ENERGY CONSUMERS COALITION OF SA
c/o Mr. John Pike
SMR Automotive Australia Pty Limited
Sherriffs Rd, Lonsdale
South Australia 5160
Ph: 08 8301-7656 Mb: 0416 039 339
Email: John.Pike@smr-automotive.com

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Mr Ross Campbell
Director
National Competition Council
GPO Box 250
Melbourne, Vic. 3001

By email to: Ross.Campbell@ncc.gov.au

Dear Mr Campbell

KCA Application for Coverage of the South Eastern Pipeline System (SEPS)

The Energy Consumers Coalition of SA (ECCSA) is a forum representing large energy consumers in South Australia. The ECCSA is an affiliate of the Major Energy Users Inc (MEU), which comprises over 20 major energy using companies in NSW, Victoria, SA, WA, NT, Tasmania and Queensland.

The members of ECCSA recognise that the cost of providing the energy transport systems is not an insignificant element of the total cost of delivered energy, and therefore the ECCSA has been very active in representing energy consumer interests in the gas and electricity markets.

Because of its interests in the costs of energy supplies[1], the ECCSA welcomes this opportunity to provide comments on the NCC's draft recommendation in relation to the application by Kimberly-Clark to seek coverage of the South Eastern Pipeline System (SEPS) – the transmission pipeline servicing the lower south east of South Australia.

It was of considerable interest to the ECCSA and its members when it learned of Kimberly-Clark's application for coverage of the monopoly gas transmission system in the Mount Gambier/Millicent region of SA. The ECCSA considers that monopoly energy transport assets should be regulated unless there is clear competitive tension which would drive the asset owner to ensure that its tariffs are demonstrably efficient.

In terms of the National Gas Law, the National Gas Objective requires that, amongst other things, the prices charged for use of gas (and electricity) transport should be efficient. The second reading speeches regarding the gas and electricity Objectives in the energy Laws, defines efficiency in economic terms. When the electricity Objective was promulgated in 2005, the Minister in the second reading speech[2] stated:

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[1] See attachment "About the ECCSA"
[2] Hansard, SA House of Assembly 9 February 2005, page 1452. It is recognised that the reference is made in terms of electricity but the gas objective is essentially the same as the electricity objective.

> "The market objective is an economic concept and should be interpreted as such. For example, investment in and use of **electricity services will be efficient when services are supplied in the long run at least cost**, resources including infrastructure are used to deliver the greatest possible benefit and there is innovation and investment in response to changes in consumer needs and productive opportunities.
>
> **The long term interest of consumers of electricity requires the economic welfare of consumers, over the long term, to be maximised.** If the National Electricity Market is efficient in an economic sense the long term economic interests of consumers in respect of price, quality, reliability, safety and security of electricity services will be maximised." (emphasis added)

It is clear that the purpose of the Objective is over-riding and provides a clear intent for what the Gas Law is to achieve. The ECCSA notes that the NCC considers that the criteria for coverage over-ride the Objective of the Law. The ECCSA considers that the NCC has erred in this. The Law states (at clause 97) that

> 97—Principles governing the making of a coverage recommendation
> (1) In making a coverage recommendation, the NCC—
> (a) must give effect to the pipeline coverage criteria; and
> (b) in deciding whether or not the pipeline coverage criteria are satisfied must have regard to the national gas objective

The ECCSA considers that the NCC must have regard for the long term interests of consumers when making assessments in terms of the criteria[3]. The NCC concluded that criterion (a) was not satisfied and that coverage would not increase competition in the upstream or downstream gas markets or in a dependent market. The ECCSA considers that the NCC has erred in its assessment of criterion (a) because it has used a narrow assessment of what is competition.

BusinessDictionary.com defines competition in economics as:

> "Rivalry in which every seller tries to get what other sellers are seeking at the same time: sales, profit, and market share by offering the best practicable combination of price, quality, and service."

The NCC concept of increased competition would be that the number of players in the market would increase. The NCC, in its draft recommendation addressing criterion (a) opines that:

Because of this the second reading speech for the new Gas Law did not reiterate the expectations of the objective as these had already been addressed earlier

[3] The ECCSA notes that the Minister, when making his/her decision must have equal regard for the objective and the criteria, which is slightly different to the requirements on the NCC.

- Beach Energy would have to formally enter the gas market in the Mount Gambier region a way that gives all consumers the ability to seek competitive offers from a party other the Origin Energy
- Kimberly-Clark already operates in a competitive market (there are multiple competitors already) and that coverage of the SEPS will not increase that competition and because there is already competition, there is a commercial imperative that all players will pass on any cost reductions.

The purpose of competition is to ensure that consumers get the lowest price for their purchases – so increasing competition results in lower prices for consumers.

In the case of upstream/downstream gas competition in the region, the NCC points out that Origin Energy (and APA with its ownership of SEPS and SESA) has a monopoly position in the market. The ECCSA considers that if Beach is able to enter the market (even in a small way) in a reasonable time frame[4] then there is the potential for competition to Origin Energy – even if Beach cannot provide sufficient gas to provide for all gas users in the region.

If the cost structure for Beach is such that it needs to have an efficient price for use of SEPS and a regime that is predictable in order to be able to compete, then the NCC must ensure that these conditions are in place to allow this competition to occur. Based on what Beach provides in its response to the NCC, it would appear that coverage of SEPS is a key element for Beach to be able to enter the Mount Gambier gas market. Therefore, the NCC should have determined that coverage of SEPS is a precursor for upstream/downstream competition in the gas market, and that criterion (a) would be satisfied.

Secondly, the NCC has not addressed competition in a holistic manner. If a firm (such as Kimberly-Clark or any other manufacturing gas user) is provided with lower input costs then competition (rivalry) will increase because the gas user, being in competition with other providers of the same product, will pass through the lower costs to increase its market share. Competitors to the firm must also lower their prices or lose market share – so increased competition will result (together with lower prices) from lower input costs. In contrast, a monopoly does not need to pass through any lower input costs and if a firm was prepared to retain the benefit of the lower costs (ie increase profits), there would be no increase in rivalry. Where there are a number of competitors, any reduction in input costs must be passed through to impact market share. So if the firm does not have a dominant market share, lowering its input costs will allow the firm to increase its "rivalry" causing others to try and match the lower selling price, thereby increasing competition.

Implicitly, the NCC draft recommendation seems to assume that:

- Lower input costs will not result from coverage of SEPS
- A firm without dominant market share will not pass through the lower input costs that coverage of SEPS would achieve and cause a resultant increase in competition (rivalry)
- Therefore coverage will not increase competition.

[4] The NCC states that Beach has gas available now and is targeting to have more available in 2-3 years time which is reasonable in terms of gas market time frames

The ECCSA considers that by taking a narrow view of competition (looking only the numbers involved in a market) the NCC has missed the point about what competition is about. Looking closer at what is intended by the criteria, criterion (a) works properly for the indirect market if a reduction in input costs has to be passed through to consumers, just as would occur if there is an increase in the number of competitors in the market. Assessing criterion (a) in this way, criterion (d) makes more sense, as this is the quantification of the market benefit that results from the lower input costs having to be passed through to the wider public.

The ECCSA point can be made just as clearly looking at the reverse of the way the criteria are applied. If there is the lack of coverage on a monopoly pipeline (ie SEPS can charge higher than efficient prices and a monopoly rent is taken) the gas using firm has higher input costs and its selling price would rise as a result. This would allow its competitors to either increase market share or increase prices. This means that a lack of coverage has resulted in a lessening of competition (rivalry).

The ECCSA therefore considers that a lowering of input costs in a competitive environment must result in an increase in competition. For criterion (a) not be to be satisfied, the NCC must demonstrate that coverage will not reduce input costs, or if input costs did reduce, that the reduction would not be passed through to the affected market. The ECCSA does not consider that the NCC can demonstrate either of these in this case.

The review by ECCSA of the NCC draft recommendation clearly identifies that the SEPS is a monopoly and because of this, the owner of SEPS is able (in the absence of coverage of the pipeline) to set whatever tariff for the pipeline use it considers the market can bear. This provides prima facie evidence that the pipeline will only deliver efficient prices when it is regulated. Regulation will only occur if the pipeline is a covered pipeline.

What is most concerning is that, according to the advice Kimberly-Clark provides in its application, there is clear evidence that Epic Energy (now APA Group) used its market power to seek monopoly rents, and that it was not concerned with ensuring its prices were demonstrably efficient – as is expected from the Gas Objective.

Yours sincerely

John Pike
Chair, ECCSA

The Energy Consumers Coalition of SA (ECCSA)

Analysis of the energy usage by the members of ECCSA shows that in aggregate they consume a significant proportion of the energy (gas and electricity) used in SA. As such, they are highly dependent on the transmission networks to deliver efficiently the energy so essential to their operations. Many of the members, being regionally based in SA and therefore heavily dependent on local suppliers of hardware and services, also consider that they have an obligation to represent the views of these local suppliers. With this in mind, the members require their views to not only represent the views of large energy users but also those of smaller power using facilities, and even of the residences used by their workforces.

The companies represented by the ECCSA (and their suppliers) have identified that they have an interest in the **cost** of the energy networks services as this comprise a large cost element in their electricity and gas bills.

Although electricity is an essential source of energy required by each member company in order to maintain operations, a failure in the supply of electricity (or gas) effectively will cause every business affected to cease production, and members' experiences are no different. Thus the **reliable supply** of electricity (and gas) is an essential element of each member's business operations.

With the introduction of highly sensitive equipment required to maintain operations at the highest level of productivity, the **quality** of energy supplies has become increasingly important with the focus on the performance of the distribution businesses because they control the quality of electricity and gas delivered. Variation of electricity voltage (especially voltage sags, momentary interruptions, and transients) and gas pressure by even small amounts now has the ability to shut down critical elements of many production processes. Thus member companies have become increasingly more dependent on the quality of electricity and gas services supplied.

Each of the businesses represented by ECCSA has invested considerable capital in establishing their operations and in order that they can recover the capital costs they have invested, long-term **sustainability** of energy supplies is required. If sustainable supplies of energy are not available into the future these investments will have little value.

Accordingly, ECCSA (and its affiliate MEU) are keen to address the issues that impact on the **cost, reliability, quality** and the long term **sustainability** of their gas and electricity supplies.