



EnergyAustralia

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The Hon Angus Taylor MP
Minister for Energy and Emissions Reduction
Gas and Governance Branch
Department of the Environment and Energy
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Dear Minister,

Consultation Regulatory Impact Statement – Gas Pipeline Regulation Reform

EnergyAustralia welcomes the opportunity to make a submission to COAG Energy Council's Regulation Impact Statement (Consultation RIS) on Options to improve gas pipeline regulation.

EnergyAustralia is one of Australia's largest energy companies with around 2.6 million electricity and gas accounts in New South Wales, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own, operate and contract an energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 4,500MW of generation capacity in the National Electricity Market (NEM).

EnergyAustralia agrees with much of the discussion in the Consultation RIS around the potential problems with the current regulatory framework that applies to gas pipeline haulage services (gas pipeline services). Now is an opportune time to holistically assess the past reviews by various regulatory bodies and recent piecemeal reform and consider how the regulatory framework can work more effectively.

In relation to our experience in negotiations, we find that most negotiations with gas pipeline service providers on the east coast, do not raise material issues and access is achieved on what appears to be reasonable price and non-price terms.

However, as an exception to our general experience, EnergyAustralia has faced some challenges in the negotiation process with the result that negotiated prices might be higher than those that would be sustained in a competitive market.

In one isolated example, pricing offered to EnergyAustralia by the pipeline service provider was 6-7 times higher compared to transportation to customers in neighbouring towns using other pipelines.

We have also found that there is limited information available to inform pricing negotiations particularly where a pipeline service provider is exempt from regulatory information disclosure requirements. This makes it difficult to assess prices offered to us.

Where pricing is not reflective of a competitive market, it might make it uneconomic for existing energy retailers to sell to customers in affected areas. Further, pricing that does not reflect a competitive market may also deter entry by new retailers where it would otherwise be efficient. We suggest that the Council refer to pricing information analysis performed by the ACCC in the gas inquiry and pricing data provided to the ACCC during the inquiry process, for more information.

We note that while Part 23 provides recourse to commercial arbitration where negotiations fail to reach an agreement, in some examples like the above one, the threat of arbitration may have a limited effect in the negotiation process.

The effect of higher pricing for gas pipeline services is clear. Generally, the cost of pipelines is a direct pass through to customers, and higher price outcomes would translate to higher prices paid by customers for their energy use. As an exception, higher prices may be absorbed by the retailer.

In response to the Options proposed in the Consultation RIS, we continue to support the negotiate arbitrate model with Part 23 and Full regulation presenting lighter and heavier handed forms of regulation, but with changes to improve those frameworks to better target the right market failures.

We have not specifically answered all the questions in the Council's feedback template but have set out our views below based on each of the Key Elements discussed in the Consultation RIS.

1. When to regulate

EnergyAustralia supports Option 3 which provides that all pipeline service providers providing third party access are subject to some form of regulation.

In relation to the test that determines when to regulate (where the pipeline service provider is not providing third party access), we support the replacement of the coverage test with the proposed hybrid market power-NGO test. We agree with the views of the ACCC in its 2015-2016 inquiry that the current coverage test is not directed at the right market and market failure in that market (the right market failure is monopoly pricing in the gas pipeline services market which might have little effect on increasing competition in dependent markets). The hybrid test appropriately focusses on whether there is market power in the gas pipeline services market.

We ask for more consultation around the exemptions that are permitted to exempt a person from regulation, including the greenfield exemption for pipelines that are yet to be commissioned. It is not clear whether subjecting greenfield exemptions to regulation, particularly Part 23, will distort incentives for investment in new pipelines. We refer to the AEMC's 2018 findings and ACCC's 2019 findings that Part 23 is not having any tangible effect on the incentive to develop new third-party access pipelines.¹ In view of this, retaining the status quo exemptions should be further tested. In our view, a clear case for their retention has not been made.

¹ AEMC, *Final Report: Review into scope of economic regulation applied to covered pipelines*, 3 July 2018, p 44.

We also support having one single organisation (the Australian Energy Regulator) have responsibility for both deciding “when to regulate”, the form of regulation, and economic regulation. However, to address any perception that the regulator is more biased towards making decisions to regulate, we suggest that the “when to regulate” decision be made in consultation with or be reviewable by another regulatory body, perhaps the ACCC. Further we note that the “when to regulate” and form of regulation decisions should be conducted separately to the fullest extent, given the similarities in what the tests could cover.

2. Forms of regulation and the movement between alternative forms

Forms of regulation

EnergyAustralia agrees with the approach of having a lighter and heavier handed regulatory option in any new framework. The determination of which option applies should be based on the form of regulation test which assesses the potential for market power to be exploited by a service provider, and the likely effectiveness of Light regulation or Full regulation in promoting access to gas pipeline services in view of the costs of each option.

To this end, EnergyAustralia supports Option 3 which has heavier handed regulation based on the current Full regulation approach and lighter handed regulation based on a strengthened Part 23. We do not support direct price control at this time due to the increased regulatory cost of determining price caps, and the risk that this would lead to greater standardisation in gas pipeline services offered, less flexibility, and less price dispersion in the market (where it is efficient).

In addition, we support adding to Option 3, protections against dynamic market power to promote competition for new pipelines/extensions (these protections are proposed for Option 4 but not Option 3). Specifically, we ask for the inclusion of new protections in the National Gas Rules:

- An explicit right of new pipeline service providers to interconnect with existing ones.
- Where existing pipeline service providers can offer an expansion or extension of an existing pipeline in substitute for a new pipeline/extension by another service provider; prohibit existing service providers from cross-subsidising new capacity (and allowing those pipelines to price below incremental cost for new capacity). This could require incremental pricing to be used where the cost of an expansion or extension would otherwise result in the price of existing capacity increasing.

Form of regulation test

While we support using the existing form of regulation test to determine whether strengthened Part 23 or Full regulation should apply, we request more consultation be undertaken on the drafting of these tests which considers:

- the interaction of the new hybrid test (replacing the coverage test) and the existing form of regulation test, particularly where both tests direct the regulator to some assessment of market power.
- The application of the form of regulation test to Part 23 (not previously applied).
- The current split of Full regulation pipelines on the one hand, and Light and Part 23 regulation pipelines on the other – being 10 and 56 pipelines in Eastern Australian and

the Northern Territory.² We ask that some analysis be performed on the likely split under the new tests. We would like to have some indication of whether we can expect Full regulation to apply to more pipeline service providers.

3. Information disclosure requirements

The current information requirements across Part 23, Light regulation and Full regulation are overly complex and confusing for both service providers and shippers to understand. The differences in exemptions add another layer of complexity, which further warrants a case for change.

Information asymmetry is a key problem in negotiations. We question the retention of the single shipper and small pipelines exemptions from information disclosure requirements. Small pipeline service providers can still exercise market power. Without information that provides a gauge on an offered price relative to other prices in the market, it is difficult to assess the competitiveness of that price and negotiate for a better price.

To address these issues, we support Option 2 which does not have any exemptions from information disclosure requirements for regulated pipeline service providers and would require service providers to publish the weighted average price and minimum and maximum prices. We prefer weighted average prices being disclosed and not individual prices, as it will have less potential effect of disincentivising discounting by service providers.

It is also key to ensure pipeline service providers disclose pricing methodologies so that shippers can at least interrogate the basis for the prices.

If exemptions are permitted under the new framework, we support the application of the requirement to provide basic information set out in Box 11.1 (which includes pricing methodologies) to all pipelines service providers including those that are exempt.

To ensure pricing methodologies are accurate, we would also ask for additional improvements in Box 11.1 relating to pricing methodologies and financial information (under Option 3), which are aimed at improving the quality of information and other improvements.

4. Negotiation frameworks and dispute resolution mechanism

EnergyAustralia supports Option 3 in relation to Negotiation frameworks and dispute resolution. However, we would support greater consistency and certainty in the commercial arbitration process under Part 23.

First, we consider there should be one arbitrator (and suggest this should be the AER) for all Part 23 arbitrations.

Second, we ask that the National Gas Rules be improved to clarify any ambiguity in the pricing methodology. One simple change would be to specify all the methods of asset valuation whether that is recovered capital method or other acceptable methods such as depreciated actual cost. The current regulation allows for unidentified methods to be used.

In addition, we ask that the National Gas Rules or guidelines should provide more detail on how the pricing principles, and particularly the asset valuation method, will be applied in practice by

² COAG Energy Council, *Options to improve gas pipeline regulation, COAG Regulation Impact Statement for consultation*, October 2019, p. 11

the arbitrator. The detail on the pricing methodology in the National Gas Rules and current AER Non-scheme Pipeline Arbitration Guide, is very high level. This creates considerable uncertainty for parties who are considering the arbitration process, which when combined with the high costs of arbitration, may discourage the use of arbitration.

Another way to improve uncertainty is to require the scheme administrator (AER) to publish more detail on final access determinations that are made in the commercial arbitration process.

We expect that the pricing methodologies, including asset valuation methods, set out in the National Gas Rules and the above issues, to be the subject of further consultation when changes to the National Gas Rules are considered.

In addition, we welcome the improvements to the Full regulation dispute resolution mechanism in Box 11.2 of the Consultation RIS.

Should you wish to discuss this submission please contact me (Selena.Liu@energyaustralia.com.au or 03 8628 1548).

Yours sincerely

Selena Liu
Industry Regulation Lead