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Wagga Wagga revocation  
National Competition Council  
Level 21, 200 Queen St  
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Submitted in hardcopy and by email: [gas@ncc.gov.au](mailto:gas@ncc.gov.au)

Dear Ms Naylor

## **APPLICATION FOR REVOCATION OF COVERAGE OF THE WAGGA WAGGA NATURAL GAS DISTRIBUTION NETWORK**

Origin Energy Limited (Origin) welcomes the opportunity to comment on the Draft Recommendation of the National Competition Council (NCC) in relation to the application made by Envestra Limited (Envestra) for revocation of full coverage of the Wagga Wagga gas distribution network (WWGDN).

Origin agrees with the NCC's Draft Recommendation. This submission provides further comments in relation to relevant coverage criteria below.

### **1. Promotion of competition (criterion (a))**

#### 1.1 Approach to criterion (a)

Origin agrees that the NCC should not confine its consideration to the current and past state of competition. It is more appropriate to assess the likely (future) effect on competition of maintaining access and reasonable terms and condition.<sup>1</sup> Such a forward looking outlook is essential to understanding the full ramifications of coverage versus non-coverage and hence, whether the WWGDN satisfies criterion (a). This approach is consistent with the counterfactual methodology under the *Competition and Consumer Act 2010* and the scope of the National Gas Objective, which focuses on long term future interests.

#### 1.2 Retail gas market competition

Origin agrees with the NCC that competition in the relatively small downstream market for gas sales in the area serviced by the WWGDN (retail gas market) to date reflects the lack of incentives for entry or expansion given available margins. We believe this is mainly attributable to the difficulties of competing for new customers given retail price controls.<sup>2</sup> Origin's submission in relation to the NSW Independent Pricing and Regulatory

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<sup>1</sup> National Competition Council, Application under the National Gas Law for a revocation of coverage determination for the Wagga Wagga Gas Distribution Network, Draft Recommendation, 17 June 2013, available at <http://www.ncc.gov.au/images/uploads/ReGaWWDR-001.pdf> (NCC Draft Recommendation), paragraph 4.28

<sup>2</sup> NCC Draft Recommendation, paragraph 4.26

Tribunal's review of gas retail tariffs 2013-2016 noted that 'in FY13, the tariffs in the ex Country Energy area are forecast to deliver negative net retail margins'.<sup>3</sup>

The NCC considers it is likely that additional incentives for competition in gas supply will emerge in NSW, including in the area serviced by the WWGDN, in the short to medium term.<sup>4</sup> Origin agrees with this view. The removal of retail price regulation and transition to cost reflective pricing has been foreshadowed as a realistic possibility in recent reports by the Australian Energy Market Commission (AEMC) and the NSW Independent Pricing and Regulatory Tribunal. We believe the introduction of cost reflective prices is a key factor in promoting increased effective competition in retail gas markets.

The NCC also noted that the development of further competition in the market for gas sales in the area serviced by the WWGDN (and more generally) may be limited by availability of gas supplies and increased gas prices, both in absolute terms and perhaps relative to electricity.<sup>5</sup> Origin does not consider this to be the case. While the NSW gas supply and demand balance is likely to tighten in the medium term, the east coast energy market is a strongly interconnected system underpinned by robust market mechanisms. This system can be expected to provide required gas volume imports to NSW, as well as price signals that may shift large gas users to gas suppliers. In addition, Origin does not agree that changes in gas prices relative to electricity will necessarily limit competition in the retail gas market. As the NCC has identified, switching costs are significant and so relative price variations would need to be significant in order to prompt switching.<sup>6</sup>

The NCC considers that revocation of coverage at this time might affect the scope for removal of retail price regulation of gas sales in NSW.<sup>7</sup> The AEMC's recent recommendations regarding removal of retail price regulation in NSW are premised, insofar as they relate to gas, on the presence of efficient market outcomes.<sup>8</sup> Revocation of coverage of the WWGDN could affect efficient outcomes. The AEMC noted the presence of some barriers to entering the retail gas market, which meant that it was performing less well than the retail electricity market.<sup>9</sup> While Origin believes that barriers to gas market entry are currently low, we consider that an uncovered WWGDN may create a barrier to entry.

### 1.3 Unrestrained monopolist supplier

The NCC has correctly identified that switching away from gas to other energy sources (in particular electricity) requires substantial expenditure by the user. This means that, on an uncovered WWGDN, Envestra could have scope to exploit significant market power without triggering significant energy source switching.<sup>10</sup> Furthermore, prospects for attracting additional throughput cannot be expected to constrain Envestra's pricing on an

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<sup>3</sup> Submission to the Independent Pricing and Regulatory Tribunal on the review of regulated gas retail tariffs and charges from 2013 to 2016, Origin Energy, November 2013

<sup>4</sup> NCC Draft Recommendation, paragraph 4.27

<sup>5</sup> NCC Draft Recommendation, paragraph 4.27

<sup>6</sup> NCC Draft Recommendation, paragraph 4.39

<sup>7</sup> NCC Draft Recommendation, paragraphs 4.45 and 4.46

<sup>8</sup> AEMC, Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales, Draft Report, 23 May 2013, page 85, available at <http://www.aemc.gov.au/Market-Reviews/Open/nsw-retail-competition-review.html>

<sup>9</sup> AEMC, Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales, Draft Report, 23 May 2013, page 85, available at <http://www.aemc.gov.au/Market-Reviews/Open/nsw-retail-competition-review.html>

<sup>10</sup> NCC Draft Recommendation, paragraph 4.39

uncovered WWGDN.<sup>11</sup> Indeed, with high gas penetration and flat population projection,<sup>12</sup> it would seem that Envestra will have limited opportunity to increase throughput and so this claimed incentive is unlikely to exist, much less constrain pricing.

We consider it prudent for the NCC to give limited weight to Envestra's stated (unenforceable) intention to return regulatory costs savings to customers.<sup>13</sup> This is particularly important given price is not the sole concern arising from the prospect of an uncovered WWGDN. As the NCC has noted, non-price terms and conditions of access may transfer risk between parties in a disproportionate manner, which could adversely affect the prospects for competition in the retail gas market in the area serviced by the WWGDN.<sup>14</sup> An unrestrained monopolist supplier could impose onerous terms and conditions on network users, with users having limited recourse to contest those terms and conditions.

#### 1.4 Conclusion on criterion (a)

If the WWGDN remains covered, we consider this an important element in supporting an increase in effective competition within the retail gas market in the short to medium term. Alternatively, if coverage were revoked, the development of retail market competition would likely be impeded by the:

- likelihood that Envestra could seek to impose onerous terms and conditions on network users, which network users would be obliged to accept to ensure continued supply to the retail gas market; and
- likelihood that end users would bear the additional costs associated with less favourable terms of access due to limited feasible alternatives to gas.

We therefore conclude that access or increased access to the WWGDN, with clearly stated fair and reasonable terms and conditions, is critical to ensuring effective competition in the retail gas market serviced by the WWGDN. Origin considers that the WWGDN satisfies criterion (a).

## **2. Not contrary to the public interest (criterion (d))**

### 2.1 Approach to criterion (d)

Origin agrees with the NCC that the preferable approach to coverage criterion (d) is to: (1) identify any matter that could mean access or increased access might be contrary to the public interest; and then (2) assess whether the likelihood and consequences of that matter make access contrary to the public interest.<sup>15</sup>

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<sup>11</sup> NCC Draft Recommendation, paragraph 4.32

<sup>12</sup> NCC Draft Recommendation, footnote 9; 'Comparing residential customer numbers against the total number of households (22,000) reveals a penetration rate of gas connections of 90%'; Envestra Ltd, Wagga Wagga Network Revocation Submission, Public Version, 1 May 2013, paragraph 30, available at <http://www.ncc.gov.au/images/uploads/ReGaWWAp-001.pdf>

<sup>13</sup> NCC Draft Recommendation, paragraph 4.35

<sup>14</sup> NCC Draft Recommendation, paragraph 4.32

<sup>15</sup> NCC Draft Recommendation, paragraph 5.13

We also agree that a detailed technical examination of the costs and benefits of access is not consistent with Australian jurisprudence regarding access to infrastructure.<sup>16</sup> As such, such an approach cannot be appropriate for criterion (d). However, given that Envestra's arguments regarding criterion (d) were confined to a cost-benefit analysis,<sup>17</sup> the NCC appears to have been constrained to considering criterion (d) solely by reference to the estimated cost of regulation and promotion of competition.

## 2.2 Estimated cost of regulation

Origin welcomes the NCC's finding that Envestra's stated \$2.3m cost for preparing and gaining approval for an access arrangement is excessive.<sup>18</sup> We noted in our previous submission that we would expect a smaller network, such as the WWGDN, to require a less onerous access arrangement application compared to a larger network. We used the example of contrasting access arrangements in Queensland to illustrate the scope for regulatory costs to vary, depending on the approach of the network owner.

Focusing on this example in more detail, when APT Allgas initially proposed its Access Arrangement, it included 19 supporting documents, five of which were from external consultants.<sup>19</sup> In contrast, Envestra's proposal for its Queensland gas distribution network included 56 supporting documents, 44 of which were produced by external parties.<sup>20</sup> Envestra also included a comparable volume of supporting documents in its proposal for the current access arrangement of its South Australia distribution network.<sup>21</sup> These three networks are of comparable size.

We recognise the WWGDN network is smaller than these Queensland and South Australian examples. That being said, Country Energy's proposal for the current Access Arrangement included five supporting documents, two of which were reports by external consultants.<sup>22</sup> This helps provide some context for the different approaches used to prepare Access Arrangement proposals.

Envestra stated in its application that:

*[T]he costs associated with a full Access Arrangement review process are to a large extent independent of the size of the network due to the prescriptive nature of the NGR - the requirements of the NGR are the same irrespective of the size of the network.*<sup>23</sup>

If Envestra is intending to apply comparable resources to the WWGDN regulatory review process as that which it has recently applied to its distribution networks in Queensland or South Australia, then Origin does not consider that such expenditure should be characterised as the 'cost' of regulation for the purpose of assessing whether the WWGDN satisfies coverage criteria. Rather, regulatory costs should be restricted to those costs incurred by a reasonable and prudent network owner, taking account of the size of

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<sup>16</sup> NCC Draft Recommendation, paragraph 5.10

<sup>17</sup> NCC Draft Recommendation, paragraph 5.14

<sup>18</sup> NCC Draft Recommendation, paragraph 5.34

<sup>19</sup> APT Allgas proposal commenced 21 October 2010, available at <http://www.aer.gov.au/node/3915>

<sup>20</sup> Envestra proposal commenced 1 October 2010, available at <http://www.aer.gov.au/node/5225>

<sup>21</sup> Envestra proposal commenced 1 October 2012, available at <http://www.aer.gov.au/node/9845>

<sup>22</sup> Country Energy proposal commenced 1 January 2009, available at <http://www.aer.gov.au/node/3909>

<sup>23</sup> Envestra Ltd, Wagga Wagga Network Revocation Submission, Public Version, 1 May 2013, paragraph 104, available at <http://www.ncc.gov.au/images/uploads/ReGaWWAp-001.pdf>

the relevant network and the relative impact of that network on the owner's business as a whole.

In addition, we would expect there to be synergies across Envestra's business units,<sup>24</sup> particularly in view of the overlapping content across Envestra's regulatory review processes. This is evidenced by many of the supporting documents provided for each of the review processes for Envestra's Queensland and South Australian networks.<sup>25</sup> As such, Origin does not consider Envestra's cost estimates for future determinations to be reasonable.

In terms of the cost of light regulation, the NCC has noted that these may rise depending on the number of disputes that occur under the regime, and that there appears to be a significant prospect of disputes if the WWGDN was subject to light regulation.<sup>26</sup> In our previous supplementary submission, we noted that the NCC's Gas Guide Part C - Light regulation explicitly states that light regulation is 'less likely' for distribution pipelines, especially established distribution pipelines with a high market penetration (as in the case with the WWGDN). Origin notes the current regulatory environment reflects this position; there has been an absence of light regulation applications for distribution networks to date, in contrast to transmission pipelines.<sup>27</sup>

### 2.3 Estimated savings without regulation

Given that an uncovered WWGDN would remain subject to some level of ongoing regulation, the NCC considers that the reduction in regulatory costs that Envestra attributes to revocation of coverage may also be overstated.<sup>28</sup> Origin agrees with this view, as well as its finding that costs of negotiating access on a commercial basis may increase in the absence of coverage; this would further erode the regulatory cost savings suggested by Envestra.<sup>29</sup>

### 2.4 Conclusion on criterion (d)

Origin agrees with the NCC that costs associated with coverage of the WWGDN are not significant. These costs are also unlikely to exceed the benefits that would flow from the promotion of competition due to continued access on fair and reasonable terms through continued coverage of the WWGDN.<sup>30</sup> Envestra has not provided any other examples of matters that could mean access or increased access is contrary to the public interest.<sup>31</sup>

Therefore, access to the WWGDN would not be contrary to the public interest. Consequently, Origin considers that the WWGDN satisfies criterion (d).

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<sup>24</sup> NCC Draft Recommendation, paragraph 5.36

<sup>25</sup> When Envestra proposed access arrangements for its Queensland and South Australian distribution networks in 2010, 22 of the consultant reports that were provided to support each proposal do not appear to be prepared specifically for those review processes. See <http://www.aer.gov.au/node/5225> and <http://www.aer.gov.au/node/9845>

<sup>26</sup> NCC Draft Recommendation, paragraph 5.39

<sup>27</sup> See Application for light regulation of the Moomba to Sydney Pipeline (08/09/08); Application for Light Regulation of the Central West Pipeline (02/10/09); Application for light regulation of the Kalgoorlie to Kambalda Pipeline (22/04/10); available at [http://www.ncc.gov.au/index.php/applications-past/past\\_applications](http://www.ncc.gov.au/index.php/applications-past/past_applications)

<sup>28</sup> NCC Draft Recommendation, paragraph 5.35

<sup>29</sup> NCC Draft Recommendation, paragraph 5.37

<sup>30</sup> NCC Draft Recommendation, paragraph 5.41

<sup>31</sup> NCC Draft Recommendation, paragraph 5.40

## Conclusion

Origin appreciates the opportunity to put forward its reasons for supporting the NCC's Draft Recommendation. In our view, coverage of the WWGDN plays an important role in promoting effective competition in the retail gas market serviced by the WWGDN. We also consider that maintaining access to the WWGDN would not be contrary to the public interest. Our findings are that the WWGDN satisfies coverage criteria (a) and (d) and support the NCC's draft conclusions that coverage should not be revoked.

Should you have any questions or would like to discuss this submission further, please contact Hannah Heath (Manager, Wholesale Regulatory Policy) on (02) 9503 5500 or [hannah.heath@originenergy.com.au](mailto:hannah.heath@originenergy.com.au).

Yours sincerely,



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