

[Santos submission]

Our Ref: L052/154/PW:jm

5 June 2000

Mrs Alison Smith
Project Manager
National Competition Council
GPO Box 250B
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Dear Madam,

Application for Removal of Coverage of the EAPL (Moomba to Sydney) Pipeline

Introduction

Santos' commercial interests are not affected by the issue of the coverage under the National Third Party Access Code for Natural Gas Pipeline Systems (NAC) the EAPL pipeline. In principle, Santos believes that the market will, with appropriate minimal regulation at the margin, provide the correct result as determined by the competitive pressures of the market place.

Santos is not however indifferent to the basis on which the coverage decision is made. This submission argues that the question of the coverage of a transmission pipeline should be primarily addressed by the application of the Coverage Criteria of the NAC to the pipeline in question. While it is inevitable that an application of the Coverage Criteria will need to consider other issues, particularly other pipelines, it is argued strongly that such consideration must recognise that the primary objective of the NAC, is the creation of access principles for third parties seeking access to the pipeline in question.

It would appear however that the National Competition Council (NCC) is inclined to interpret the Coverage Criteria at Section 1.9 (and particularly S1.9(a) and (d)) in a way that may lead to a conclusion that coverage can be applied selectively to pipelines (operating into the same market) to achieve what might be described as 'competition outcomes'. Any decision which, in the name of competition, reduces the ability of such a third party to gain access would be a perversion of the intent of the NAC. There appears to be a danger that the Coverage Criteria has an inherent internal inconsistency.

There is a parallel with the questions raised in relation to the assessment of Riverlink under the National Electricity Code (NEC). It became clear in that case that there was an internal inconsistency within the NEC. It may be that such an inconsistency also exists within the NAC. The NCC should explicitly and transparently address this issue.

It is inappropriate for the NCC to decide the outcome of either this application for revocation or the application for coverage of the Eastern Gas Pipeline (EGP), on the basis of a judgment that it appears to make that it can second guess the whole of the market for gas in South Eastern Australia. The application for the revocation of the coverage of parts of EAPL coincides with the application for the coverage of EGP. The EAPL application and the EGP application are separate and should stand alone to be judged individually against the criteria of the Code. These criteria relate to whether access to the relevant pipeline, not access to markets or any other matters, meet the criteria set out in the Code.

It is noted that the objectives of the NAC, stated therein, are to be achieved by establishing a National Access Regime for Natural Gas Pipeline Systems (NAC). This makes it clear that the Code is designed to facilitate competition by the mechanism of providing a framework for third party access to gas pipelines. This is the primary and undeniable objective of the NAC.

Clearly therefore it should not be one of the NCCs objectives or outcomes to favour one pipeline at the expense of another. This would be a perversion of the NAC. We submit that it is the NCCs duty to apply the Code to each pipeline and to come to a recommendation on that basis alone. To act in any other way could create a situation where a third party is denied the 'benefit' of the NAC in seeking access to a particular pipeline because of a regulators desire to 'create' competition by other means.

It is noted on P.8 of the Issues Paper that the NCC believes there is a public interest case for regulatory symmetry and that it believes that there are strong policy justifications for uniform regulation under the National Code of all pipelines that meet the coverage criteria. Santos submits that the Code requires compliance with the matters set out in Section 1.9 thereof, one of which is that access to the services provided by means of the pipeline would not be contrary to the public interest. The NCC is attempting to invert this criterion from a negative obligation to "not be contrary to public interest" to a positive obligation that it is in the public interest to have symmetry in regulation of all pipelines. Again, the NCC appears to be getting confused with regard to its duty to apply

the Code to the access arrangements placed before it and to a broader question of competition.

Santos indicated at the time the NAC was introduced that the use of Schedule A was effectively an administrative convenience which was unnecessary and potentially dangerous. Unnecessary, because at the time it was applied (and presently) there was and still is little evidence of any party or parties seeking access to pipelines which could not be offered by means of commercial operation. Dangerous, in that this implies public control over private assets. At the same time, it was clear that Part IIIA of the *Trade Practices Act* provided, (and still provides), adequate mechanisms for an interested third party to seek access to EAPL or other pipelines. In short, the policy of including pipelines or other facilities under a Code prior to the need for inclusion is flawed.

Competition in Eastern Australia

It is noted there is an apparent divergence in opinion between the ACCC and the NCC as to the impact of the GPU Interconnection on competition. In reaching its conclusion on the question of rolling the GPU Interconnect assets into the Principal Transmission System, the ACCC argued that this would enhance competition benefits:

‘ the Interconnect Assets would be expected to present some competitive pressure’

The NCC however, decided in its Draft Decision on the application for Coverage of the Eastern Gas Pipeline that the GPU Interconnection is of no relevance, viz:

‘ with only two sources of competition in the gas sales market, via the Moomba to Sydney and Eastern Gas Pipeline(s) ... ’

This means that there is a factual difference behind the regulation of the three pipelines. This needs to be noted because of the Media Release issued by the ACCC and the NCC on 21 January 2000 indicating their intention to ‘work together’ on the EGP Access Undertaking. This apparent divergence between the two regulators should be explained. It would be unfortunate if there was a perception that facts were being treated differently to achieve desired outcomes. It would be useful therefore for both the NCC and the ACCC to publish all material relating to their co-operation on the EGP issue.

Partial Coverage

The concept of partial coverage of main trunklines and the related concept of a main trunkline not being covered but branchlines therefrom being covered appears to be inconsistent. The NCC in the EGP recommendation, has suggested that coverage from the branch from the main pipeline to Canberra and from there north to Horsley Park does not meet the criteria but the rest of the pipeline does. This appears to be an unusual decision. In the case of a gas producer in, for example, offshore Victoria wanting to sell gas into Sydney, coverage to

Canberra will determine his conditions of transport only part way. It would possibly be open to the pipeline owner to manipulate the charges north and south of that point to suit its desired profit levels. The concept of the EAPL pipeline providing effective competition to the EGP pipeline for those distances is unsound. Questions of capacity and availability thereof, and willingness of gas transporters and both pipelines to always deal in and provide capacity as required, remain unanswered by this approach. If either pipeline is to be covered or not covered, it should be so over its entire length.

Social Test

Santos has considerable concerns about the use of 'social test' rather than the 'private test' in relation to the question of economic duplication.

The Issues Paper states '... a social test consider whether building a new facility represents an efficient use of resources from the viewpoint of the community.'

Without indulging in hyperbole, this view is tantamount to allowing the NCC (and eventually the ACCC as regulator) a role in resource allocation within the economy. It is not just a question of whether the bodies have the capacity to undertake such a role, rather there needs to be a serious consideration of whether the NCC should have such a role.

Obviously, any regulatory decision may have resource allocation impacts and the more significant of these should be considered in any regulatory decision. This is however a subsidiary role and is different from the role that the NCC seeks to appropriate by means of the 'social test'.

It might be arguable that in the context of an application for coverage by a genuine third party (excluding the NCC itself) that de facto the 'private test' is applied. This is so, because arguably, a third party seeking access has reached the conclusion that it would not be able to invest in a new facility.

Such an argument however ignores the fact that this application of the 'private test' is not made transparently. It is possible (likely) that a third party will want to test the outcome of an Access Arrangement under the NAC even though its own assessment is that the investment is viable. It is highly likely that any third party will seek to see if it can achieve a lower cost through access to an existing pipeline even if duplication is viable. Such a lower cost probably means cross-subsidisation. It becomes more difficult to argue that this is 'efficient use of resources' even from the community viewpoint. Such decision-making will remove dynamic efficiency.

However in a case such as EAPL (and indeed the other major pipelines) where coverage has been achieved by administrative fiat, even the de facto application of the 'private test' will not occur. This means that the NCC is left to apply the 'social test'. This may lead to a bias against revocation.

The 'social test' is dangerous and it extends considerably the intent of the NAC from the deliberations of the Energy Reform Task Force and the Gas Reform

Implementation Group. As a minimum the NCC should test the duplication question against both the 'private' and 'social test' and justify its decision.

Measurement of Competition

The Issues Paper raises several issues in relation to competition. It states:

'... the Council must be satisfied that access would actually promote more competitive outcomes – such as lower prices – in another market'.

There are a number of issues here.

1. *Material Effect on Competition*

There is an argument to support the need for an objective process in assessing impact on competition. This does not mean that there needs to be a strict test, rather decisions made by regulators in relation to the material effect on competition should be expressed in a more transparent manner.

This comment is made because, while Santos views compulsory access arrangements as an intrusion on property rights which should not be granted easily or without a strong case, there may be a circumstance where access is justified.

It is difficult to understand therefore how the NCC can propose in the case of EGP that coverage of that pipeline north of the ACT might not promote competition beyond that which EGP's construction might cause. (The same argument would apply to EAPL).

The apparent contradictory treatment of the Victorian Interconnect would also appear to justify this view.

2. *Competitive Outcomes*

The test of material effect needs however to be tempered. The concept of 'competitive outcomes' as lower prices, as suggested in the Issues Paper may be too simplistic. There is a distinct difference between the creation of the conditions of competition within a market and the creation of competitive outcomes which are defined as lower prices (or similar).

The creation of competitive conditions is a reasonable and measurable objective. In fact the NCC appears to have based its attitude towards the GPU Interconnect on competitive conditions (i.e. relative size to other pipelines). Using 'competitive conditions' relies on an expectation about possible outcomes of greater competition.

However the use of competitive outcomes introduces a wide range of variables which are probably beyond the scope of the NCC to measure. and

control. An objective like lower prices will have direct consequences for infrastructure investment and for exploration and development.

For the reasons contained in this submission the view of Santos is that the NCC is in danger of misdirecting itself. Further, public explanation of its motives and how they comply with the objectives of the legislation is required. Failing this, the danger is a perception of bias unconstrained by the legislation providing the power for its activities.

Yours faithfully

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