

# NT Gas Pipelines

Application to Revoke Coverage  
Under The National Gas Access Regime

Draft Recommendation  
June 2000

National Competition Council

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# 1 Draft Recommendation

On 20 April 2000, the National Competition Council (the Council) received applications from Envestra Limited to revoke coverage under the *Gas Pipelines Access (Northern Territory) Act 1998* (NT Act) of the following natural gas pipelines owned by Envestra:

- the Palm Valley to Alice Springs (transmission) pipeline; and
- the Alice Springs gas distribution network.

The effect of revocation is to remove a pipeline from regulation under the National Gas Pipelines Access Code (National Code).<sup>1</sup> In effect, the owner of the pipeline is relieved of any obligation to grant access to third parties.

The Council hereby releases its draft recommendations on the applications. While consultation is continuing with a number of parties, the Council has reached a preliminary view that:

- the Palm Valley to Alice Springs transmission pipeline should remain covered under the National Code; and
- coverage of the Alice Springs distribution network should be revoked.

The Council's reasons are set out in section 3 of this document. In essence, the Council believes there is evidence to suggest that access to the transmission pipeline would promote competition in the electricity generation and electricity sales markets, with public interest benefits.<sup>2</sup> The Council has been unable to find evidence that warrants coverage of the Alice Springs distribution network.

## Call for further submissions

The Council is calling for submissions from interested parties on the draft recommendations. Submissions received no later than **Thursday 22 June** will be taken into account in determining the Council's final recommendations, which will be conveyed to the Northern Territory Minister for Resource Development.

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<sup>1</sup> The National Code is applied in the Northern Territory by the Act.

<sup>2</sup> These issues are raised under coverage criteria (a) and (d). See Section 3 of this paper.

Written submissions should be sent to Mr. Stephen Dillon, National Competition Council, GPO Box 250B, Melbourne VIC 3001 or e-mailed to [stephen.dillon@ncc.gov.au](mailto:stephen.dillon@ncc.gov.au). Due to time constraints imposed by the National Code, the Council may not be able to consider submissions received after 22 June.

While the Council is considering each application<sup>3</sup> as separate, the Council is running joint public consultation processes. The Council sees efficiencies in this approach, given that the applications were received simultaneously from the same company; and that the applications cover inter-related facilities.

It would be appreciated if respondents could supply a copy of their submission in both electronic and print form. Submissions will be made available to interested parties on the Council's web page at [www.ncc.gov.au](http://www.ncc.gov.au)

### **Confidentiality issues**

The Council is conscious of the need to protect confidential information, including commercially sensitive material. However, in order to maintain a public and transparent process, the Council will carefully examine claims of confidentiality.

Where a person intends to make a confidential submission to the Council, it is recommended that they discuss the submission, including the claim for confidentiality and the form of the submission, with relevant Secretariat Officers. The Council notes the following relevant matters:

- If the Council considers that a submission is not confidential, it will advise the person who has prepared the document. The person will then have the choice of withdrawing the claim for confidentiality or withdrawing the submission.
- Where confidentiality is claimed over part of a document, two copies should be provided: one with the confidential sections omitted, and one with the confidential sections included. The first copy will be made publicly available. The second document (where the claim for confidentiality is accepted) will only be examined by Council Officers who are dealing with the application, and the Council.

Applicants should be aware that any information they provide to the Council, whether in the form of written submissions or as recorded in notes

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<sup>3</sup> The Council received two applications: one relates to the Palm Valley to Alice Springs pipeline; the other relates to the Alice Springs distribution network.

## **Draft Recommendations: Northern Territory Gas Pipelines**

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made by the Council during meetings, may be publicly accessible under the *Freedom of Information Act*.

### **Further information**

Should you have any queries, please contact Ms Angela Houpis (administrative matters) on 03 9285 7089 or Mr. Stephen Dillon (other matters) on 03 9285 7481.

## 2 Background

### 2.1 The applications

The revocation applications relate to the following gas facilities owned by Envestra:

- the Palm Valley to Alice Springs gas pipeline; and
- the Alice Springs gas distribution network, comprising:
  - the Alice Springs Town reticulation pipeline system (downstream of the first flange after the processing plant); and
  - the Alice Springs Metering and Pressure Station.

Details of these gas pipeline systems are set out in Table 1. The arguments advanced by the applicant are set out in the applications (available on the Council's web page at [www.ncc.gov.au](http://www.ncc.gov.au)) and noted in section 3 of this paper.

TABLE 1

<b>Pipeline Licence</b>	<b>Location / Route</b>	<b>Operator</b>	<b>Length (km)</b>	<b>Regulator</b>
NT: PL1	<b>Palm Valley to Alice Springs gas transmission pipeline</b>	Origin Energy Asset Management Ltd	146 (Diameter 200 mm)	ACCC
Not licensed	<b>Alice Springs gas distribution network</b> (a) Alice Springs Town reticulation pipeline system (downstream of the first flange after the processing plant)	as above	30 km	ACCC
NT:PL5	(b) Alice Springs Metering and Pressure Station	as above	Not applicable	ACCC

## 2.2 The Northern Territory Gas Access Act

Currently, the Envestra-owned facilities listed above are ‘covered pipelines’ under the *Gas Pipelines Access (Northern Territory) Act 1998*. The Act applies the *National Third Party Access Code for Natural Gas Pipeline Systems* (National Code) to gas pipelines in the Northern Territory (NT).

The National Code is a central element of National Competition Policy reforms aimed at promoting free and fair trade in gas. Under the Code, owners of certain gas pipelines (known as ‘covered pipelines’) must submit access arrangements for approval to an independent regulator (in the Territory, the regulator is the Australian Competition and Consumer Commission, ACCC). These access arrangements set efficient benchmark prices for third parties to seek access to spare capacity in a pipeline.

Interested parties can find the National Code on the Code Registrar’s website at: [www.coderegistrar.sa.gov.au](http://www.coderegistrar.sa.gov.au)

Schedule A of the National Code lists pipelines which are covered by the Code from the commencement of its operation. The pipelines which are the subject of Envestra’s applications are listed in Schedule A.

## 2.3 Revocation of coverage

The Code recognises that the public benefits of regulating access to a service may change over time due to such factors as changes in market conditions (for example, the emergence of competition) or technological changes affecting the economic viability of new infrastructure. In time, the benefits of regulating a particular pipeline may be outweighed by the cost of regulation and other factors.

For this reason, the Code allows parties to seek revocation of coverage of a pipeline under the National Code. Applications are made to the National Competition Council. Following consideration of issues raised in public consultations, the Council conveys a recommendation to the relevant Minister (in this case, the Hon Daryl Manzie, MLA, in his capacity as the NT Minister for Resource Development), who decides the matter. Both the Council and the Minister must observe the criteria for revocation set out in Section 1.9 of the National Code (discussed in Section 3 of this paper). The steps involved in a revocation application, including timeframes for the current applications, are set out in Appendix 1.

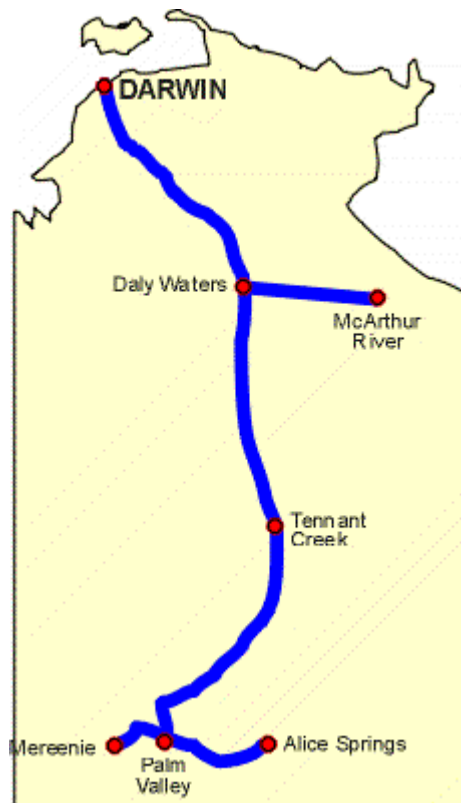
If revocation is granted, the owner and operator are released from their obligations under the Act and the National Code. The owner and operator

are no longer required to submit an access arrangement for the pipeline to the ACCC, to set efficient benchmark prices for access, or to respond to access requests by third parties. However, a person seeking access in the future could apply to the Council to have coverage of the pipeline reinstated under the National Code.

The NT Act includes a process for administrative (merits based) appeals against a decision to revoke coverage. The process is set out in section 38 of the *Gas Pipelines Access Law (GPAL)*, which applies as a schedule to the NT Act. In the Northern Territory, appeals are heard by the Australian Competition Tribunal.

The GPAL can be viewed on the Code Registrar's website at: [www.coderegistrar.sa.gov.au](http://www.coderegistrar.sa.gov.au)

## 2.4 The pipelines: background information



## Palm Valley to Alice Springs gas pipeline

Envestra provided the following background information on this pipeline.

- owned by Envestra Limited ('Envestra'), which purchased the pipeline from Holyman Limited in January 1999.
- capacity of approximately 10 PJ per annum, with current throughput of approximately 3 PJ per annum.
- transports gas 146km from Palm Valley gas field to the Alice Springs gate station (see map) for one customer, the Northern Territory Power and Water Authority (PAWA). PAWA uses the majority of the natural gas (2.7 PJ per annum) for power generation in Alice Springs and sells small amounts to Energy Equity Ltd (0.2 PJ per annum<sup>4</sup>) for power generation and to Origin Energy for its Alice Springs retail operations (0.1 PJ per annum).
- there is a significant amount of uncontracted capacity (50% – 70% per annum).
- currently subject to the National Code and regulated by the ACCC. An extension of time to submit an Access Arrangement until 30 June 2000 has been granted by the ACCC.

## Alice Springs gas distribution system

Envestra provided the following background information on this pipeline.

- owned by Envestra.
- primarily designed to supply domestic and small commercial customers. The network consists of 30 km of pipe that distributes 0.1 PJ of natural gas annually to 642 customers.
- currently subject to the National Code and regulated by the ACCC. An extension of time to submit an Access Arrangement until 30 June 2000 has been granted by the ACCC.

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<sup>4</sup> Energy Equity Ltd informs the Council that this figure understates the company's use of the pipeline.

### 3 Revocation Issues

This section outlines the criteria in the National Code against which Envestra's applications must be assessed, and the reasons underlying the Council's draft recommendations.

#### First round submissions

The Council advertised the applications in *The Australian* and the *Northern Territory News* on 4 May 2000; and the *Centralian Advocate*, Alice Springs (on 5 May). In addition, the Council consulted directly with a number of parties, including the service provider, gas producers in the Territory, gas users in the Alice Springs region, the Northern Territory Chamber of Commerce and the Department of Mines and Energy. Only one formal submission was received – from Clayton Utz, representing the Northern Territory Power and Water Authority (PAWA).<sup>5</sup>

#### The revocation criteria

Under section 1.31 of the National Code, the Council *cannot* recommend revocation of coverage if it is satisfied that a pipeline meets all of the criteria set out in section 1.9 of the Code. From another perspective, the Council *must* recommend revocation where a pipeline fails to meet one or more of the section 1.9 criteria.

The criteria set out in section 1.9 are:

- (a) that access (or increased access) to services provided by means of the pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the pipeline;
- (b) that it would be uneconomic for anyone to develop another pipeline to provide the services provided by means of the pipeline;
- (c) that access (or increased access) to the services provided by means of the pipeline can be provided without undue risk to human health or safety; and

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<sup>5</sup> PAWA's submission refers to the Palm Valley to Alice Springs pipeline only. It does not cover the Alice Springs distribution pipeline network.

- (d) that access (or increased access) to the services provided by means of the pipeline would not be contrary to the public interest.

In applying the criteria, the Council considers that greater clarity flows from considering criterion (b) first. In essence, criterion (b) considers whether duplication of the infrastructure in question is inefficient, while criterion (a) considers whether this gives the facility owner leverage to restrict competitive outcomes in another market.

**Criterion (b)** that it would be uneconomic for anyone to develop another pipeline to provide the services provided by means of the pipeline.

## Background

The National Code (as applied by the NT Act) envisaged that access regulation should be limited to infrastructure where it is not viable to build competing facilities. As such, access regulation should normally be confined to infrastructure with entrenched monopoly power, and usually to infrastructure exhibiting *natural monopoly* characteristics – that is, where a single facility can meet market demand at less cost than two or more facilities. In these circumstances, duplication of a facility can be considered a ‘wasteful’ or inefficient use of the community’s resources.

Such a facility is normally characterised by large up-front investment costs and low operating costs, resulting in economies of scale across a broad range of output – that is, as output increases, average costs per unit continue to decrease across the range of output sought by the market.

In revocation applications, the Council must consider whether natural monopoly characteristics or other restrictions currently inhibit the construction of competing pipelines. For example, a pipeline may have been covered under the National Code at a time when it exhibited natural monopoly characteristics. However, the position may have changed due to such factors as technological innovation or growth in the market to the point where construction of another pipeline is economic.

In considering whether it is economic to build another pipeline, the Council adopts a social test rather than a private test. While a private test would consider whether it is viable for an individual to invest in a new facility, a social test considers whether building a new facility represents an efficient use of resources from the viewpoint of the community.

## The Envestra applications – views put to the Council

This criterion was not addressed in the applications or in views put to the Council by stakeholders.

The Council considers that the Palm Valley to Alice Springs pipeline provides services involving the transport of gas from the Palm Valley gas fields to Alice Springs (and potentially to places along the route). The Alice Springs distribution network provides services involving the transport of gas to end users in the vicinity of Alice Springs.

In considering whether it is would be uneconomic to develop another pipeline to provide these services, the Council notes that gas pipelines typically have high construction costs and low operating costs, making the marginal cost of transporting a unit of gas very low. Moreover, up to the point of fully expanded capacity, average costs of transport per unit of gas decline. These features are indicative of natural monopoly characteristics. In lay terms, it is almost always cheaper to transport gas through existing pipelines (if spare capacity exists or can be added) than it is to build another pipeline to transport gas. Duplication of a gas distribution network that services a city or town may face additional obstacles of urban town planning and environmental restrictions.

Moreover, investment in new pipelines is, in economic language, ‘sunk’. That is, the investment is fixed or committed, and if the investment is a failure, little or none of it can be retrieved. This means that incremental or gradual entry – a common form of entry in other industries – is not feasible in the gas transport industry.

Finally, it is not uncommon for existing pipelines to have spare capacity. From a pipeline company’s point of view, it is often prudent to cater to the unpredictability of future requirements by building a larger capacity pipeline. This is because the costs of laying a new pipeline rise slowly compared with increases in the capacity of that pipeline. In other words, it is much less expensive – per unit of capacity – to lay a large capacity pipeline than a small capacity pipeline.

In summary, therefore, it is generally not economic to develop another pipeline where an existing pipeline has existing spare capacity (or can develop it through greater compression and/or looping). Having said this, the Council recognises it will always be necessary to consider the facts of particular pipelines.

In considering the services of the pipelines that are the subject of the Envestra applications, the Council has found no evidence to suggest that these pipelines deviate from the typical characteristics noted above. The Council notes in this regard that the Palm Valley to Alice Springs pipeline

is currently operating at around 30 to 50 per cent of capacity<sup>6</sup>, suggesting that the most efficient way of satisfying any future expansion in demand would be through the services of the existing pipeline.

## Draft Recommendations

The Council's preliminary view is that the Palm Valley to Alice Springs pipeline and the Alice Springs distribution network satisfy criterion (b).

**Criterion (a)** that access (or increased access) to services provided by means of the pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the pipeline.

## Background

The rationale for this criterion is that access regulation is only warranted where access is likely to generate tangible benefits (for example, reduced prices or improved quality) which flow through to at least one market beyond the market for the services of the particular gas pipeline. In other words, while criterion (b) considers whether a natural monopoly occurs, criterion (a) looks at whether this creates a bottleneck that allows the monopolist to inhibit competition in another market.

To satisfy this criterion, two requirements must be satisfied:

- (a) access must be shown to promote competition in a market separate from the market for the regulated service; and
- (b) access must promote more competitive outcomes – such as lower prices – in that other market. Greater competition in another market will be less likely where that other market is already highly competitive, or where the other market is a monopoly (in the second case because cost savings are unlikely to be passed on to consumers).

The Council must also consider whether access charges are a significant enough input into the other market to have a material

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<sup>6</sup> Envestra's application.

effect on competition. In general, while a trivial increase in competition would not be sufficient, the Council considers access would not need to substantially promote competition in order to satisfy this test.

## The Envestra applications: views put to the Council

Envestra argues that there is little scope for competitive benefits to flow from regulated third party access to the pipelines. The applicant states that:

1. No third parties have sought access, or indicated a desire to seek access, to the pipelines.
2. The market for natural gas in the Alice Springs region is miniscule on a national scale and not expected to grow significantly because:
  - Major industrial gas users do not exist in the vicinity of the pipelines, and are not forecast to do so<sup>7</sup>;
  - In the case of the Palm Valley to Alice Springs pipeline, the gas is currently shipped for one customer, the Northern Territory Power and Water Authority (PAWA). PAWA uses 2.7 PJ per annum for its own electricity generation. The balance is on-sold to Energy Equity (0.2 PJ<sup>8</sup>) for power generation and Origin Energy (0.1 PJ) for its Alice Springs retail operations. Envestra argues that current and medium term regional power generation requirements will be satisfied by the existing system of four electricity generators (three owned by PAWA and one owned by Energy Equity). Envestra claims that additional generation capacity has not been planned for Alice Springs in the short term<sup>9</sup>;
3. The gas transported in the pipelines is sourced from the Palm Valley field, with Mereenie used as a secondary supply source. Both fields are jointly owned by Santos Ltd and Magellan Petroleum Australia Ltd.<sup>10</sup> Envestra states that these fields have economic lives in excess of 25

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<sup>7</sup> In support of this statement, Envestra cites: Australia's Northern Territory, *Major Projects June 1998*, produced by the Department of Asian Relations, Trade & Industry and the Ministry of Regional Development.

<sup>8</sup> Energy Equity Ltd informs the Council that this figure understates the company's use of the pipeline.

<sup>9</sup> In support of this statement, Envestra cites: Australia's Northern Territory, *Major Projects June 1998*, produced by the Department of Asian Relations, Trade & Industry and the Ministry of Regional Development.

<sup>10</sup> The ownership ratios vary. Magellan is the majority owner of the Palm Valley field, while Santos is the majority owner of Mereenie. Kufpec Australia Ltd has a small minority interest in Palm Valley.

years at current production levels, which discourages further exploration. On this basis, Envestra argues that, in the medium term, all gas transported through the Palm Valley to Alice Springs pipeline will be provided by the current producers. Envestra notes that an alternative field (Dingo, located 75 km south of Alice Springs<sup>11</sup>) has to date proved uneconomic to develop.

4. Gas from the Alice Springs distribution network is used predominantly by consumers for domestic heating and cooking purposes, not as an input into products for sale in a competitive market. There were 642 customers that consumed 95 TJ in 1998-99, with only one customer (the Alice Springs hospital) consuming more than 10TJ. There were 82 small commercial and industrial customers consuming less than 10 TJ per annum.

PAWA's submission<sup>12</sup> disputes the information provided by Envestra on gas reserves at Palm Valley. According to PAWA, Envestra's estimates are 1999 figures, which have since been significantly downgraded by Magellan – one of the project partners at Palm Valley. PAWA has provided a Media Release by Magellan, dated 25 January 2000, in support of this claim. PAWA claims that even the revised estimates may be too high:

According to expert advice PAWA has received... those revised estimates are also likely to be optimistic. Given the likelihood of offshore gas becoming available in the next 5 to 9 years as an alternative supply source, and the fact that Gasgo's contract with the Palm Valley producers expires in 2012, it may be that the life of the Palm Valley field will be considerably less than the 25 years suggested by Envestra in its application.

PAWA supports Envestra's argument that third parties are unlikely to seek access to the Palm Valley to Alice Springs pipeline, citing a lack of available gas at Palm Valley as a constraining factor:

...the Pipeline was built to ship gas from the Palm Valley field to PAWA's generating facilities in the Alice Springs region and the Palm Valley field is declining. The Palm Valley Producers are unlikely to be in a position to sell gas to any third party.

PAWA notes that its current contract with Envestra expires on 1 September 2008. While PAWA supports revocation, it notes that it reserves the right to apply for the pipeline to be covered once its contract expires in 2008.

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<sup>11</sup> See diagram in Envestra's application for the Palm Valley to Alice Springs pipeline.

<sup>12</sup> PAWA's submission refers to the Palm Valley to Alice Springs pipeline only. It does not cover the Alice Springs distribution pipeline network.

Energy Equity Ltd is a company that buys gas from PAWA to generate electricity, all of which is currently sold to PAWA. Energy Equity has informed the Council that it is considering options for expanding its generation capacity in the short to medium term. This would increase the company's demand for gas and would require access to the Palm Valley to Alice Springs pipeline. The company believes it would be in a position to sell the additional electricity generated into the recently deregulated market.

## Analysis

### **Does a separate market exist**

The first step in satisfying this criterion is to determine whether there is a separate market in which access promotes competition. The information supplied by Energy Equity Ltd suggests that markets in which access could promote competition are electricity generation and electricity sales in central Australia. The Council has also examined prospects for competition in the gas sales market and upstream gas production markets in central Australia.

It needs to be established whether these markets are separate from the market(s) in which gas transportation services are provided. In determining whether a separate market exists, the Council considers four market dimensions:

- the *product* market, which considers the types of goods and services produced.
- the *functional* market, focussing on a different stages in a production process. In considering whether functional separation exists, the Council has regard to:
  - whether the transaction costs of separate provision would act as an obstacle to separate provision such that vertical integration is not inevitable; and
  - whether each activity uses assets that are not readily substitutable.
- the *geographic dimension* of the market; for example, the market may be national or specific to a region.
- the *temporal dimension* of the market, especially relevant where market conditions are changing over time.

The Council notes that *electricity generation* and *electricity sales* are functionally distinct in the sense that these activities tend to be carried out by different businesses – suggesting that vertical integration is not inevitable. The assets used across these activities are not readily substitutable.

Both *electricity generation* and *electricity sales* can be separated from *gas transportation services* in the sense that the products of these markets are different and are not substitutable.

Both *gas production* and *gas sales* can be separated from *gas transportation services* on a functional basis. In central Australia, gas transport services tend to be provided by separate businesses, using separate types of assets, from businesses that produce gas and those businesses that sell gas.

### **Is competition promoted in another market?**

#### ***Palm Valley to Alice Springs pipeline***

The Council found little evidence that access would promote competition in the gas sales market. PAWA – the sole customer of this pipeline – is under contract with Envestra for its current needs until 2008. In the meantime, regulated access would bring no competitive benefit to PAWA and its customers unless PAWA can grow the market to ship gas above and beyond its current contractual arrangements.

The Council notes that an alternative route by which access could promote competition is through an independent party buying gas from the Palm Valley or Mereenie fields (or perhaps a new field such as Dingo) and then seeking access under the National Code to buy transport services from Envestra. This would promote competition in the gas sales market, and possibly in the upstream gas market.

Currently, the only significant users of gas other than PAWA in Alice Springs are Origin Energy (which retails gas to Alice Spring customers), and Energy Equity, which uses gas for electricity generation. These customers currently buy their gas and gas transport services as a bundled product from PAWA. According to PAWA's submission, Energy Equity Ltd's generating capacity is 8.5 MW, compared with 50 MW for PAWA.

The Council notes that Energy Equity Ltd is considering increasing its demand for gas to expand its electricity generation activities in Alice Springs. The Council understands that under third party access reforms in electricity, the company may be in a position to sell electricity generated above current contractual commitments in the electricity sales

market. In this sense, access to the Palm Valley to Alice Springs pipeline may be needed to ship gas that would promote competition in the electricity generation and electricity sales markets in central Australia.

The Council has taken note of the recent downgrading of Palm Valley gas reserves in the sense that availability of gas would be necessary for competition benefits to be realised. However, the Palm Valley to Alice Springs pipeline also interconnects with another gas field – Mereenie. The Council further notes that, given the uncertainty over future gas availability at Palm Valley, alternative fields such as Dingo may become more feasible to develop.

While ownership of gas fields in central Australia appears to be fairly concentrated at present, the Council notes PAWA's claim that natural gas from offshore should be available as an alternative supply source between 2005 and 2009. This raises the possibility of greater upstream competition. The Palm Valley to Alice Springs pipeline would presumably remain the principal means of shipping offshore gas from the Palm Valley junction to Alice Springs. In this sense, access may promote upstream competition in the supply of gas to central Australia in the medium term.

#### *Alice Springs Distribution network*

In theory, regulated access to the Alice Springs distribution network could promote competition in the gas sales market by enabling customers to buy gas directly from a producer, and contract separately with Envestra to transport the gas through its transmission and distribution pipelines.

To determine the likelihood of these benefits materialising, the Council held telephone discussions with the Alice Springs Town Council, the Alice Springs hospital, and the Northern Territory Chamber of Commerce. The Chamber fax streamed its members with details of the Envestra applications. To date, no concerns about revocation of coverage have been raised with the Council.

The potential benefits to individual consumers of undertaking their own third party access arrangements are likely to be minimal, given the small volumes involved. The potential may be more significant in the case of an energy retailer. Currently, all gas shipped through the Alice Springs distribution network is sold by Origin Energy Ltd, which purchases gas from PAWA.

Regulated access would allow Origin Energy to purchase gas directly from a producer and negotiate separately on transport prices under the National Code. The potential for consumers to benefit may be limited, however, in the sense that Origin Energy is related to Origin Energy Asset

Management Ltd, which operates the pipeline on behalf of the applicant.<sup>13</sup> In this sense, the interests of the two companies may not be consistent.

Another possible source of competition in the gas sales market is through the entry of an independent retailer. However, the Council has received no indication that this is under consideration. The size of the Alice Springs retail market appears to limit the potential for retail competition.

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The Council is continuing its consultation with a number of parties with regard to criterion (a). However at this stage, the Council's preliminary view is that:

- the Palm Valley to Alice Springs transmission pipeline satisfies criterion (a).
- the Alice Springs distribution network does not satisfy criterion (a).

**Criterion (c)** that access (or increased access) to the services provided by means of the pipeline can be provided without undue risk to human health or safety.

## Background

The rationale for this criterion is that the National Code should not be applied to pipelines where access might pose an undue risk to human health or safety.

## The Envestra applications – views put to the Council

This criterion was not addressed in the applications or in views put to the Council by stakeholders.

The Council therefore concludes that on the evidence available, access (or increased access) to the pipelines can be provided safely.

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<sup>13</sup> The Council understands that Origin Energy Ltd and Origin Energy Asset Management Ltd are legally distinct companies, observing the ring fencing obligations of the National Code.

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The Council's preliminary view is that the Palm Valley to Alice Springs pipeline and the Alice Springs distribution network satisfy criterion (c).

**Criterion (d)** that access (or increased access) to the services provided by means of the pipeline would not be contrary to the public interest.

## Background

In revocation matters, the Council considers whether access to a pipeline is contrary to the public interest. This assessment examines, among other matters, whether regulatory or compliance costs outweigh any benefits of access – such as cheaper prices and more efficient use of resources. The Council also takes into account the effect access might have on the environment, regional development, and equity.

## The Envestra Applications: views put to the Council

The applicant argues that regulated access to the pipelines would be contrary to the public interest because of the large regulatory costs relative to any potential benefits.

According to Envestra:

1. *Regulatory costs* for each pipeline would be about \$150,000 - \$250,000 for Envestra, with similar costs to the Regulator and the Northern Territory Government. These costs are ultimately recovered from the end users of gas pipeline services. Envestra argues that for pipelines with large throughput and large customer bases, third party access costs are generally not material relative to a customer's total gas cost, and the benefits of access outweigh the costs. But according to Envestra, these conditions do not apply here. Envestra states that:
  - The *Palm Valley to Alice Springs pipeline* has a relatively low throughput (3 PJ/a) and only one customer (PAWA). This means that all of the regulatory costs would be recovered from PAWA, and ultimately, from PAWA's customers.
  - The *Alice Springs distribution network* has a small throughput and a small number of customers – 559 domestic consumers, 82 small commercial/industrial (less than 10 TJ p.a.) and one customer

consuming more than 10 TJ per annum (the Alice Springs hospital). The small market makes regulatory costs a significant portion of the distribution tariff (approximately \$0.30 to \$0.50 per GJ). The cost per consumer would be in the order of \$230 to \$390 for the preparation of the initial Access Arrangement, with further costs at each reset.

2. Envestra argues that the potential benefits of access are limited as no third party has requested access to the pipelines and no other significant user(s) of transportation services are likely to commence operations in the vicinity of the pipelines in the medium term.

On this basis, Envestra argues that regulatory compliance costs on Envestra, the customer, the Regulator and the Northern Territory Government would outweigh the benefits of access to these pipelines. Envestra argues that *negotiated access* (ie outside the National Code) would be the most efficient form of access for small pipeline systems such as the Palm Valley to Alice Springs Pipeline and Alice Springs distribution network.

## Analysis

The Council accepts that there would be significant costs imposed if the pipelines are regulated. These costs would include the direct costs to Envestra, the regulator, and third parties that would arise from the preparation and use of an access arrangement, and more generally may include any unintended effects of regulation, such as stifling of incentives and a switch in focus for management from its core activities to managing its relationship with regulators. The Council has sought evidence from Envestra in support of the quantum of costs set out in the applications.

The Council notes that most of the direct regulatory costs nominated by Envestra would be incurred upfront at the start of the coverage period and thereafter would subside across the tariff review period, normally five years.

### *Palm Valley to Alice Springs pipeline*

The Council found evidence of benefits from regulation under criterion (a) in the sense of access promoting competition in another market. It is difficult to quantify the benefits that access could provide, but the Council considers that they may be of potential significance in the context of economic conditions in central Australia.

The Council notes that future demand for access to the pipeline may be contingent on proposed investments occurring in the future. In this sense,

there is some merit in the argument that coverage be revoked until a party is in a position to demonstrate a current need for access. The Council notes however, that coverage may be a factor encouraging marginal investments that may not otherwise proceed, in the sense that the National Code creates obligations on a pipeline company to:

- provide information to interested parties and;
- establish efficient benchmark prices.

The Council further notes that, once revoked, there may be considerable costs and delays in seeking re-coverage.

The Council considers that there is sufficient prospect in the medium term that demand will arise for access to the pipeline to suggest that the public benefits of access outweigh the costs.

### *Alice Springs distribution network*

The Council accepts that there are relatively limited benefits from regulation in view of the Council's findings under criterion (a) that access was unlikely to promote competition in another market in the short to medium term.

Submissions did not raise any other matters to support the view that the pipelines should remain covered in the balance of the public interest.

The Council considers that in the short to medium term, the costs of regulation are likely to outweigh the benefits.

## Draft Recommendations

The Council is continuing its consultation with a number of parties with regard to criterion (d). However at this stage, the Council's preliminary view is that:

- the Palm Valley to Alice Springs transmission pipeline satisfies criterion (d).
- the Alice Springs distribution network does not satisfy criterion (d).

## Appendix 1: The Revocation Process

The procedure for seeking revocation of coverage of a pipeline is set out in sections 1.24 – 1.39 of the National Code. The Code can be viewed at : [www.coderegistrar.sa.gov.au](http://www.coderegistrar.sa.gov.au)

In summary, the procedure is as follows:

- 1 Any person may apply to the Council for revocation of coverage of a pipeline.
1. If the Council considers that the application has been made on trivial or vexatious grounds, it may reject the application. In all other cases, the Council must, within 14 days of receipt of the application, inform the service provider and other interested parties, and will call for submissions by advertising the application in a national daily newspaper.

The Council advertised the applications in *The Australian* and the *Northern Territory News* on 4 May 2000; and the *Centralian Advocate*, Alice Springs (on 5 May).

2. The closing date for the initial round of consultation was **25 May 2000**.
3. The Council must prepare a draft recommendation within 14 days of the close of the consultation period, and circulate it to the applicant, the service provider, and other interested parties (including those parties that made submissions). For this application, the Council released a draft recommendation on 8 June 2000.
4. Parties have an opportunity to make further submissions to the Council within fourteen days after the draft recommendation is made publicly available. The closing date for submissions on the Northern Territory applications is **22 June 2000**.
5. The Council must consider any further submissions received and convey its final recommendation on revocation to the Relevant Minister within 28 days of the release of its draft recommendation.

For these applications, the Council's final recommendations must be sent to the Northern Territory Minister for Resource Development. The Council expects the recommendations to be conveyed by 6 July 2000.

6. The Council must recommend that coverage be revoked if it is satisfied that the pipeline does not meet one or more of the criteria set out in section 1.9 of the National Code (see below).
7. The Minister must make a decision on revocation of coverage on the basis of the same criteria applied by the Council. The Minister has 21 days to decide the matter.
8. The Minister's decision may be appealed to the relevant appeals body (in this case, the Australian Competition Tribunal).