CWP LIGHT REGULATION SUBMISSION

NON-CONFIDENTIAL SUBMISSION

Country Energy

28 October 2009

This submission is made by Country Energy (ABN 37 428 185 226) (**Country Energy**) in response to the Application for light regulation determination for Central West Pipeline services by APT Pipelines (NSW) Pty Limited (**Application**).

Some parts of this submission are confidential and have been redacted.

This submission adopts the terminology and acronyms used in the Application.

1. Introduction

1.1 Country Energy is a state owned energy retailer, supplying natural gas to NSW customers connected to the CWP and to customers connected to the CRP network, downstream from the CWP.

1.2 Country Energy opposes the revocation of coverage of the CWP and a move to light regulation. Light regulation of the CWP would render APA unconstrained in its ability to recover monopoly rents from shippers and retailers on the CWP and a change to the tariff structure would likely result in higher costs to it and/or end users. Light regulation would not effectively promote access to the CWP services.

2. Principles governing the appropriateness of light regulation

2.1 The NGL sets out the considerations that the NCC must take into account in determining whether light regulation is appropriate for a covered pipeline. Relevantly, section 122 of the NGL provides:

(1) "In deciding whether to make a light regulation determination ... the NCC must consider—

(a) the likely effectiveness of the forms of regulation provided for under this Law and the Rules to regulate the provision of the pipeline services (the subject of the application) to promote access to pipeline services; and

(b) the effect of the forms of regulation provided for under this Law and the Rules on—

(i) the likely costs that may be incurred by an efficient service provider; and

(ii) the likely costs that may be incurred by efficient users and efficient prospective users; and

(iii) the likely costs of end users.

(2) In doing so, the NCC—

(a) must have regard to the national gas objective; and

(b) must have regard to the form of regulation factors; and

(c) may have regard to any other matters it considers relevant."

2.2 Section 23 of the NGL sets out the national gas objective as follows:

"The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."

3. Country Energy's involvement with the CWP

3.1 Country Energy is a retailer on the CWP. Country Energy estimates that its load accounts for approximately 50% of the load on the CWP. Of this, 45% of the load on the CWP is accounted for by throughput to the CRP. Country Energy is currently the only natural gas retailer on the CRP.

3.2 [redacted]

3.3 [redacted]

3.4 Country Energy does not expect that the customer base on either the CWP or the CRP will increase substantially in the future. New connections on either pipeline system would only be marginal.

4. Effectiveness of light regulation to regulate the provision of pipeline services and likely costs of end users

Price Control

4.1 If the CWP were subject to light regulation Country Energy and other users would not have the benefit of any CWP Reference Tariffs as a benchmark against which future tariffs could be negotiated. Without that benchmark (and due to the lack of constraints on APA in setting tariffs and tariff structures for the reasons set out below), there would be no certainty as to the price that Country Energy and consequently an end user might be required to pay for the pipeline services. In addition, the availability of binding arbitration as a check on the ability to dictate prices is illusory. Again, an arbitrator would not have the benefit of a benchmark by which to judge the appropriateness of any tariffs offered by the service provider.

4.2 Access to pipeline services is therefore not effectively promoted under light regulation and the costs to end users are likely to be increased. This is inconsistent with subsection 122(1)(a) and (b) of the NGL.

Tariff Structure

4.3 Under the AA, the Reference Tariff is based on a throughput charge per GJ. However, the Application foreshadows that APA will change the tariff structure so that it incorporates both a capacity charge and a throughput charge per GJ (paragraph 1.40 to 1.47). In addition, it is conceivable that overrun charges may apply.

4.4 APA suggests that it will retain the existing revenue base at the same level into the future and that the new tariff structure is to be revenue neutral (paragraph 1.47).

4.5 Country Energy and other users are unable to take any comfort from this assurance. Under light regulation, APA may determine its pricing in whichever manner it thinks fit. APA is not committed to behave in any particular way into the future. There is no compulsion to remain revenue neutral. To the extent that users can pass through any increase costs to its customers under supply contracts, end users will suffer increased costs. To the extent that users cannot pass through those increased costs (as discussed below), users of the CWP will also have to bear increased costs.

4.6 As indicated in the Application (paragraph 1.39), the owners of the CWP and the MSP agreed to discount the transport cost through the MSP and CWP for the gas transported to the CRP as part of the incentive to construct the CRP. A throughput charge of $2.62 per GJ is currently payable by Country Energy (**Current Rate**).

4.7 Whilst Country Energy is concerned about the possible uplift to all tariffs under light regulation, a change to the Current Rate is of particular concern. Country Energy has long term contracts with customers on the CRP which are based on the Current Rate. Any change in the Current Rate or method by which it is charged will result in a "mismatch" between customers' contract charges and charges levied by APA for the CWP. Under the AA, if Country Energy's customer base changes and its load profile changes, since only a throughput charge is payable, Country Energy would not be penalised. Since:

(1) [redacted]

(2) [redacted]

(3) [redacted]

(4) [redacted]

under a capacity-based regime requiring Country Energy to commit to certain capacities, the only option available to Country Energy would be to pass this risk on to customers in the form of higher tariffs and/or take or pay obligations.

4.8 In addition, if the CWP were to move to capacity-based charging, a retailer could be exposed to penalties for exceeding MDQ's or MHQs. There may therefore be some reluctance to commit to certain capacities. This denies the service provider an ascertainable revenue base into the future. As such, there is an increased risk for all users. Costs may be accordingly increased.

4.9 [redacted] Currently the CRP has not embraced daily read metering. The CRP also uses throughput tariffs exclusively and (subject to an application to amend its access arrangement, will continue to do so until 2019). It is not appropriate to initiate a capacity charge without the contract loads downstream having daily read meters. A retailer is otherwise unable to manage its portfolio.

4.10 This leads to the consequent issue of who will accept the responsibility for the cost of the upgraded metering and who will be responsible for ongoing data management.

4.11 It has also been foreshadowed that overrun charges will be payable if a user exceeds MDQs and MHQs in using the CWP. This issue presents a risk to all users in that they do not, by and large, have control over volumes passing through the receipt point at Marden or Dubbo due to the configuration of the CWP.

4.12 For example, a retailer might be liable to pay a penalty when an hourly quantity flows through a gate station (from the transmission pipeline into the local reticulation) that exceeds that retailer's MHQ. A MHQ equates to a MDQ divided by 24. During one day, it is possible that more than the MHQ (plus an allowable excess) would flow in one hour even if the overall MDQ was not reached. Even though there is no way to verify if it was that retailer, another retailer or both causing the hourly spike in flow, the retailer could be charged a penalty for the spike in overflow in that hour. This is despite the fact that the daily flow is under the MDQ booked. There is no avenue for a retailer to pass this cost on as retailers are not able to view their customers' hourly usages. The only option to avoid penalty would be to book up and pay for MDQ well in excess of the actual MDQ required.

4.13 Moreover, since the amount of overrun charges would be unconstrained under light regulation, a user's risk is heightened. Again, to manage this risk, it may be necessary to pass this on to customers through higher prices.

4.14 With a tariff based on capacity, some end users will be disadvantaged. Customers with loads that are seasonal are a good example. These customers have already committed to purchasing natural gas on the basis of commercial natural gas prices (reflective of all third party charges including the current throughput tariff) which may become substantially higher under a capacity-based tariff.

4.15 If APA wishes to adopt capacity-based charges and to charge for overrun, it can do so by amending its existing AA under section 132 of the NGL and in any event can seek the change when it submits a new AA in 2010. Adopting this approach would permit APA to augment its revenue-recovery in its favour and still protect users of the CWP from APA extracting monopoly profits. To move to light regulation to permit a change to the tariff structure would compound the risks and exposure faced by Country Energy and end users by not constraining the amount of the charges faced by them.

4.16 Due to the fact that some parts of the Application are confidential, Country Energy does not know what new tariffs are proposed. It is therefore unable to provide specific examples of its concern. Country Energy requests that the proposed new tariffs accompany the Application so that the real impact can be calculated for all customer groups. In any event, as discussed above, Country Energy could not rely on the proposed tariffs as stated as APA has an unfettered ability to change those tariffs at any time.

5. National Gas Objective

5.1 Country Energy acknowledges that a change to the tariff structure for the CWP *may* further the National Gas Objective in promoting efficient operation and use of, natural gas services. It is possible, however, for APA to achieve these objectives without subjecting the CWP to light regulation. In fact, the benefit of an access arrangement is that the most efficient operation of the CWP can be properly determined. As previously mentioned, APA can seek to amend the tariff structure in the existing AA or in 2010, can submit a new AA with a revised tariff structure. It should not be accepted, without further elaboration and analysis, that the National Gas Objective would be promoted by reason of light regulation in itself.

6. Form of Regulation Factors

Substitutes

6.1 The Application is conspicuous in its brevity in relation to the existence of substitutes in the market for the pipeline services. Country Energy submits that there are no meaningful substitutes to the CWP pipeline services.

6.2 In paragraph 2.42, APA admits that there is currently limited availability of other pipeline services substitutable with the CWP. In Country Energy's view, this is a clear differentiator between the current Application and the case for the light regulation of the covered portion of the MSP. In the case of the MSP, it might have been considered that the existence of the EGP, as a competing pipeline presented a level of competitive constraint. There is no alternative for the delivery of gas to customers supplied through the CWP as it is a radial feed line, and not a part of a ring main system.

6.3 As to the availability of natural gas substitutes, Country Energy is unable to accept that any meaningful substitution possibility is presented by electricity or other energy sources.

Countervailing Power

6.4 Country Energy is the largest user of gas transportation services on the CWP. However, it rejects the proposition that it or any other retailer is in a strong negotiating position with APA.

6.5 Assuming that a service provider is willing to negotiate an increase in capacity reservation, the only time when a retailer has any bargaining power with the service provider is when it has a new customer. That is the only time when the load is fully contestable. A customer seeking to connect for the first time still has the flexibility to move to another site, connect to another network or to not go ahead with a connection at all. To say that a retailer has countervailing power at any other time is erroneous. In addition, any bargaining power may be further diluted with the emergence of gas fired generation on the CWP.

6.6 As indicated above, Country Energy's forecast for new connections predicts only minor growth. Most of Country Energy's customers are the established, foundation customers of the CRP. Load requirements are therefore mostly entrenched and not contestable. To that end, it is in fact APA that holds the bargaining power as the retailer and customers have no alternative but to accept gas transportation services on its terms.

Network externalities

6.7 APA is the ultimate owner of the MSP. All shippers on the CWP also use the MSP. Contrary to the Application, (paragraphs 2.36 to 2.38), the interdependency within APA group's portfolio of natural gas pipelines is suggestive of market power on the CWP. This is undiluted by the fact that APA might deal with the same group of shippers. For the reasons that Country Energy does not have countervailing power on the CWP, it does not have countervailing power on the MSP and accordingly the externalities support APA's market power for the CWP.

7. Other Matters

7.1 APA argues that Country Energy would have the incentive to bargain hard for CWP services because of the incentive to create a margin on any reduction achieved (see paragraphs 2.78 to 2.84). This is incorrect as normally third party charges are passed through at cost to a customer. In any event, absent countervailing power, whether or not Country Energy has the incentive to bargain hard is meaningless.

8. Conclusion

8.1 Due to the lack of meaningful substitutes and countervailing power, APA's ability to determine tariff structures and tariff amounts for the CWP would be mostly unconstrained under light regulation. A change to the tariff structure would also likely result in a high costs to Country Energy, other users on the CWP and/or end user customers. Accordingly, light regulation would not effectively promote access to the CWP services in a manner more favourable than full coverage.

8.2 Country Energy might be willing to agree that light regulation is appropriate in circumstances where:

(1) daily read metering is funded and installed on all contract customer sites in the CRP;

(2) no end user is disadvantaged by the tariff change that is being sought; and

(3) the existing tariff structure based on throughput tariff also should be preserved and the capacity-based tariff should only be introduced as an alternative tariff.

8.3 However, light regulation cannot be granted subject to such conditions. Accordingly, Country Energy opposes the revocation of coverage of the CWP and a move to light regulation.