



APPLICATION FOR LIGHT REGULATION

ON

THE MOOMBA TO SYDNEY PIPELINE

**SUBMISSION TO THE NATIONAL COMPETITION
COUNCIL**

By Major Energy Users Inc

2 October 2008

This project was part funded by the Consumer Advocacy Panel (www.advocacypanel.com.au) as part of its grants process for consumer advocacy and research projects for the benefit of consumers of electricity and natural gas.

The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel or the Australian Energy Market Commission.

The content and conclusions reached in this submission are entirely the work of the MEU, and its consultant, Bob Lim & Co Pty Ltd.

Contents	Page
Overview	3
1. Introduction	4
2. Comments on Part 1 of the MSP Application	5
3. Comments on Part 2 – Effectiveness Criteria – of the MSP Application	7
4. Factor (a) Presence and Extent of Barriers to Entry in a Market for Pipeline Services	14
5. Factor (b) Network Externalities between Natural Gas Services of the Same provider	16
6. Factor (c) Network Externalities between Natural Gas Service and Other Services of Provider	17
7. Factor (e) Presence and Extent of any Substitute in a Market for the Pipeline Service	17
8. Factors (f) Presence and Extent of any Substitute on Market for Electricity or Gas	18
9. Access to Information	21
10. Incentive to Negotiate/Arbitrate	22
11. Light Handed Effective for all Shippers	24
12. Summary on Effectiveness Criteria	24
13. Part 3 – Comparative Cost of Forms of Regulation (s122 (1) (b))	25

Overview

1. The Major energy Users Inc. (MEU) provides, in the very limited time available, its comments to the National Competition Council on the Moomba to Sydney Pipeline (MSP) application for light regulation.
2. This submission argues that the MSP will continue with, if not increase, its ability to exercise significant market power, moving forward as a result of light regulation.
3. Consumers have little or no countervailing power, and there is very limited pipeline competition now and in the foreseeable future.
4. APA is not an altruistic pipeline service provider. The differences in regulatory costs to APA between full and light regulation appear very marginal. This raises the very pertinent question as to what benefits APA will gain through light regulation.
5. There are very substantial concerns in respect of the availability of information disclosures needed to allow consumers to assess the reasonableness of tariffs offered by APA as part of light regulation, and to identify grounds for appeal to the AER and for the AER to be effective in its arbitral role. Such information is needed in order to negotiate with the pipeline service provider on a basis even approaching some level of equality.
6. The MEU provides many points responding to the Application, which require qualification or correction.

1 Introduction

1. The Major Energy Users Inc (MEU) welcomes the opportunity to provide comments on the Moomba to Sydney Pipeline (MSP) application for light regulation.
2. The MEU represents major electricity and gas users, a number of whom directly use gas transported on the MSP or indirectly via gas retailers. MEU members use gas for transportation and as a feedstock. Gas can represent a significant proportion of the input costs incurred by member companies.
3. MEU members have participated in the National Competition Council's (NCC's) coverage processes in earlier years, and in an initial appeal before the Australian Competition Tribunal against Federal Minister Ian MacFarlane's decision to only partially cover the MSP.
4. The participation of MEU members in the reviews cited above and in the current review, is based on the imperative of ensuring that transportation tariffs are economically efficient. Where competition in gas transportation is not available, economic regulation is seen as the surrogate for applying a certain amount of competitive pressure. However, the MEU notes the introduction, under the new National Gas Law (NGL) of a new light regulatory approach, returning to the "negotiate/arbitrate" model provided for under Part 111A of the Trade Practices Act 1924. This model relies on users and pipeline service providers negotiating the terms and conditions of the services concerned, with binding arbitration by the Australian Energy Regulator.
5. The NGL provides the criteria for considering applications for pipeline owners to apply for light regulation. From the perspective of users, the key issues are the:-
 - Significance or degree of market power that a pipeline applicant may exercise;
 - Extent of countervailing power of users; and
 - Transparency and adequacy of information available to users and to the AER (the latter when it exercises its arbitration role).
6. This submission follows the structure of the MSP application.

2 Comments on Part 1 of the MSP Application

7. Some useful background information is as follows.
:
8. APA, the owner of the MSP, is also the monopoly owner of the Victorian Main Transmission Pipeline. It can transport gas from Longford, Victoria via Culcairn, in addition to the transportation of gas from Moomba, South Australia. Although the capacity of the Culcairn interconnect relative to the capacity of MSP is quite small, it does provide APA with a unique ability to set the price for transportation to Wagga/Canberra consumers at the highest price.
9. Apart from Visy, which is shown in the Application as a large industrial end user/shipper, some other large industrial users have also directly negotiated transportation tariffs. The majority of end users ship gas from Moomba via their retailer/shippers, and these gas contracts are not necessarily fully transparent or unbundled, so the accuracy of the transportation component of the bundled contract cannot be determined with certainty.
10. Gas from Moomba is not only used as an energy source, but also as feedstock in the manufacture of ammonium nitrate for explosives and fertilisers.
11. Gas can represent a significant proportion of a large industrial user's input costs. At the same time, the investment made by an end user requires the delivery of gas in order for the investment to generate a return. In most cases there is little ability to change to alternative forms of energy, implicitly making the supply and delivery of gas an essential service.
12. The Sydney Gas/AGL joint venture's Camden gas project, which is stated to have the potential to provide some 30 PJ of gas per year (or some 25% of total NSW/ACT demand) and is a potential alternative source of gas for Sydney as reserves are located within the Sydney distribution network system, is noted as being possibly developed over the next 3 to 4 years. In other words, a new competitive gas source is some 3 to 4 years away.
13. Unfortunately, CSM in the NSW coal fields is classed as "very tight" meaning that release of gas from the NSW coal fields is much more difficult to release and gather than from the Queensland coal fields. Thus whilst the concept of CSM appears attractive in the NSW context, it still has to be proven that CSM will be available as a commercially viable alternative to gas imported via MSP, Culcairn or EGP.

14. The Application refers to various proposals for new pipelines, some of which are under construction, while others are “under consideration”. Apart from the “QNI Link” where construction is scheduled to be completed in 2009, the other proposals mentioned in the application, are many years away, if they are viable at all.
15. In other words, the degree of market power that the MSP may have will not be largely affected in the foreseeable future, as a result of these proposals as there is significant doubt as to their practical viability as competitors to MSP.

3 Comments on Part 2 – Effectiveness Criteria – of the MSP Application

3.1 Approach

16. The Application refers to s122 (1)(a) of the NGL and states that whilst the term “effectiveness” is not defined, some guidance is provided by reference to circumstances in which light regulation is intended to apply “where it is likely to reduce costs” while still providing an effective check on a pipeline’s market power.
17. In the MEU’s view, “cost reductions” are also not defined, but should be interpreted to mean “significant” or “effective” cost reductions. “Minor” cost reductions should not be accepted in the “with or without” analysis.
18. Para 24 of the Application states:

“The effectiveness of this model (i.e. the “negotiate/arbitrate” model) depends on the ability and willingness of users to engage in effective negotiations against the service provider so as to make the negotiation the mechanism through which commercially acceptable terms for both parties can be agreed. In other words, the negotiations need to be commercially meaningful and this requires an ability and incentive on the part of the user to “look after itself” when negotiating with the service provider. If this is not the case, the arbitration mechanism becomes the one through which outcomes become principally determined. A single arbitration may be less costly than full regulation. However, the regulatory fixation of tariffs and terms for all users under full regulation, particularly where there are many users, would likely be most cost effective than a series of arbitrations, were that to be the outcome of light regulation”.
19. The MEU notes that the effectiveness of the “negotiate/arbitrate” model really depends on the transparency and the adequacy of information that the pipeline service provider is prepared to provide to the user, in order that the user can establish that the terms and conditions of the service are “fair and reasonable”. This is a realistic way in which the user is able to “look after itself” in a negotiation (see para 2.5). The more the degree of market power held by the service provider, based on experience in “negotiating” with a monopoly provider, the less willing will be the provision of such information.
20. The “countervailing power” of the user can be over-rated. In the MEU’s submission to the NCC on its draft light regulation guidelines, the MEU said:

“It is worthwhile to note that many large users are sceptical about their ability to exercise countervailing power, notwithstanding the confidence

held by some that such power exists. In particular, it is worth noting, from the Productivity Commission's Report *Review of the Gas Access Regime* (June 2004), which states that:

“Although such alternatives might provide some users with a degree of bargaining power relative to a pipeline owner, other users might not be in such a position. A user that has no real fuel or energy substitute and is located in a market that is serviced by a single transmission pipeline (for which there is excess demand) is unlikely to have significant bargaining power. Western Power argued this, noting:

...[as] contracts expire, and WPC's [Western Power Corporation's] needs for gas transmission capacity increase, WPC is finding that it has little or no bargaining power. There are a number of large users in the south west of Western Australia, all with a critical need for gas and all competing for the limited amount of the DBNGP [Dampier-Bunbury pipeline] transmission capacity that is available. ... In circumstances where WPC has a large sunk investment in gas-fired generators and there are no alternative gas or gas transportation options, WPC cannot make a credible threat to not deal with the owner of the DBNGP. (sub. DR115, p.16).

Worsley Alumina also argued its bargaining power was constrained by some of these factors:

In the present environment, the user will incur the highest cost if it is unable to secure gas transmission capacity. In Western Australia, users lack any real ability to credibly make a threat to the owners of the DBNGP [Dampier-Bunbury pipeline] that users will cease contracting to access gas transmission services as users' bargaining power is severely constrained by a number of factors...

- (a) lack of alternative transmission pipelines;
- (b) the extensive sunk costs in infrastructure that can only be fuelled by natural gas for example gas turbines;
- (c) a very limited ability to substitute alternative fuels for natural gas, especially in industrial applications where product quality considerations may require the use of natural gas, for example in calcination in alumina refineries; and
- (d) environmental agreements. (sub. DR110, p.4)

Similarly, WMC Resources argued (with particular reference to the Western Australian goldfields region) that users lacked bargaining power because they lacked credible alternatives:

...there appears to be little significance attributed to the lack of bargaining power of pipeline users, which are completely dependent upon the services of a particular pipeline. That's particularly the case, I thin, in Western Australia, particularly in the goldfields region and a lot of the mining and industrial clients there. (trans., p.923)

It is worth noting that the [Productivity Commission] Report also draws attention to a submission from a large user, Orica, to the effect that it could cease manufacturing and switch its ammonia requirements over to imports once its gas contracts expired, and imputes that Orica could have negotiating coin with the pipeline owner. The Productivity Commission did not make the point that should Orica switch to imports of ammonia, it would have had to write off several hundreds of millions of dollars in ammonia manufacturing plant and equipment!"

21. Para 2.6 states:

"In addition to considering whether users would have the ability and incentive to negotiate effectively under light regulation, s.122(1) requires a comparison of the effectiveness of full and light regulation to promote access to pipeline services. The key question here is - would light regulation be at least as effective as full regulation in promoting access to pipeline services. If so, and the costs of light regulation are lower, than light regulation would be appropriate".

22. The MEU makes the point (as in para 9 above) that the "cost reduction" should be interpreted to mean "significant" or "effective" cost reductions and not simply "lower".

3.2 Position Under Full Regulation

23. The regulated and posted tariffs information shown in para 2.8 clearly show the consequences of the Australian Competition Tribunal's interesting decision in significantly raising the Regulatory Asset Base of the MSP, to the effect that the regulated tariff, from 2005/06, exceeded the posted tariff. The regulated tariff, however, has always been regarded as the maximum tariff, and opportunity to negotiate tariffs below the regulated tariff was the intention under-pinning the review process.

24. The Tribunal's 2003 decision effectively removed the effectiveness of the Gas Code in protecting the interests of consumers, whereby the

regulator set maximum tariffs and provided scope for tariff negotiation below that maximum. That posted tariffs almost immediately rose in 2006/07 and again in 2007/08 is primarily due to revenue maximisation rather than reflecting “the need to cover costs associated with major capital maintenance works on the MSP associated with the repair of stress corrosion cracking as well as capacity augmentations on the pipeline”. (para 2.11). These increased costs would have been anticipated by the MSP at the last regulatory review and the AER would have made provision for such expenditures at that time. The MEU considers this observation as important in the relative tariff analysis provided by the Application. There is no information available or any suggestion made by the application that posted tariffs will not rise substantially beyond 2007/08 i.e. should the application for light regulation be successful. Should light regulation result in further increases and the negotiate/arbitrate approach fail to stem the rising costs, the question arises whether any change from the full regulation approach should have been supported.

25. The principle of arbitrate/negotiate is predicated on the assumption that users of the pipeline service have the ability to negotiate. As noted earlier, the MEU is of the view that many end users will not have a “champion” to negotiate on their behalf and as a result be disenfranchised by the entire process, and be left exposed to a monopoly service provider keen to maximise its returns for its shareholders.

3.3 Form of Regulation Factors

3.3.1 MSP Low Degree of Market Power

26. The MEU recalls that the NCC had previously recommended full coverage of the MSP. The subsequent decision by Federal Minister MacFarlane was to “uncover” the large proportion of MSP and retain coverage of the Marsden to Wilton element including laterals. In the recommendation to the Minister, the NCC recommended that the entire MSP should remain covered, based on the principle that the fully contracted EGP did not provide competition to MSP. In the MEU’s view, the NCC must examine whether the circumstances underpinning its earlier recommendation have changed, and warrant a move to light regulation for the last remaining covered parts of MSP.
27. The MEU accepts for the moment the tests adopted within the Application for considering a gas pipeline’s market power.

3.3.2 Existence of Spare Pipeline Capacity

28. APA goes to considerable lengths to point out there is likely to be adequate spare capacity on MSP in the future, as the demand in ACT/NSW will not exceed the combined capacity of MSP and EGP. APA asserts this provides a competitive pressure on it not to use market power to drive up the tariffs in the future under a light regulatory model.
29. APA floats (conveniently) between capacities and demands based on PJ/a and TJ/d in order to make its points. What is critical is the need to assess daily capacities (TJ/d) as even if on one day demand exceeds capacity then large industrial gas users are constrained immediately without recompense. The costs to such consumers are much more than the value of the gas not available, yet at the same time revenue to MSP is hardly impacted.
30. What APA fails to address in its considerations is the impact on actual and planned gas fired generation on gas demand. In this regard, the NCC must have cognisance of the:-
- current status of generation in NSW which is currently a large net importer of power from other states by over 1000 MW on average peaking at nearly 5000 MW inflow to the state.
 - The planned greenhouse gas mitigation measures of encouraging more efficient generation (such as more cogeneration) and the impact of the Emissions Trading Scheme (ETS), which will result less coal fired generation and more gas fired generation,
 - Overall major need for new gas fired power generation in the state.
31. In this regard the MEU has assessed that in addition to the current Botany, Smithfield and Hunter Valley generation (560 MW) will be added new generation already approved and/or being built (Uranquinty, Tallawarra, Munmorah, Tomago and Port Kembla totalling 2650 MW), and there will be perhaps another 1000MW (Eraring, Nowra and Marulan) of additional gas fired generation. Even though a number of these plants are open cycle and unlikely to operate continuously, they will place a significant additional gas demand on EGP, MSP and Culcairn supply arrangements.
32. Noting that Uranquinty and Tallawarra (1050MW) are already built we can assume that in the near future there will be added 3000 MW of new generation with 1/3rd of these base load (ie are combined cycle generation for 20 hours/day) and the other 2/3rd are open cycle generation operating for 6 hours/day, then this will require some 280 TJ/d additional gas delivered.

33. Based on the data provided by APA (2.28) currently there is capacity of delivering some 600 TJ/d including the expansion of MSP and the current peak demand has reached 550 TJ/d, providing a minimum surplus of only 50 TJ/d. With the addition of new gas fired generation this surplus will quickly become a deficit of between 200-250 TJ/d.
34. For APA to allege that there is adequate unused capacity and therefore a commercial pressure to negotiate is an incorrect view of the likely future position.

3.3.3 Commercial Imperatives on MSP

35. The EGP is fully contracted at the moment. In fact, it had to increase its capacity recently in order to provide gas for the new Tallawarra combined cycle generator. A pipeline operating at full capacity provides little commercial pressure on competing pipelines.
36. This leaves the MSP and the inter-connect as the alternative providers of gas transport, both of which are owned by APA. In the absence of competition from EGP there would appear to be no competition to MSP allowing it to use its market power to maximise revenue. Thus with EGP operating at full capacity and requiring more investment to increase its capacity, there is a commercial opportunity for the MSP to increase its revenue through either increasing its throughput and/or increasing tariffs. In either case there is little countervailing competitive pressure from EGP.
37. It is quite clear that new generation will be the major cause of increased gas demand, and it has been identified already in the Owen Inquiry¹ that there is a shortage of generation in NSW. With the pressure to reduce greenhouse emissions, gas fired generation will be the generation of choice, providing a strong impetus for increased gas transportation on MSP (and EGP).

3.3.4 Competition from EGP

38. Gas transportation tariffs on the EGP have risen sharply recently, based on the latest auction of capacity registered.
39. Give the shortage of gas transport capacity, it is unlikely that there will be competition between the MSP and EGP. Rather, a duopoly is likely to develop with limited competition.
40. It is the view of the MEU that the MSP throughput since the completion of the EGP in 2000 has declined due to a number of causes, including

¹ Report on Inquiry into Electricity Supply in NSW, issued September 2007

- The much heralded and forecast reduction in the availability of gas from Moomba,
- EGP antecedents and relationships in that EGP was originally part owned by BHP and was contracted to BHP entities Bluescope and OneSteel, targeted pricing by Longford for BHP affiliates and other firm gas users,
- Increased gas availability from Longford,

rather than competition in transport services from the EGP.

41. With respect to the growth of gas-fixed power stations in the coming two decades, the MEU's view is that NSW is likely, on the basis of known projects, to be short of >200TJ's in capacity. This suggests that the pipelines are unlikely to be robustly competing, but if anything, ensure that transportation prices keep rising.

42. Against that background, it is difficult to accept that consumers and shippers will have bargaining leverage with the MSP or with the EGP.

4. Factor (a) Presence and Extent of Barriers to Entry in a Market for Pipeline Services

4.1 New Pipelines providing alternative supply routes

43. It is agreed, as stated in para 2.46 of the Application that:

“Alternative pipelines tend to reduce barriers to entry for new gas basins to supply customers that may have previously been captive to a single basin and its associated transmission pipeline”.

44. However, the MEU notes that as a counter point to this observation:

- The EGP is currently fully contracted
- The interconnect is owned by APA, also the owner of MSP

Thus whilst there is greater range of gas supply options (including via the Ballera to Moomba pipeline owned by Epic Energy), the fact is that other than EGP, APA owns and controls all other gas transport options into the NSW market through its ownership of the MSP and the interconnect, and therefore APA is able to extract rent from users, irrespective of the gas supply source.

4.2 Resale of Pipeline Capacity by MSP's Large Shippers

45. It is true that a number of large users and gas shippers have undertaken secondary market transactions in MSP (and EGP) transportation services. However, a secondary transaction is based on the premise that the capacity has already been acquired by the initial shipper. Therefore what is occurring does not disadvantage MSP as such although it does prevent MSP from selling the same capacity twice. This is hardly competition for MSP.

46. Equally, it is noted that these transactions are generally tied to other non-transaction arrangements that these parties have with other parties. It is not certain that these secondary market transactions are not undertaken opportunistically and would tend to support MSP tariffs. In addition, it is not clear the extent of these trades do offer competitive pressures to the MSP. It is also noted that large gas wholesalers and retailers offer bundled services. These transactions largely involve short term trading.

47. APA makes reference to the approach by some producers/aggregators offering bundled services of gas and delivery on RBP. The MEU finds it intriguing that APA sees this as competition. The producer aggregators still acquire capacity on RBP and pay for the transport. Whether transport is paid by the producers, end users or by retailers, APA still

receives payment for the services it provides, regardless of who the shipper is.

48. For shippers to resell capacity they have paid for but are not using, does not in reality impact on MSP, unless MSP considers that it should be paid twice for providing the same service. After all, the same amount of gas is transported regardless of which shipper ultimately pays for the service.

4.3 New Pipeline Developments and Emergence of CSM

49. It is agreed that new pipeline developments and the emergence of CSM will lower barriers to entry for new gas demand. The key issue is the timing and availability of the competition. The concern that MEU has is that such potential competition can be overstated without a good understanding of the likely reality. As noted above in para 13, NSW CSM is classed as “tight” gas. As a result its ready availability is limited and its cost is higher than the CSM available from the Queensland coal fields.
50. APA makes reference to the potential for one or two new pipelines being constructed – Wallumbilla to Newcastle and Wallumbilla to Bulla Park. It should be noted that the pipeline from Wallumbilla to Newcastle has been under consideration for many years, and one of the main constraints on being built is the high cost. A new high cost pipeline is unlikely to provide competition for MSP.
51. The pipeline from Wallumbilla to Bulla Park will not provide competition to the regulated section of MSP (Marsden to Wilton) and has the potential to increase usage on the regulated section of MSP or to offset the declining output from Moomba. Either way, this proposal will not be a competitor but enhance the value of the regulated part of MSP.

4.4 Swap Contracts

52. It is noted that there are few examples of swap arrangements and their potential to enhance a shipper’s bargaining position with a pipeline should not be overstated.
53. MEU points out that whilst swap contracts are in place, such swaps can occur in the absence of a pipeline. However, the ability to enter into swaps is quite constrained due to the conditions precedent for enabling the swap to occur, and as a result, swaps do not cause significant competition for MSP.
54. Overall, a swap does not reduce the amount of gas transported on the pipeline, but do prevent the pipeline from selling the same capacity twice

5 Factor (b) Network Externalities between Natural Gas Services of the Same Provider

55. It is accepted that network externalities tend not to be an issue in the case of gas transmission pipelines, especially in Australia where traditionally each gas transmission pipeline provides a connection between a specific gas field and a specific gas market. Thus there is an intertwining of gas producer and gas pipeline needs rather than a need for multiple gas pipelines with the same owner to provide support for each other and as a result reduce competition.
56. MEU is not as sanguine about the ability of the Interconnect with APA's ownership of VTS to foster competition. APA points to the fully regulated status of VTS, yet if the VTS is considered to be a source of gas, APA ownership of the Interconnect does provide it with an ability to influence the cost of gas transmission on elements of the regulated part of MSP.
57. As gas from the Interconnect comes from either Longford or Otway Basin, and the NSW market accesses such gas via the APA controlled Interconnect, APA does have some market power over gas supplies from Moomba and further north when QSN is completed. As gas from Moomba into the NSW market can only be delivered by MSP, this gives a degree of market power of MSP over gas from Moomba. APA can provide pressure on Moomba producers due to its ability to provide gas transmission services for gas from other gas fields via the Interconnect. Thus APA has the ability to pressure Moomba producers into paying higher gas transmission prices by increasing gas flows on the Interconnect.

6. Factor (c) Network Externalities between Natural Gas Service and Other Services of Provider

58. The MEU agrees that there are no network externalities with the MSP with other network service providers that might give rise to market power.

7. Factor (e) Presence and Extent of any Substitute in a Market for the Pipeline Service

59. APA asserts that its loss of market share on MSP is evidence of competition, but there are other reasons for this loss of market share. The progressive loss of market share by the MSP to EGP may be due to:

- more competitive gas supplies from Longford, Victoria, relative to Moomba, South Australia
- declining gas supplies from Moomba and the quality of gas issues applying at Moomba
- relative physical conditions of the two pipelines and hence relative available capacities
- relative efficiencies of the two pipelines and hence relative available capacities

60. The Sydney Gas supply of 12TJ/day is relatively marginal.

61. Reference is made to the potential for QSN to negatively impact MSP. This is extremely unlikely. In fact, for gas to move from the declining and increasingly expensive gas resources of Moomba to the extremely low cost and extensive reserves in Queensland beggars belief. The more likely scenario and the basis for the building of QSN is that gas from Queensland will flow into Moomba and hence available for the NSW market via MSP.

62. This observation is supported by the APA view that new pipelines from Wallumbilla to Newcastle or Bulla Park are likely to occur.

63. Demand for MSP transport services is not elastic, but is influenced by the degree of free capacity on EGP and the Interconnect. Once the capacity on these is reached, there is no elasticity of demand on MSP.

64. The extent of price elasticity on MSP is predicated on the relative costs of gas from Moomba vis-à-vis Longford. With lower costs for gas ex Queensland this will improve the ability of MSP to set prices and increase the gas flow on MSP.

8. Factors (f) Presence and Extent of any Substitute on Market for Electricity or Gas

65. There is limited substitutability between gas and electricity. In fact, as APA notes gas fired electricity producers have very limited ability to substitute gas for another fuel. It is gas fired generation that constitutes the burgeoning demand for gas and therefore this provides MSP with a position of market power.

66. APA points to the example of the Central Ranges pipeline where consumers can change to other fuels. This avoids two very fundamental but major constraints on competition by other fuels to gas:-

- Once a change has been made to gas firing it is very capital intensive to revert to other forms of fuel, whether this is at a household level or an industrial level. Therefore the costs of conversion create a barrier to change.
- With the national requirement for reducing greenhouse emissions, to revert to liquid fuel, LPG, wood or coal, will face a carbon emissions charge that makes reversion to these other fuels less attractive compared to gas. Of all the alternatives noted by APA, gas has the lowest carbon emission per unit of fuel.

67. Overall, in a carbon constrained environment gas has less competition than in the past.

8.1 Countervailing Power of Users

68. As previously noted, there is limited countervailing power by users due to:

- the lack of real alternatives
- dealing with a monopoly

Past experience of users in attempting to negotiate with monopoly service providers only reinforces this view.

8.2 Vertically Integrated Energy Majors

69. Although the MEU tends to agree with the sentiments expressed by the Application, it is important to note that there are other reasons for the “majors” to diversify their portfolios, rather than just attempting to place pressure on APA.

70. In fact it is the need for overall certainty of supply that predicates the “majors” using both pipelines. Large shippers have experienced reliability issues with both the Moomba/MSP supply and the Longford/EGP supply arrangements. Diversity is not fundamentally an attempt to secure better pricing but one of reliability.

71. That the “majors” may have some ability to exert pressure on MSP through related party transactions is feasible, but whether such pressure is provided for the benefit of end users (especially small end users) is debatable. As noted above, full regulation does provide end users with the view of their ability to influence outcomes, whereas in a negotiation they have almost no power to provide pressure on MSP

8.3 Stand-alone Energy Retailers

72. The MEU agrees with the sentiments expressed by the Application.

8.4 Power Stations

73. The MEU agrees with the view expressed up to the time the generator commits and for the duration of its initial contract. However, once the initial contract is complete, the generators is at the mercy of the pipeline owner, due to large amount of sunk assets dependent on the pipeline.

8.5 Large Industrials

74. APA alleges that as a large user of gas has the option of using either direct service or via a retailer, this constitutes countervailing market power. MEU members do not support such a view.

75. A large user will seek a bundled price but uses the unbundled individual prices to develop a view as to which option is commercially more attractive. Neither option increases the amount of gas used or flowing on the pipeline.

76. What does occur with the two options is that an aggregator is able to provide a benefit through the diversity of the aggregated demands. Few users have a perfectly flat load, and an aggregator is able to offset one user’s variability with another user’s variability. If each user contracted directly with the pipeline then each user has to contract for the peak demand. An aggregator attempts to match peak demand of one with a less than peak demand of another, overall reducing the amount of capacity needed to be contracted.

77. Aggregation only reduces the amount of capacity paid for rather than increasing the countervailing power, and prevents the pipeline owner from selling large amounts of capacity that are never used.

78. In a regulatory review, this impact of aggregation is implicitly included in the tariffs set.

79. When this is considered the observation in the application that large consumers have countervailing power is simply not valid.

80. APA makes no attempt to provide any view about the ability of small consumers to have any countervailing power, yet small users require large amounts of gas, especially in winter, to the extent that small user consumption is a significant amount of the total gas usage.

9 Access to Information

81. Adequacy of information is critical in assessing the relative merits of full versus light regulation. The application points to the availability of information (under light regulation) from many different sources, many of which may not be strictly comparable; confidential only to the AER; and relate to different time frames. Key cost components such as capex and opex data are not available, except in statements to the ASX.
82. Whilst Origin and AGL clearly possess the expertise to assess the reasonableness of MSP costs, industrial users do not necessarily have that capability.
83. It is access to information that allows consumers of gas to identify if the total amount paid for gas is reasonable, by developing a notional bundled price. In the absence of such information consumers cannot be assured that they are paying a fair price for what must be effectively considered to be an essential service.
84. The absence of such an ability to assess the price set by a monopoly provider outside of direct government control or oversight must be considered to be a failure of the regulatory regime.

10 Incentive to Negotiate/Arbitrate

10.1 Industrial, Commercial and Residential Gas Usage

85. The Application provides a view that as the cost of gas transmission is such a small element of the total cost and comparable to the retail margin, then:

- A change in transmission tariff has little impact, and
- A retailer has the incentive to increase its margin by driving the transmission price down.

86. What the analysis overlooks is that of the total delivered cost of gas transport (transmission and distribution) is more than half of the total delivered cost of gas. As the transport is essentially a monopoly service, then there is a desire of consumers to see that the monopoly service provider does not extract monopoly rents.

87. Thus where there is the ability to extract rents, then the response from consumers is to either have government oversight or regulation. APA posits that for a small element regulation need not be invasive. In fact, APA seeks many \$10s of millions from the use of its asset and this is not an insignificant sum.

88. APA then asserts that there is an incentive for retailers to bargain with it. This seems to be counter to the view put by APA at paras 2.97-2.101 where APA asserts that it will give the same benefit of negotiation with the "majors" to the minor stand alone players. This then means that status quo is maintained with full regulation where there is a maximum tariff permitted and most users pay the same, except where there is an agreed discount.

89. A tariff negotiated separately with each user is not transparent and therefore there is no ability for all to see what is considered to be an acceptable maximum tariff

10.2 Power Station Gas Usage

90. APA quite rightly points to power station load shape which predicates the gas usage pattern. The implication is that a gas transmission pipeline crafts a unique tariff for a gas fired power station to match its profile. This may be the case, but either the gas power station agrees to an interruptible tariff (ie one that only provides when there is unused capacity available) or a tariff which reserves firm capacity when needed by the power station,

91. It would seem incongruous that a power station would base its ability to operate on the vagaries of the available capacity of a gas pipeline in preference to the certainty it can call on capacity at the time it needs it.
92. While a power station might take this interruptible capacity risk when there is ample capacity on the pipeline, to do so when capacity is close to constraint would be a “courageous” decision, and certainly not one that lenders to the power station owner would countenance.
93. APA points out that the unique demand profile of power stations would be better managed by a light regulatory approach as it would provide more flexibility. The MEU points out that this flexibility is available to MSP under the current maximum tariff arrangement, but where a cap is provided. The implication of the APA approach seems to imply that a cap might need to be exceeded if flexibility is granted.

11 Light Handed Effective for all Shippers

94. The MEU requirement is there is a need for transparency as this ensures that there is no price discrimination. Light regulation does not provide this transparency.
95. APA points out that they consider they will grant to all shippers the same tariff that the “majors” receive. If this is the case there is no incentive on the “majors” to negotiate as they will not receive a commercial benefit for this negotiation. Thus light regulation as interpreted by APA is that the majors will continue to negotiate, and this benefit will flow to all. But if the majors don’t negotiate (because they receive no commercial benefit) this raises the question as to whether they will continue to negotiate.
96. The main thrust of the APA application is predicated on the continuation to negotiate by the “majors”. The MEU doubts this will happen if there is no commercial benefit to do so, and the tariff will become a “pass through” just as the distribution tariff is.

12 Summary on Effectiveness Criteria

97. The MEU believes that the MSP has significant market power:
- the substitution threat from the EGP is limited, because the latter is already fully contracted, and the competition from Sydney Gas is limited and in any case, is fully contracted to AGL.
 - The sources of information are diverse, may not be strictly comparable, and are time-consuming and resource-intensive to obtain
 - The Interconnect is also owned by APA.

13 Part 3 – Comparative Cost of Forms of Regulation (s122 (1) (b)

98. Para 3.5 of the Application makes the point that APA is unable to comment on the cost savings of light regulation for end users. Consumers that take a bundled gas contract from a retailer often do not know the cost of transportation, so any saving from light regulation is less than likely to be passed on. Should this be the case, then the NGL objective "... in the long term interests of consumers" is not met.

It is also not acceptable, as claimed in para 3.6 that:

"the assessment of the costs of regulation outlined in this Part 3 assumes APA is an efficient service provider. This assumption is consistent with general capital market disciplines on APA to minimise costs and maximise efficient outcomes".

99. A pipeline owner, even without significant market power, is not under full competitive pressure to minimise costs and maximise efficient outcomes

100. The APA points out that a move to light regulation will result in cost savings, and provides substantiation of these savings. There is no certainty that light regulation will result in these savings being passed onto to consumers, in fact there will be no ability of consumers to see if this has occurred.

13.1 Nature and Outcomes of Commercial Negotiations Unaffected by Form of Regulation

101. APA points out that the provision of information used by users and potential users needed to assess MSP tariff under light regulation, will remain unchanged. This is not really so. As light regulation continues to be applied over the years, the relevance of past regulatory determinations wanes, making these of marginal use at best, and possibly no use at all. EGP tariffs are public only because EGP makes them so. In future, in the absence of regulation on MSP, EGP could decide to dispense with this public provision of tariffs and follow the approach used by other unregulated pipelines.

102. End users will need to incur more costs in assembling and analysing the diverse services of information said to be available prior to negotiations with the pipeline under light regulation. A normal practice will be to engage a consultant to undertake the preliminary assessments, prior to in-house assessments. Tenders will then be called for shippers/gas retailers to provide quotes. Negotiations will then be conducted with the pipeline. The costs of all this will be higher than under full regulation.

103. Whilst those consumers who have the time, funds and ability to carryout such detailed evaluations as mentioned by APA to assess the negotiated tariffs, there will be many consumers that do not have this ability to assess the fairness of the APA set tariffs. Effectively these consumers will be disenfranchised by the proposed change.

13.2 Differences between Forms of Regulation

104. To achieve the transparency needed for reasonable assessment of equity for all users, requires the sort of information required under full regulation. Full regulation only requires that the information be presented (only once every 5 years!) in the form required under an AA and AAI. APA wants only to provide price terms and conditions and none of the information considered by consumers as essential for their needs.

105. It is not unambiguous that there is any appreciable cost difference for the pipeline under full or light regulation. However, periodic reports to the regulator on access negotiations will be a new additional cost to the pipeline.

13.3 Costs to APA

13.3.1 MSP

106. The costs to APA shown in para 3.18 are exceptional and unique, as APA was forum shopping – i.e appeals to the ACT and then subsequently to the High Court. It was always worthwhile for the APA to incur these costs, as the price of success was a very much higher ICB.

107. APA provides costings showing that even when these costs are excluded, it still incurs significant costs, some of which might not be recovered. From APA's view it is recompensed much of the "normal" costs a regulated pipeline would incur, so a move from full to light regulation will have a marginal impact on APA costs. In fact, increased negotiation will erode much of the unrecovered costs of full regulation.

108. If there is no overt commercial benefit for APA to move from full to light regulation (and possible increased unrecovered costs), this raises the very apposite question as to why such a change is being sought by APA.

109. APA has not previously been demonstrably altruistic, as its appeals against previous regulatory decisions show. The only construct MEU can put on why APA seeks light regulation for MSP is that it sees there is a strong commercial case for doing so. This commercial benefit can only come from increased costs for using MSP.

13.3.2 GasNet as a Proxy

110. APA uses GasNet charges incurred in its recent reset review as a proxy for future costs MSP might incur.
111. The MEU does not agree that GasNet is a useful proxy. MSP is essentially a single pipeline with a few laterals. VTS is a complex and well meshed transmission pipeline system, comparable more to a distribution network than a transmission pipeline like MSP.
112. Notwithstanding the differences between the two, the bulk (if not all) of the costs GasNet incurred were allowed to be included in the reset by the ACCC.

13.3.3 Other Proxies

113. The use of the other proxies needs to be assessed in light of the additional investment made by the owners to achieve greater revenue than the regulator allowed. Such investment is a part of all commercial enterprise – is it worth investing now to gain a larger benefit in the future.
114. It is quite difficult to assess from the information provided by APA whether the regulatory decisions were reasonable and that the additional investment by the pipeline owners was aimed at increasing their revenues.
115. On this basis the MEU recommends very careful use of such information, as there is a high risk that quite distorted assessments will be derived.
116. APA points out that much of the direct costs for a full regulatory review are allowed as part of the reset, but then asserts that internal costs are not included. The MEU is not convinced that this is the case as the internal costs are usually lumped into the normal operating costs included in the opex element of an application. Without definite proof that such internal costs were excluded from the allowed opex, the MEU counsels extreme care before accepting this APA assertion.

13.3.4 Potential for Increased Costs due to Appeals

117. APA notes that appeals have caused considerable cost as part of full regulation. This is not denied, but the decision of the owner to appeal a regulatory decision is made knowing there is a potential reward for the cost involved. The MEU considers that many of the appeals made by pipeline owners have been generated because the owners considered there was a reward greater than the cost of an appeal.

118. Consumers are of the view that generally regulators favour regulated businesses, There is some justification for such an approach as the downside risk of failure of a regulated asset will be greater than the upside the regulator grants in order to maintain the regulated asset in good financial order.

119. Because of this there is a view held by consumers that regulators tend to make reasonably good and fair decisions. When a regulated entity sees an opportunity for a windfall benefit it will take this opportunity and so increase its profitability. If an appeal is the mechanism for achieving this then the regulated owner will carry out a cost benefit analysis based on this process to assess its likely return.

120. APA notes that most of the appeals related to the value for the initial capital base and the WACC. The problem with setting the ICB and the WACC is the wide range of values permitted in the Gas Code. Asset owners sought the highest possible rate so as to maximise their profitability.

13.3.4 Costs for shippers and end users

121. Again, APA shows altruism in seeking to reduce costs for representation at resets by end users. That end users see this cost as an investment in mitigating the excessive costs claimed by regulated entities is their election.

122. If all regulated entities only claimed their fair costs then this end user representation would not be needed. What is concerning is that light regulation will not provide a basis for end users to be confident that the tariffs set under light regulation will be fair and reasonable

13.3.6 Ongoing regulatory costs

123. APA points out that it will no longer have to incur ongoing costs associated with regulation. This is concerning as there will be a need to provide information to the AER in the event of arbitration. Such data needs to be kept continuously so that the data is available when required

124. As APA notes any saving in regard to this will be relatively modest.