deliberations. If you require any further information please do not hesitate to contact me on 02 9269 4913 or Brian Steffen, Manager Retail Regulatory Affairs on 02 9269 4867.

Yours sincerely

Nick Saphin
General Manager Retail & Marketing

Summary

Energy Australia (EA) supports the consideration of the Duke Energy (DEIEGP) Access Undertaking (AU) as submitted to the Australian Competition and Consumer Commission (ACCC) on 18 November 1999 under section 44ZZA of the *Trade Practices Act 1974(TPA).*

EA considers that the undertaking adequately takes into account the legitimate business interest of DEIEGP, the public interest and the interest of those who may seek access.

In addition EA believes that submission of the undertaking in this manner will not only promote competition in downstream and upstream markets but will provide much needed pipeline on pipeline competition, which will result in public benefits such as lower end use prices and reduced greenhouse gas emissions through greater use of natural gas in processes such as generation and co-generation of electricity.

Issues for Consideration

4.1 Information requirements

The information provided is adequate in scope and detail to make informed comment on the proposed undertaking and to appreciate the resultant benefits over coverage by the National Gas Access Code (the code) and the introduction of pipeline competition.

4.2 Proposed tariff structure

a) The basis for tariff setting is adequately explained. Analysis has shown that the proposed tariffs are significantly less than other pipeline tariffs in NSW. (%% than the EAPL and Central West tariffs). The CPI escalation is also % less than EAPL. The setting of tariffs in this manner encourages efficient use of and investment in the pipeline as the incentive to accumulate losses is limited by the fact that a maximum tariff is guaranteed for the term of the undertaking.

b) The use of a market-based approach is appropriate for this pipeline as it is setting a price to encourage use of the pipeline in competition with other pipelines, it could be described as an "entrepreneurial" pipeline. As with any entrepreneurial venture there should be appropriate return and the risk.

   A regulated access and pricing regime based on a cost of service would appear to be more appropriate for infrastructure with entrenched monopoly power, for example where there is one provider / owner of infrastructure in one state and operates close to full capacity.

c) The other charges; overruns, imbalances, fuel and UAG appear fair and reasonable.

d) The undertaking provides a guarantee to the ACCC and access seekers that the tariffs are non-discriminatory. Discounts may be provided as a competitive response however DEIEGP guarantees that it will make the discount available to all access seekers based on a material equivalence test. This concept will assist in ensuring market power is spread amongst all shippers regardless of market share. This differs from the code where discounts may be applied to avoid competitive threats such as bypass yet the discount is recovered from other participants and not made available to them.

e) Forecasts for growth appear reasonable and in line with industry assumptions. By offering 20 year capped tariffs DEIEGP will be taking on the risk if the forecast volumes are not met. The onus to mitigate the forecast risk will be on DEIEGP to encourage the use of the pipeline (in competition with EAPL) through both competitive discounts and to encourage growth in the NSW natural gas market by supplying new geographic areas and industries. An important point to note here is that the users of the pipeline will not bear the risk of forecast errors as would be the case with the cost of service approach. On the other hand if forecast volumes are exceeded then DEIEGP would be rewarded and would begin to secure a commercial rate of return sooner than the 20 years as modelled in the proposed undertaking, consistent with investment in a competitive environment.

f) DEIEGP has explained the risks faced by the project which include

- Forecast volumes
- Maximum tariff for 20 years
- Competition
- Discounts being unrecoverable from other participants
- Losses not being capitalised and recouped in later years
- Capacity

Under the cost of service approach the Moomba to Sydney (MSP) and other pipelines are not exposed to these risks as there are periodic resets and consequently the ACCC has determined a capital base and WACC commensurate with the risk involved.

g) Given the entrepreneurial nature of the pipeline and competition provided by the MSP and the incentives incorporated in the undertaking it would appear likely that efficient use of the DEIEGP pipeline would be promoted.

4.3 Non-tariff issues

a) The competitive and fixed (pricing) nature of tariffs in the proposed undertaking coupled with the development of a secondary capacity market would stimulate effective downstream (retail) competition in NSW. Energy Australia believes the introduction of a second source of competitively priced gas in NSW will support the objectives of the NSW Government to introduce competition to the NSW gas retail market.

The 'brave new world' of pipeline on pipeline competition is untested in Australia and not contemplated in the development of the code (other than allowing for prudent discounts to avoid bypass). The benefits of the concept of competitive markets have been extolled by many and experienced by many electricity and a few gas customers in NSW. The National Electricity Market is now contemplating and encouraging the development of entrepreneurial interconnectors on an unregulated pricing basis.

It is highly likely that the development of the secondary market, as discussed in the proposed undertaking will occur. DEIEGP will need to actively encourage the development of a liquid secondary to assist in mitigating the risk of not meeting its forecast volumes.

b) At this stage in the market development the three services offered are appropriate and are adequately defined in the undertaking. DEIEGP will need to respond to requests from access seekers for new services not yet contemplated to ensure use of the pipeline. A liquid secondary market for gas will also see new services develop.

c) The 20-year term of the undertaking will provide access seekers and end use customers with a price certainty for the services. This would be advantageous to end use customers particularly owner's / developer's of large scale projects that utilise gas, such generation and cogeneration. DEIEGP has submitted the modelling to the Commission to demonstrate the reasoning for a 20 year term to secure a commercial rate of return. EA believes that with this information the Commission is best placed to consider the term of the undertaking.

d), e), f) EA has not at the time writing received expert legal opinion on the elements of the undertaking but believes them to be specific enough to commence negotiations to seek access with a degree of certainty. EA believes that there are no elements that would hinder competition either upstream, downstream or pipeline on pipeline

g) The policies in this section are considered both clear and adequate for access seekers experienced in gas market operations.

h) The proposal to treat expansions to capacity outside the scope of the undertaking is reasonable. If there were concerns about this issue then EA suggests that negotiations for expansion be subject to the same dispute resolution processes as described in the proposed undertaking. This would provide for independent mediation and /or arbitration whilst ensuring confidentiality of the participants to the dispute. The Commission's involvement in the dispute process would also ensure the interests of the parties would be given due consideration.

i) EA considers the details in regards to queuing policy as adequate.

j) The proposed dispute resolution procedures would seem appropriate given the proposed involvement of the Commission.

k) Given that the ringfencing procedures prescribed by the code are to be used in the undertaking, EA considers them adequate.

l) The detailed approach to responding to concerns regarding DEIEGP's compliance with the undertaking should be adequate to allay concerns of non-compliance.

m) DEIEGP proposes to work with the ACCC to develop the "appropriate compendium of to be released to the public". The proposal of releasing annual financial returns in listed company format would assist in reducing the information asymmetry limitations. Consideration should be given to involving shippers in the discussions between the Commission and DEIEGP in the development of the information to be released. DEIEGP also proposes to establish a website for information regarding capacity and other details relating to operations. DEIEGP is also proposes to place affiliate contracts on its website which will ensure public scrutiny and access to discounts if provided. EA suggests a proactive notification (by email) to shippers advising of changes / amendments to the website be considered.

4.4 Regulatory Regime

DEIEGP has proposed that certain elements of the undertaking be consistent with those prescribed in the code such as ringfencing and non-discriminatory pricing. While some may have an issue with the undertaking lodged under Part IIIA, EA considers this undertaking approach as preferable. The concept of pipeline on pipeline competition and entrepreneurial risk appears not to have been considered in the development of the code. EA considers the approach taken by the code in the lodging of an access arrangement is more appropriate to infrastructure with entrenched monopoly power that exhibits natural monopoly characteristics such as the existing pipelines in NSW.