Response to National Competition Council Draft Decision of the Application for Light Regulation of Envestra's Queensland Gas Distribution Network

Envestra Ltd

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Introduction

1. Envestra agrees with the National Competition Council's (NCC) draft decision to make a light regulation determination in respect of the Queensland Gas Distribution Network (QGDN)[1]. Envestra considers the NCC's decision is consistent with not only the National Gas Law (NGL) but also the intent of the introduction of the "light" form of regulation into the National Gas Law in 2008. As stated in the NGL's Second Reading speech:

   "…where light regulation can reduce the costs of regulation while still providing an effective check on a pipeline's market power, the light regulation option should be available."

2. The NGL seeks to ensure the form of regulation is commensurate to the degree of market power in the provision of pipeline services. As explained in our application, Envestra does not have the ability to exercise market power due to the low cost and readily available electric or LPG alternatives for the services provided by the QGDN. As the NCC recognised in its draft decision[2]:

   "The most significant constraint on market power associated with the QGDN is the ability for end users to substitute other forms of energy – electricity and LPG. The Council (NCC) acknowledges the precarious competitive position of gas in areas served by the QGDN"

   and

   "Importantly the level of constraint imposed by these factors is unlikely to be reduced by the application of light regulation of the QGDN."

3. On the matter of cost savings under light regulation compared to full regulation, the NCC acknowledged:

   "..the Council's view the estimates supplied by Envestra are broadly reasonable and there is no need for the additional precision which might result from more extensive analysis."[3]

   and

   "…the Council accepts that the costs of light regulation of the QGDN are likely to be significantly less than those associated with full regulation."[4]

4. Given the constraint on Envestra's market power and the likely savings to be made under light regulation relative to full regulation, it is appropriate that the NCC concluded[5]:

   Light regulation is likely to be similarly as effective as full regulation of the QGDN. Users and other interested parties may notify an access dispute where this is

[1] NCC, Draft Decision and Statement of Reasons – Application for a light regulation determination in respect of the Queensland Gas Distribution Network, 29 September 2014, paragraph 4.60, p18

[2] Ibid paragraph 4.28, p 12

[3] Ibid paragraph 4.45, p 14

[4] Ibid paragraph 4.50, p 15

[5] Ibid paragraph 4.59, p 18

necessary and in such an event the AER is no less able to address relevant issues than it would be in a full regulation context.

Light regulation is likely to involve significant cost savings – primarily for Envestra, but also for other parties.

Light regulation of the QGDN is consistent with promotion of the national gas objective.

5. Envestra also considers the NCC's draft decision for a light regulation determination in respect of the QGDN to be consistent with the broader regulatory/policy push:

   a. for network service providers (gas and electricity, distribution and transmission) to engage more effectively with stakeholders; and

   b. to review, and where appropriate, reduce the regulatory cost burden to the community.[6]

6. Light regulation facilitates both of the above objectives.

7. Envestra does not intend to restate the case for light regulation in this response to the NCC"s draft decision. Envestra however will take this opportunity to respond to certain issues raised by the submissions received from Origin Energy (Origin), Simply Energy (Simply) and the Energy Retailers Association of Australia (ERAA). While the NCC adequately dealt with these issues in the draft decision, Envestra considers further explanation and information from Envestra may be of additional benefit.

Ongoing Safeguards

8. Each of the submissions raised a concern regarding the need for retailers to negotiate with Envestra for access to the QGDN. The ERAA stated (which view was similarly held by Simply):

   … new entrants have little countervailing power against Envestra's monopoly power to negotiate terms and conditions[7]

9. The above assertion is predicated on the false belief that Envestra would gain from discriminating between retailers. This however is not the case. The competitive position of the QGDN relative to the alternative fuel sources of electricity and LPG is likely to be improved by a greater number of retailers serving the market, which will in-turn most likely lead to an increase in throughput of gas.

10. Envestra therefore has no incentive to discriminate against any retailer, existing or new entrant, tier 1 or tier 2, for the reasons the NCC correctly identified in the draft decision:

    Given Envestra's assessment of the position of gas in the Queensland market and the constraints imposed by light regulation, the Council finds it difficult to see why or how Envestra would discriminate against Simply Energy or any other

[6] As an example, the Queensland state government has set a target for government agencies to reduce the burden of 'red tape' by 20% by 2018 across all sectors of the Queensland economy.

[7] Energy Retailers' Association of Australia, Application for light regulation of Envestra's Queensland Gas Distribution Network, 11 September 2014, p 2

party which might encourage additional gas sales. Perhaps more importantly, the Council does not see how a shift to light regulation would materially change Envestra's ability to do so.[8]

11. Origin Energy also considered that, in the long term, its ability to negotiate effectively for terms and conditions of access to the QGDN would deteriorate over time.

> *… past regulatory information will become less and less relevant over time and as circumstances change. In addition, information on other distribution networks cannot explain the underlying fundamentals that drive changes in the QGDN.*[9]

12. Envestra believes the retailers have not given due (or any) consideration to the continued safeguards that will exist under light regulation, which safeguards are:

    a. access to a dispute resolution process that is administered by the AER;

    b. a requirement for Envestra to publish any price and non-price terms of access on its website and inform the AER of access negotiations; and

    c. the ability for any user to seek to have full regulation reinstated if this is considered to be appropriate.

13. Envestra agrees with the NCC's conclusion that the provision of information continued to be required under light regulation:

> *…will assist prospective users in determining the reasonableness of prices offered and if necessary to trigger an access dispute. While some of this information may become less relevant over time, dramatic changes in relation to the operation of the QGDN seem unlikely*[10]*.*

14. Envestra considers that the safeguards referred to in paragraph 12 are a central feature of light regulation and will facilitate the continual delivery of efficient market outcomes on the QGDN.

Queensland Electricity Market

15. Envestra considers the attempts of retailers to link the light regulation determination for the QGDN with the impending changes to the electricity market in Queensland to be spurious. The extent of electricity retail competition in Queensland will not be influenced by the form of regulation of the QGDN. Envestra agrees with the NCC's view on this matter:

> *In relation to concerns about electricity markets, it is not clear to what extent any effects on competition in an electricity market can appropriately be considered in the context of an application for light regulation of a gas pipeline. It might be open to consider such an issue under s 122(2)(c) in appropriate situations. However, the Council does not consider this to be such a situation.* [11].

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8 Op Cit NCC paragraph 3.8, p 7

9 Origin Energy, Application for light regulation of Envestra's Queensland Gas Distribution Network, 11 September 2014, p 6

10 Op Cit NCC, paragraph 4.29, p 12

11 Op Cit NCC, paragraph 3.9, p 7

16. Retailers themselves are not clear on the importance of being able to retail gas and electricity to a customer, particularly in regard to improving the environment for market entry. Responses to the AEMC's retailer survey conducted for the 2014 retail gas and electricity competition review sought views on the importance of dual fuel offerings. These responses were summarised in the report as follows[12]:

    a. Interviewees held mixed views about the importance of economies of scope (i.e. dual fuel) in electricity retailing. That is, while some interviewees claimed it is an important source of efficiency in terms of customer acquisition costs (i.e. two revenue streams from the same level of market expenditure), others claimed that supplying dual fuel or multi-utility products is just a form of product differentiation (or retention strategy) and doesn't give rise to any cost efficiencies; and

    b. Those interviewees that claimed economies of scope are important noted that its importance can differ across jurisdictions, and that it tends to be more important in those jurisdictions with a higher gas penetration rate (e.g. Victoria and the ACT).

17. It is clear from the above that a dual fuel offering will not play a significant role in the Queensland retail gas and electricity market, particularly given the gas connection penetration rate of 15%. As such, and consistent with the NCC decision, a light regulation determination will have no influence on the retail electricity market in Queensland (or vice versa).

Customer Numbers

18. Origin Energy observed in its submission that the AER's decision on Envestra's 2011-16 Access Arrangement incorporated a projection for an increase in net customer numbers. Origin Energy's premise appears to be that customer number growth bestows market power on Envestra, which is therefore not conducive to a light regulation determination for the QGDN.

19. Envestra disagrees with any assertion that competitive markets are characterised by declining customer growth. That aside, and contrary to Origin Energy's submission, which was based on benchmark information, the actual data shows that there has been a declining trend in customer growth in Queensland, whereas the benchmarks assumed an increasing trend.

20. In particular the data shows that actual customer growth is around 25% below benchmark levels over the current (2011/12 to 2013/14) regulatory period (reflecting average actual customer growth of around 1,650 per year relative to average benchmark customer growth of 2,250 per year)

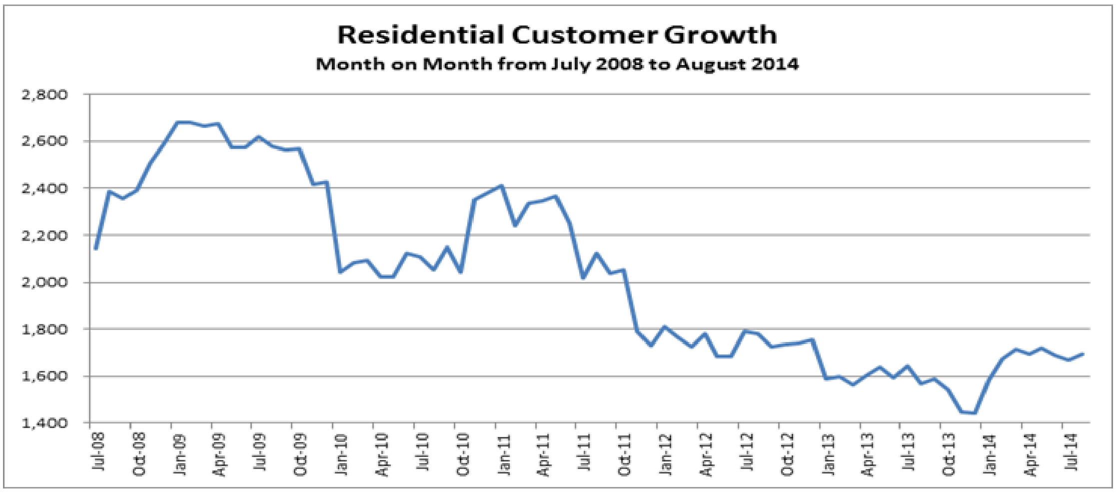
Residential Customers	2011/12	2012/13	2013/14
Benchmark	1,914	2,259	2,279
Actual	1,685	1,594	1,689
Variance	-229	-665	-590

21. The below chart shows that this declining trend in residential customer growth is not a recent phenomenon. The chart shows that customer growth has dropped by more than 30% over the

[12] K Lowe Consulting and Farrier Swier Consulting, AEMC 2014 Retail Competition Review: Retailer Interviews, June 2014, p40

past seven years (from an average growth rate in residential customer numbers of 2,500 in 2008/9 to around 1,650 customers in 2013/14). While the Queensland government's repeal, from 1 February 2013, of the mandatory requirement to install energy efficient (gas, solar or heat pump) hot water systems has had some influence on this reduction, there are clearly other factors influencing customers not to connect to the QGDN.

22. Envestra considers the Origin Energy submission, when actual data is considered, provides another example of the relatively weak (and declining) competitive position of gas relative to electricity (that is, in addition to the low market penetration rates and average consumption levels).



Future Prices under Light Regulation

23. Envestra's original application to the NCC seeking a light regulation determination for the QGDN incorporated a commitment to pass back to users the avoided cost of full regulation if a light regulation determination were made.[13] Envestra also advised it intends to continue to rely on similar methodologies to set prices under light regulation as currently applies for full regulation[14]. The ERAA however called for Envestra to outline a more robust plan by which it will deliver the financial benefit to consumers from light regulation[15].

24. The NCC noted in the draft decision that it has no power to impose a requirement on Envestra to produce a plan demonstrating how the savings from light regulation will be passed back to users. The NCC also concluded that the manner by which the savings arising from light regulation are shared between Envestra, retailers and customers is not a relevant factor in determining whether light or full regulation should apply to the QGDN[16].

25. The same issue was raised by retailers during the NCC's review of revocation of our Wagga Wagga network. Consistent with our submissions at the time, Envestra passed through to customers the avoided costs of regulation once revocation was granted for our Wagga Wagga network.

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13 Envestra, Application for Light Regulation of the Queensland Gas Distribution Network, August 2014 paragraph 212, p 45

14 Obid paragraph 222, p 48

15 Op Cit ERAA, p 2

16 Op Cit NCC paragraph 4.46, p 14

26. Stakeholders therefore should be confident Envestra will act in accordance with the undertakings given in its application.

Conclusion

27. The NGL seeks to ensure the form of regulation is commensurate to the degree of market power in the provision of pipeline services. Light regulation is appropriate where it is at least as effective as full regulation and can be achieved at a lower cost than full regulation.

28. In its original application to the NCC seeking light regulation for the QGDN, Envestra explained it does not have the ability to exercise market power in the QGDN due to the low cost of readily available substitutes. This was acknowledged by the NCC in the draft decision, noting that[17]:

> *"The most significant constraint on market power associated with the QGDN is the ability for end users to substitute other forms of energy – electricity and LPG. The Council (NCC) acknowledges the precarious competitive position of gas in areas served by the QGDN"*

29. On the matter of cost savings under light regulation compared to full regulation:

> *"…the Council accepts that the costs of light regulation of the QGDN are likely to be significantly less than those associated with full regulation."*[18]

30. Given the constraint on Envestra's market power and the likely savings to be made under light regulation relative to full regulation, it is appropriate that the NCC's draft decision was to make a light regulation determination in respect of the QGDN as:

    a. Light regulation will be as effective as full regulation given the characteristics of the market served by the QGDN;

    b. There will continue to be ongoing regulatory safeguards under light regulation – light regulation is not the same as revocation of coverage; and

    c. Light regulation will involve significant cost savings.

31. Light regulation of the QGDN is therefore consistent with promoting the national gas objective.

[17] Op Cit NCC paragraph 4.28, p 12

[18] Ibid paragraph 4.50, p 15