20 October 2014

John Feil
Executive Director
National Competition Council
GPO Box 250
Melbourne Vic 3001

NCC Draft Decision and Statement of Reasons – Light Regulation of Envestra's Queensland Gas Distribution Network

Dear John,

The Energy Networks Association (ENA) welcomes the opportunity to provide a response to the National Competition Council's (NCC) Draft Decision in relation to Envestra's application for a light regulation determination in respect to the Queensland Gas Distribution Network (QGDN), which was made on 29 September 2014.

By way of background, the ENA is the national industry association representing the businesses operating Australia's electricity transmission and distribution and gas distribution networks. Member businesses provide energy to virtually every household and business in Australia. The ENA's members own energy network infrastructure assets valued at over $100 billion.

The ENA strongly supports the NCC's Draft Decision that the services provided by the QGDN be light regulation services.

The ENA considers that Envestra's application for light regulation of the QGDN made a compelling case that light regulation of the QGDN will be as effective as full access regulation in promoting access to the pipeline services but at a considerably lower cost. This assessment was guided by the *National Gas Objective* and consideration of the "form of regulation factors".

POLICY FRAMEWORK FOR LIGHT REGULATION

It is widely recognised that regulatory oversight is costly and should therefore be proportional to the issue that the regulation is seeking to address. The provisions for light regulation were introduced into the *National Gas Law* (NGL) in recognition that full access regulation may not be appropriate for the pipelines that do not possess substantial market power.[1]

The existing regulatory framework specifically allows for a diverse range of gas networks with differing levels of potential market power to be regulated in a proportionally calibrated way. In making a decision whether to apply light regulation, the NCC needs to compare the effectiveness and the costs of light regulation versus full access regulation. This assessment needs to be guided by the *National Gas Objective* (NGO) and consideration of the "form of regulation factors". In this way, the regulatory regime allows for reductions in the cost of regulation without compromising on its effectiveness. Such an outcome better promotes the long-term interests of consumers by allowing for reliance on competition and countervailing market power to lead to efficient outcomes.

[1] South Australian Hansard 2008, National Gas (South Australia) Bill 2088, Legislative Assembly, 9 April 2008, p.2889.

Envestra's application for light regulation determination for the QGDN follows the removal of coverage for a range of smaller regional networks. As a small network that serves a low usage market and does not possess market power, the QGDN is a precise fit for circumstances that the light-handed options were designed in contemplation of policy makers. Indeed, it would be difficult to envisage a situation where light regulation would be applied if not to the QGDN.

The ENA considers that the NCC's Draft Decision is consistent with the policy intent of the framework for light regulation.

EFFECTIVENESS OF FULL AND LIGHT REGULATION

In determining the appropriate form of regulation, the key consideration is whether there is the potential for market power to be exploited by a service provider.[2] The NGL provides seven "form of regulation" factors that the NCC needs to consider in order to make this judgment. The ENA notes that the NCC broadly accepted Envestra's views in relation to the "form of regulation factors".[3] The ENA agrees with this decision and does not intend to repeat the assessment of each factor in this response.

However, the ENA wishes to re-emphasise that gas is a fuel of choice and there are practical and low cost substitutes, such as LPG and electricity, available in the area serviced by the QGDN. This is becoming an increasing issue for marginal gas networks such as the QGDN given pending increases in wholesale gas costs driven by the commencement of the LNG export industry in Queensland, which is occurring at a time of relative stable (or declining) electricity prices.

Also, large industrial users have sufficient countervailing power as they are able to bypass the QGDN and source gas from the either Allgas distribution network, the Roma to Brisbane Pipeline or the Queensland Gas Network, depending on the location of their facilities. This pressure is particularly strong for new industrial users and/or those users undergoing an expansion and/or renewal of their facilities.

Envestra's pricing decisions are, therefore, constrained by the risk of losing throughput as its customers may choose to substitute gas for alternative fuels and countervailing power of the existing and prospective large industrial users.

COSTS OF REGULATION ALTERNATIVES

There are significant costs associated with full access regulation. In its application, Envestra notes that most of the costs are incurred in the preparation of the access arrangement proposal, as well as ensuring annual compliance with the approved access arrangements.[4] The ENA agrees that these costs are significant and unnecessary given that light regulation would be as effective as full access regulation in promoting access to the QGDN services.

The Australian Energy Market Commission has previously indicated that the cost to a service provider of participating in a regulatory determination process is in the range of 0.01 to 0.3 per cent of total revenue over a five year period.[5] This is in line with the cost estimate of $3.35 million in direct costs to Envestra from participating in the access arrangement approval process that is put forward by Envestra.

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[2] South Australian Hansard 2008, National Gas (South Australia) Bill 2088, Legislative Assembly, 9 April 2008, p.2889.

[3] NCC, Draft Decision and Statement of Reasons, Light Regulation of Envestra's Queensland Gas Distribution Network, September 2014, p.17.

[4] Envestra, Application for Light Regulation of Envestra's Queensland Gas Distribution Network, August 2014, p.40.

[5] Australian Energy Market Commission, Perspectives on the Building Block Approach, 2009, p.9.

In its application for light regulation determination, Envestra estimated that that the total costs of light regulation are likely to be in a range of $0.4-0.8 million over a five year period. This compares to the estimated total cost of full access regulation of $5.2 million over a five year period.[6]

Therefore, the ENA expects that light regulation will result in significant cost savings for the network operator, the regulator, industry stakeholders who participate in the access arrangement approval process and, ultimately (and importantly), gas users.

REGULATORY INTERVENTION UNDER LIGHT REGULATION

The key difference between full access regulation and light regulation is that under light regulation the reference tariffs are not prescribed through the access arrangement approval process. However, the fact that light regulation does not require the prescription of reference tariffs does not mean that pipeline services are not regulated. Rather, light regulation places a greater emphasis on market-driven outcomes by facilitating commercial negotiation on terms and conditions of access and provides for a regulatory intervention when commercial negotiation is unsuccessful.

In a case in which commercial negotiation is not successful, the NGL provides for a dispute resolution mechanism. Under the NGL, the Australian Energy Regulator (AER) is the dispute resolution body, which can determine terms and conditions of access if required. If an access dispute is referred to the AER, it is able to determine a price for services provided by the QGDN for the purpose of resolving the dispute. The ENA notes that light regulation currently applies to three gas pipelines. The ENA observes that, to date, no access disputes were reported to the AER, suggesting that that the framework for light regulation has created the right incentives for network operators and access seekers.

Further, the *National Gas Rules* provide for additional safeguards in order to promote effective commercial negotiation. These safeguards include:

- The requirement on the service provider to publish price and non-price terms on its website;[7] and
- The requirement to report to the AER on access negotiation relating to light regulation services.[8]

Finally, there is a credible risk that if any concerns about market power being exploited arise, the NGL allows any person to request the imposition of full access regulation.[9]

The ENA considers that such safeguards are integral to light regulation and should provide significant assurance to stakeholders that efficient market outcomes will continue to be delivered, particularly against the backdrop of the market characteristics of the QGDN. The ENA notes that such safeguards were not mentioned by any of the three submissions received by the NCC on Envestra's application.

If you have any questions, or the ENA can be of further assistance in developing the NCC's views on this matter, please contact me on 02 6272 1555.

Yours sincerely,

John Bradley

Chief Executive Officer

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[6] Envestra, Application for Light Regulation of Envestra's Queensland Gas Distribution Network, August 2014, p.45.
[7] National Gas Rules, section 36
[8] National Gas Rules, section 37
[9] National Gas Law, section 118