

15 July 2013

John Feil
Executive Director
Wagga Wagga Revocation
National Competition Council
Level 21, 200 Queen Street, Melbourne, VIC 3000

Via email: gas@ncc.gov.au

Dear Mr Feil,

NCC Draft Recommendation - Revocation of coverage determination for the Wagga Wagga Gas Distribution Network

The Energy Networks Association (ENA) welcomes the opportunity to provide commentary in relation to the National Competition Council's (NCC) Draft Recommendation – *Application under the National Gas Law for a revocation of coverage determination for the Wagga Wagga Gas Distribution Network* (WWGDN) published on 17 June 2013.

The ENA considers that Envestra's application for revocation of coverage of the WWGDN made a compelling case to conclude that the WWGDN should no longer be a covered pipeline. This outcome should be given effect on the basis that not all of the Pipeline coverage criteria contained in the section 15 of the *National Gas Law* (NGL) are met at this time. In particular, the ENA considers that criterion a) is not satisfied because Envestra does not possess significant monopoly power. This is because Envestra's pricing decisions are constrained by competition from alternative fuels, such as LPG and electricity. Further, the ENA considers that criterion d) is not satisfied. That is the benefits of continued coverage of the WWGDN would not outweigh the associated costs. Therefore, continued coverage of the WWGDN is contrary to the public interest.

In its Draft Recommendation, the NCC disagreed with Envestra's position in relation to criterion a) and d), suggesting that these criteria are satisfied with respect to the gas market in the area serviced by the WWGDN.¹

Criterion a) – Material promotion of competition in a dependent market

In relation to criterion a), the ENA understands that the NCC has been satisfied that access (or increased access) to the WWGDN would be unlikely to promote competition in upstream markets. The NCC's concerns raised in the Draft Recommendation were related to the impact of the WWGDN's state of coverage on competition in downstream dependent markets. The NCC provides a number of factors, which, in its view, would discourage competition in downstream markets should the WWGDN become uncovered. The ENA outlines its main concerns with the NCC's position below.

¹ National Competition Council, Draft Recommendation, Application under the National Gas Law for a revocation of coverage determination for the Wagga Wagga Gas Distribution Network, p.17 and p.25.

Lack of market power

The ENA notes that Envestra is a vertically separate service provider. Therefore, Envestra is unable to seek monopoly rents from upstream or downstream markets by virtue of exploiting a vertically integrated structure.

Being a natural monopoly in itself is not a sufficient condition to suggest that Envestra exhibits monopoly power. Gas is a fuel of choice and practical substitutes such as LPG and electricity are available in the area serviced by the WWGDN. Envestra's pricing decisions are, therefore, constrained by risk of declining demand as customers may choose to substitute gas for alternative fuels. The ENA has significant concerns that this risk has been underestimated by the NCC in its Draft Recommendation.

Similarly, the ENA considers that the countervailing power of industrial users to substitute alternative fuel choices has been understated by the NCC. The presence of this countervailing power further supports the contention that the scope to charge monopoly rents is limited in Envestra's case.

The ENA considers that the service providers which own and operate a single asset with no vertical integration upstream or downstream have strong incentives to increase throughput, as well as to maintain high quality standards.² This argument is strengthened by the availability of alternative fuels for users of gas in the area serviced by the WWGDN. Therefore, it is reasonable to suggest that the WWGDN can maximise its profits by increasing throughput on the network and is unable to do so by extracting monopoly rents through price increases on existing users.

The ENA considers that the issue of market power is central to consideration of criterion a) under the NGL. The ENA considers that Envestra does not have sufficient monopoly power to negatively affect competition in downstream dependent markets. This is due to the countervailing power of gas retailers and industrial users, low network utilization and availability of alternative fuels. Since Envestra does not have market power, the NCC can not be satisfied that coverage of the WWGDN will promote competition in dependent markets (either upstream or downstream).

Retail competition

The ENA is concerned that the NCC appear to consider vigorous retail competition as a pre-condition for the criterion a) to be met. The ENA considers that there is a range of reasons that explain low levels of retail competition in the small regional markets, such as the area serviced by the WWGDN. These, for example, include the large costs and risks involved in entering a small regional retail market relative to potential benefits that can be derived from this market and are unrelated to the state of network coverage. The ENA considers that the level of retail competition is unlikely to change if the state of coverage changes.

Potential deregulation of retail pricing in New South Wales

The NCC appears to premise its Draft Recommendation on a consideration that the removal of coverage may affect the likelihood of the deregulation of retail gas prices in NSW. This consideration appears both incorrect in its assumption and in its interpretation of the application of criterion a).

While the AEMC is yet to finalise its advice to the New South Wales Government, both the AEMC and IPART have separately noted that the retail energy market is likely to be sufficiently competitive to allow removal of retail price regulation. Neither entity have indicated that their assessment was dependent on the coverage of the WWGDN, nor has the NCC Draft Recommendation substantiated the relevance of retail pricing deregulation to its current assessment under criterion a). Given the potential for fuel substitution, there is no evidence that competition in the future retail gas market will be impaired by a decision to remove coverage of the WWGDN, should it no longer be subject to price regulation.

² Productivity Commission, Review of the National Access Regime, Inquiry report, 2001, p.61.

Criterion d) – Access not contrary to the public benefit

In relation to the criterion d), the ENA considers that the benefits of regulation of the WWGDN do not outweigh the costs. In the ENA's view, regulation should only be imposed where it has the capacity to promote more efficient operation and use of infrastructure that provides monopoly services. However, in those areas where more contestable conditions exist, the costs of regulation for both community and regulated business are unlikely to be justified. As explained above, the ENA considers that continued coverage of the WWGDN would not promote competition in downstream dependent markets. Therefore, the most significant benefit of regulation can not be achieved.

Furthermore, the costs of participating in price reviews are a function of the regulatory requirements set out in the *National Gas Rules (NGR)* and are largely insensitive to the size of the network under consideration. The ENA notes that Envestra's estimate of regulatory costs that was presented in its application to the NCC has accounted for a smaller size of the WWGDN. These regulatory costs are likely to rise in future due to the changes that have been recently introduced to the NGR and given the evolving nature of the regulatory regime.

Given that the continued coverage of the WWGDN would not promote competition in dependant markets, the ENA considers that the pipeline's coverage is contrary to the public interest.

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

Yours sincerely

A handwritten signature in blue ink, appearing to read 'John Bradley', is positioned above the printed name.

John Bradley
Chief Executive Officer