



8 July 2013

Wagga Wagga Revocation
National Competition Council
Level 21, 200 Queen Street
MELBOURNE VIC 3000

Submitted via email to gas@ncc.gov.au

Dear Sir/Madam

Submission on NCC draft recommendation relating to the application for revocation of coverage of the Wagga Wagga gas distribution network, and response to Envestra's comments of 5 June 2013

1. INTRODUCTION

- 1.1 AGL Energy (**AGL**) welcomes the opportunity to comment on the National Competition Council's (**NCC**) draft recommendation relating to the application by Envestra Limited (**Envestra**) for the revocation of coverage of the Wagga Wagga gas distribution network (**WWGDN**) (**Draft Recommendation**).
- 1.2 For the reasons set out below, AGL agrees with the NCC's Draft Recommendation and preliminary view that all of the pipeline coverage criteria are satisfied (and therefore the revocation application should be rejected). The NCC and Envestra accept that criteria (b) and (c) are satisfied in relation to the WWGDN,¹ AGL agrees with this approach and does not address those criteria below.
- 1.3 In summary:
- (a) access to the WWGDN on reasonable terms and conditions will reduce or remove barriers to entry and expansion in the retail supply of gas, and therefore materially promotes an increase in competition in a dependent market (satisfying criteria (a)); and
 - (b) the cost of regulating the WWGDN is not such as to make access (or increased access) to the WWGDN contrary to the public interest (and criteria (d) is satisfied).

2. BACKGROUND

Current access arrangement

- 2.1 Country Energy concluded an Access Arrangement Review with the Australian Energy Regulator (**AER**) prior to divesting WWGDN to Envestra (the term of that Access Arrangement is 1 July 2010

¹ See paragraphs 3.11 and 3.15 of the Draft Recommendation.

to 30 June 2015), Envestra is required to submit an amended full Access Arrangement proposal to the AER for review in July 2014 and every 5 years thereafter.²

Pipeline coverage criteria and statutory regime

- 2.2 The pipeline coverage criteria and the NCC's statutory powers in relation to coverage revocation decisions are outlined in section 15 of the National Gas Law (**NGL**) and Chapter 3, Part 1, Division 2 of the NGL respectively. This regime is outlined in section 3 of the Draft Recommendation.
- 2.3 Importantly, pipeline coverage criteria (a), (b) and (d) mirror the criteria that the NCC must consider when deciding whether to recommend that a service be declared under Part IIIA of the *Competition and Consumer Act 2010* (Cth) (**CCA**).³ Therefore judicial interpretation (including decisions by the Australian Competition Tribunal (**Tribunal**) and the Full Federal Court) relating to the Part IIIA criteria are relevant to considering Envestra's Application.
3. **CRITERIA (A) - MATERIAL INCREASE IN COMPETITION IN AT LEAST ONE (DEPENDENT) MARKET**

Relevant dependant markets

- 3.1 AGL agrees with the NCC that, for the purposes of assessing the Envestra Application, the relevant dependant markets are:
- (a) an upstream eastern Australian gas wholesale market and a separate upstream market for transmission services linking eastern Australia gas sources to the WWGDN; and
 - (b) a downstream market for gas sales in the Wagga Wagga and Uranquinty area serviced by the WWGDN.

AGL notes that the question of the geographic scope of gas retail markets is a subject on which analysts and experts may reasonably differ. However, the exercise of market definition is an analytical tool under the CCA and not an end in itself. Therefore, in the context of assessing access issues in relation to the WWGDN it is appropriate to focus on sphere of supply of gas at a retail level that is facilitated by haulage on that network.

Effect of access on competition in dependant markets

Upstream markets

- 3.2 AGL agrees with the approach taken by the NCC in paragraphs 4.19 to 4.23 of its Draft Determination in relation to upstream markets.

Downstream market for gas sales in the Wagga Wagga and Uranquinty area serviced by the WWGDN

- 3.3 Coverage of the WWGDN materially increases competition in the downstream market for gas sales in the Wagga Wagga and Uranquinty area serviced by the WWGDN.
- 3.4 The NCC has indicated that it not only examines the current and past state of competition but also considers the likely effect on competition of, in this case, increased access in the future on reasonable terms and conditions.⁴ This is consistent with the approach taken by the Tribunal.⁵

² See paragraphs 32 and 101 of Envestra's "Wagga Wagga Network Revocation Submission" dated 1 May 2013 (**Envestra's Application**).

³ Criterion (a) of the pipeline coverage criteria mirrors s 44G(2)(a) of the CCA, criterion (b) mirrors s 44G(2)(b) and criterion (d) mirrors s 44G(f).

⁴ Paragraph 4.28 of the Draft Determination.

3.5 AGL agrees with the NCC's view that:

"This criterion allows for coverage to be revoked (or denied—when considering a coverage application) where access would not materially enhance the conditions or environment for competition in any dependent market".⁶

3.6 The appropriate assessment of criterion (a) requires a comparison of the state of competition with no access or restricted access against the state of competition where access is available on reasonable terms and conditions. This is consistent with the decision of the Full Federal Court in the 2006 case of *Sydney Airport Corporation Limited v Australian Competition Tribunal* (**Virgin case**):

"..all s. 44H(4)(a) requires is a comparison of the future state of competition in the dependent market with a right or ability to use [the] service and the future state of competition in the dependent market without any right or ability or with a restricted right or ability to use the service".⁷

3.7 AGL sets out relevant considerations to this assessment below.

The current state of competition

3.8 Origin Energy is the major retailer in the network with Energy Australia also operating with a relatively small share of sales in the region.

3.9 The WWGDN is the sole network for distributing gas in the Wagga Wagga and Uranquinty area and is monopoly infrastructure susceptible to becoming a bottleneck.

3.10 Regulated access ensures barriers to entry in the retail supply of gas in the region are low.

3.11 Retail price charges to a mass market (<10TJ pa) customer not on a market contract with a retailer in NSW is regulated by IPART.

Effect of access on competition

3.12 In assessing whether access is likely to promote a material increase in competition, AGL submits that the key consideration is whether access on reasonable terms and conditions will reduce or remove barriers to entry and expansion.

3.13 AGL notes the following guidance from decisions of the Tribunal:

- (a) "the Tribunal's view is that the nature and extent of competition in a market are the outcomes of both structural and behavioural factors";⁸
- (b) "the promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial";⁹
- (c) "Will the act (eg an alteration to an aspect of market structure or a change in a firm's conduct) increase the constraints on the market power of sellers or, more directly, will it

⁵ The Tribunal in *Fortescue Metals Group Limited* [2010] ACompT 2 at 1066 concluded that when considering criteria (a), the Tribunal should "assume that access is on reasonable terms and conditions, without speculating about any particular terms that might be imposed by arbitration under Part IIIA".

⁶ Paragraph 4.2 of the Draft Determination.

⁷ *Sydney Airport Corporation Limited v Australian Competition Tribunal* [2006] FCAFC 146 at 83.

⁸ *Re Chime Communications Pty Ltd (No 2)* [2009] ACompT 2 at 60.

⁹ *Re Sydney Airport Corp Ltd* [2000] ACompT 1 at 107. This approach was approved by the Full Federal Court on appeal, see *Sydney Airport Corporation Limited v Australian Competition Tribunal* [2006] FCAFC 146 at 57.

increase their rivalry in a way that will produce greater efficiency? If the answer is in the affirmative, the act will promote an increase in competition";¹⁰

- (d) structural conditions of the market (ie, low barriers to entry) are as important as market share in considering the effect of competition. As the Tribunal stated in *Re Chime Communications (No 2)*:

"The Tribunal acknowledges that the competitiveness of a market cannot be measured simply by the number of firms in the market, their market shares and the market concentration. That can only be the starting point of the analysis. A feature that is "equally important" (to adopt the terminology of Viscusi et al (at 164)) or simply another factor that must be brought to account, is the ease of market entry. Viscusi et al state (at 164-165) that entry conditions are important in assessing competition in a market, first because the number of firms in the market is partially determined by the cost of the entry as well as by factors such as economies of scale. Hence entry conditions play a role in determining concentration. Second, entry conditions determine the extent of potential competition. Most courts and economists accept ease of entry by potential competitors is likely to affect the competitiveness of the actual competitors. The debate amongst economists concerns the extent to which it has that effect."¹¹

- (e) "Of all these elements of market structure, no doubt the most important is (2), the condition of entry. For it is the ease with which firms may enter which establishes the possibilities of market concentration over time; and it is the threat of the entry of a new firm or a new plant into a market which operates as the ultimate regulator of competitive conduct."¹² Although the Tribunal has since stated that this "paradigm is no longer an infallible guide to assessing the behaviour of firms and markets" and should not be the sole measure to assessing competition,¹³ conditions to entry remain an importance consideration. (emphasis added)

3.14 Taking this guidance into account, it is clear that increased access on reasonable terms and conditions will materially increase competition in the downstream market because:

- (a) the threat of new entry provides a competitive constraint on Origin, which in turn encourages Origin's prices to remain at a competitive level (as increased prices and larger profit margins would make the market attractive, inducing new entry);
- (b) new entrants can make pricing and other business decisions (and determine whether to enter the market) based on transparent information known well in advance (and are therefore more likely to enter);
- (c) the costs and risks of competing in the market (especially for small second tier retailers) are lower when the conditions for access are known in advance. Whilst there has not been new entry to the market, as the NCC outlines¹⁴ this may reflect the lack of incentive for new market entry or expansion given the available margins and difficulties of competing for new customers in the presence of price controls; and
- (d) monopoly infrastructure needs regulated access to encourage new entry. An increase in access to the WWGDN would in turn increase competition for gas sales in the area serviced by the WWGDN and lower prices for the end consumer. The level of benefit to the end

¹⁰ *Fortescue Metals Group Limited* [2010] ACompT 2 at 1061.

¹¹ *Re Chime Communications (No 2)* [2009] ACompT 2, 234 FLR 210 at 223.

¹² *Re Queensland Co Operative Milling Assn Ltd* (1976) 8 ALR 481 at 516.

¹³ *Re Chime Communications Pty Ltd* [2009] ACOMPT 4 at 11.

¹⁴ Paragraph 4.26 of the Draft Determination.

consumer would be lower were access is not regulated as market entry is discouraged, or access is provided on potentially unfair, or uneconomic terms.

- 3.15 AGL agrees with the NCC's approach that additional incentives for competition in gas supply will emerge in NSW in the short to medium term¹⁵ and that the NCC should consider changes in the regulatory landscape when addressing criteria (a).¹⁶
- 3.16 AGL further supports the proposition that there would be greater incentives for new entrants (and therefore an increase in competition) if the regulation of retail prices in NSW is removed.
- 3.17 It is also important to consider the effect on competition if coverage is removed:
- (a) the cost and time involved in negotiating access terms would increase and act as a deterrent to access seekers;
 - (b) non-price access terms, and unregulated measures to transfer risk adversely affects the prospects for competition;
 - (c) users would be exposed to inefficient (monopoly) prices which would restrict the development of competition; and
 - (d) there would be increased uncertainty and reduced transparency and accountability in setting access prices for gas retailers. These additional costs would flow on to the end consumer.
- 3.18 Envestra has suggested that it is constrained by the availability of other fuels (namely electricity and LPG). In that respect, AGL agrees with the NCC Draft Recommendation at paragraphs 4.39 and 4.40. AGL further notes that Envestra is not sufficiently constrained in setting access prices and terms by the risk of customers switching to other energy sources because:
- (a) it is common ground that gas is not in close competition with electricity;¹⁷
 - (b) switching to alternatives for users are costly. Installing new appliances or machinery that use an alternative source of fuel to gas requires expenditure and is not time efficient for the user; and
 - (c) large customers would incur significant capital costs establishing new infrastructure.
- 3.19 AGL agrees with the submissions outlined at paragraph 4.16 of the Draft Recommendation, including that:
- (a) only covered networks have more than one retailer currently supplying gas to small customers (AGL also refers to paragraph 2.7 of Energy Australia's supplementary submission);
 - (b) negotiations with Envestra (and other distribution businesses) are fraught even in relation to covered pipelines and removal of coverage would significantly exacerbate this situation;
 - (c) time and costs involved to reinstate coverage would allow price and other outcomes to deteriorate and may deter potential new entry; and
 - (d) gas distribution pipelines have no substitutes.

Conclusion on criteria (a)

¹⁵ See paragraph 4.25 of the Draft Determination.

¹⁶ See paragraph 4.28 of the Draft Determination.

¹⁷ *Power New Zealand Ltd v Mercury Energy Ltd and Commerce Commission* (1996) 1 NZLR 686 at 704.

3.20 It is clear that increased access to the WWGDN materially increases competition in the downstream market for gas sales in the Wagga Wagga and Uranquinty area serviced by the WWGDN and that criteria (a) is satisfied.

4. **CRITERIA (D) - ACCESS NOT CONTRARY TO PUBLIC INTEREST**

Introduction

4.1 The NCC considers that a detailed technical examination of the costs and benefits of access is inconsistent with the High Court's view on the judgment involved in considering declaration criteria (f) and by implication the equivalent pipeline coverage criteria, criteria (d).¹⁸ AGL agrees with the NCC's assessment of the High Court's reasoning in *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36.

4.2 The NCC's preferred approach is to seek generally to identify any matter that could mean access (or increased access) might be contrary to the public interest and then assess whether the likelihood and consequences of that matter make access contrary to the public interest.¹⁹ AGL agrees with this approach.

Regulatory costs

4.3 AGL notes that regulated access regimes for gas pipelines have now been in operation for nearly 20 years. On the east coast of Australia the current framework for access arrangements has been in place since 1997. Envestra owns approximately 22,500 kilometres of natural gas distribution networks and 1,120 kilometres of transmission pipelines, serving over 1.14 million consumers in South Australia, Victoria, Queensland, New South Wales and the Northern Territory. Most of those networks are covered by the NGL. AGL expects that Envestra is well placed to manage the processes of regulation in a cost efficient manner. In particular, AGL anticipates that the resources used to manage access regulation issues on the WWGDN are shared across Envestra's network and are more cost efficient as a consequence.

Conclusion on criteria (d)

4.4 AGL agrees with the NCC's comments at paragraphs 5.36, 5.37 and 5.41 to 5.43 of its Draft Determination and the NCC's conclusion that criteria (d) is satisfied.

Please contact me on 03 8633 6239 if you wish to discuss this matter further.

Yours sincerely

George Foley

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¹⁸ See paragraphs 5.8 to 5.10 of the Draft Recommendation.

¹⁹ See paragraph 5.13 of the Draft Recommendation.