18 July 2018

Australian Energy Market Commission
Level 6 201 Elizabeth Street
Sydney NSW 2000

Lodged online

Dear Commissioner

Request to change National Gas Rules

We write to request a change to the National Gas Rules.

Name and address of the person making the request

1. This request is made jointly by:

   Environmental Justice Australia (**EJA**), a not-for-profit legal practice.

   Environmental Justice Australia
   Suite 3-03, 60 Leicester St
   Carlton VIC 3053

   The Institute for Energy Economics and Financial Analysis (**IEEFA**).

   31 Inverallan Ave
   West Pymble NSW 2073

A description of the rule that the proponent proposes be made

2. The change we request is the revocation, in its entirety, of the derogation applicable to the Northern Gas Pipeline **(NGP)** contained in the *National Gas Rules* (**NGR**). At the date of this letter the current NGR is *Version 38*. The rule in question is numbered rule 3, Part 2, Schedule 4, on p 524 of the official *Version 38*. In this letter we define that rule as the **NGP Derogation**. It appears at **Annexure 1** to this letter.

3. The revocation does not require any other rules to be made or amended, and no changes are required to any legislation. We understand revocation is within AEMC's power under s 74 of the *National Gas Law* (**NGL**).

4. Annexed to this letter is further information in:

   (a) IEEFA's *Pipe Dreams* report dated May 2016 at **Annexure 2**;

(b) IEEFA's submission to the Northern Gas Pipeline Environmental Impact Statement dated 4 October 2016 at **Annexure 3**;

(c) EJA's report *Fracking the Northern Territory* dated 25 May 2018 at **Annexure 4**.

A statement of the nature and scope of the issue(s) concerning the existing rules that is to be addressed by the proposed rule change request and an explanation of how the proposed rule change request would address the issue(s)

5. The effect of the NGP Derogation is to create an unregulated monopoly pipeline, with no limit on tariffs, for 15 years. This does not promote the efficient operation of natural gas services for the long-term interest of consumers of natural gas, especially with respect to price and security of supply. Based on reasonable rates of return to the operator, consumers may be out of pocket for over $2 billion.

6. The NGP Derogation also applies to any extensions and expansions to the NGP, beyond the scope of the pipeline now under construction.

7. Paragraphs 10–18 below describe how the NGP Derogation operates to produce an unregulated monopoly.

8. Revoking the NGP Derogation will put the Northern Gas Pipeline (**NGP**) on a level playing field with other gas pipelines in Australia. Revocation would go toward ensuring an efficient market and allocation of capital for future expansion or extension of the NGP, and to ensure all future pricing for access to the NGP, and any expansion or extension, is overseen by the Australian Energy Regulator. The result would be that tariffs under dispute would be set such that pipeline users and gas consumers are not disadvantaged, and the NGP is subject to the same rules as other pipelines in Australia.

Operation of the NGP Derogation

9. The NGP Derogation exempts the NGP from Chapter 6A of the NGL.

10. Chapter 6A NGL sets out how access to pipelines is negotiated and how it is referred to arbitration where disputes arise. The dispute process is overseen by the 'scheme administrator' (ss 216H, 216I, 216J NGL). The scheme administrator is the Australian Energy Regulator (**AER**) (s 216A NGL). Ultimately disputes are referred to arbitration (ss 216J, 216K NGL). The arbitrator takes into account pricing in the NGR and the NGR can guide the arbitrator's decision (ss 216M, 216L NGL).

11. The NGP Derogation provides that the 'Access Principles' agreed between the NGP service provider (**Jemena**) and the NT government apply (s 3(1)(a) NGP Derogation). Those Access Principles are subject to change by Jemena at any time, as is apparent from the definition of the 'Access Principles'. The definition provides that the principles can be

amended by Jemena 'from time to time'.[1] There is no restriction on when, or how often, Jemena can change the principles.

12. For tariffs to be changed under the Access Principles there is merely a notification requirement to the NT government (s 24 of the Access Principles). These Access Principles give Jemena considerably more power than is ordinarily afforded under the NGL, and removes the oversight of the AER. Jemena can change the principles unilaterally to give it unfettered market power.

13. Furthermore, the dispute procedure available to Jemena under the Access Principles is considerably more favourable to them. Unlike the dispute process set out in Chapter 6A, the dispute procedure found in Annexure 2 of the Access Principles is not overseen by the scheme administrator, nor is it informed by the NGR. This raises a clear issue in that dispute processes under the Access Principles are clearly lacking oversight and consistency with the NGL.

14. The application of the NGP Derogation to 'any extension to, or expansion of the capacity of, that pipeline that is subject to the Access Principles' means that the derogation applies to any future parallel pipeline. Jemena has proposed a second, parallel pipeline worth $4 billion.[2]

15. The NGP Derogation exempts the NGP from complying with Part 23 of the NGR in its entirety. Part 23 includes disclosure principles that are designed to create an informed, and efficient market. The ACCC describes the Part 23 disclosure requirements in the following terms:[3]

> *In the ACCC's 2015 inquiry, we found that information asymmetries were potentially limiting the ability of shippers to identify monopoly pricing of pipeline services and to negotiate effectively with pipeline operators. The aim of the Part 23 disclosure obligations is to reduce this information asymmetry and imbalance in bargaining power that shippers can face when negotiating transportation arrangements with pipeline operators.*

16. The ACCC provide further detail about the benefits to the market of the Part 23 disclosure requirements:[4]

> *A key element of Part 23 is the requirement for operators of non-scheme pipelines to publish information that shippers can use to access whether the prices they are offered for transportation services are cost reflective, including:*
>
> - *the standing price for all the services offered by the pipeline (including firm forward haul services, as available and interruptible transportation services, part (storage) and loan services, and other ancillary services)*

[1] NGP Access Principles, p1: https://jemena.com.au/getattachment/industry/pipelines/Northern-Gas-Pipeline/Services/NGP-Access-Principles.pdf.aspx
[2] https://www.smh.com.au/business/the-economy/northern-territory-lifts-ban-on-onshore-gas-fracking-20180417-p4za0v.html ; http://www.abc.net.au/radio/programs/nt-country-hour/gas-pipeline-expansion-needs-fracking-says-jemena/9644592
[3] www.accc.gov.au/system/files/Gas%20inquiry%20April%202018%20interim%20report.pdf p12
[4] www.accc.gov.au/system/files/Gas%20inquiry%20April%202018%20interim%20report.pdf p47

- *the methodology used to calculate the standing price and sufficient information to enable shippers to understand how the price reflects the application of this methodology*
- *financial information for each non-scheme pipeline and the weighted average prices paid by users for each service.*

…

The publication of this information represents progress towards increased transparency in a market that has historically been relatively opaque, and a shift towards reporting frameworks which exist overseas such as in the United States. It should assist shippers, particularly smaller shippers and new entrants, to assess the reasonableness of a service provider's offer.

17. Even if some of the information is disclosed by Jemena in the NGP's Access Principles, the NGP Derogation means there is nothing stopping Jemena from changing those principles and removing any of the information required under Part 23 NGR.

An explanation of how the proposed rule change request will or is likely to contribute to the achievement of the relevant energy objective

18. The NGP Derogation offends the National Gas Objective (**NGO**) in s 23 of the NGL.

> *The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.*

19. The revocation of the NGP Derogation will contribute to the achievement of this objective.

20. The tender process for the NGP was for a 14-inch pipeline. Jemena applied for and won the tender. The NGP diameter was then reduced to 12 inches, which had led to a 25% reduction in capacity. The tender process was not repeated. The result is a flawed outcome, which may require future expansion or extension. So to then provide exclusion from tariff oversight for any such expansion or extension only serves to reward the inefficient use of capital. Taken to its logical conclusion, the NGP Derogation could permit not just two, but three or four pipelines, built over the next 15 years to expand capacity. Jemena itself contemplates expansion and extension to the NGP in the Access Principles.

21. The NGP Derogation appears to confirm 2016 financial analysis of the NGP by IEEFA which found the NGP was not viable unless 'substantial new fossil fuel subsidies from the Northern Territory government ... and the federal government' materialised. (Annexure 2, p2)

22. The NGP Derogation is a part of a number of measures that Jemena has worked toward to make the NGP profitable. In 2015 the company underwent a restructure and created $800 million in convertible instruments, for the purpose of building the NGP, that guaranteed a high return to Jemena's offshore owners. That transaction appears to be currently under investigation by the ATO for transfer pricing. It appears to be part of a scheme that could see taxpayers miss out on up to $500 million (Annexure 4, p8). The irregularities with the current

NGP are many and serious. The AEMC should remove what is effectively a subsidy in the form of the NGP Derogation without delay.

23. Despite the 25% reduction in capacity from Jemena's initial proposed pipeline, there remains a lack of demand for gas flowing through the NGP. According to the ACCC's Gas Inquiry 2017–2020 Interim Report dated April 2018, the NT's Power and Water Corporation (**PWC**) had contracted only a third of Jemena's start out capacity, being 30 TJ/day, for a duration of 10 years. On 25 June 2018 Jemena announced a further contract with Incitec Pivot to supply its Brisbane Gibson Island fertiliser plant. The terms are for 32 TJs of gas per day, from December 2018 to December 2019. There is an option for extension.[5]

24. The two contracts fall far below the NGP's capacity. Jemena expects the NGP's initial capacity will be 90 TJ/day, reaching up to 160 TJ/day with compression.[6]

25. The suite of measures implemented by Jemena to make the pipeline profitable, many of them questionable, have caused a distorted market which will lead to inefficient operation and use (see **Annexure 4**). Jemena asserts that the NGP will be fully contracted by the time it is operational. However, ACIL Allen's October 2017 final submission to the Northern Territory Independent Scientific Inquiry Into Hydraulic Fracturing suggested any gas delivered by the NGP will be uncompetitive under current policy settings.[7]

26. The estimated cost of the NGP is $800 million, without expansion or extension. The high costs of the pipeline may enable Jemena to justify non-commercial prices. As an unregulated monopoly pipeline under the NGP Derogation, Jemena will have the ability to charge as much as it wants, despite the fact that the global LNG market is over supplied.[8] That is not an efficient operation of a natural gas service in the long-term interests of customers.

27. The current state of the NGRs is simply inefficient for the NGP. The is especially so given the NGP Derogation covers extension or expansion, and Jemena's ability to squeeze the consumer under the derogation is possible for up to 700 TJs of gas flow per day, the expected expansion capacity.[9]

28. On 18 June 2018 Jemena published a media release about an agreement with Senex to build, own, and operate the Atlas Gas Processing Plant and Pipeline (AGPP). It referred to plans to expand and extend the NGP.[10]

> *We are also continuing to work on our Northern Gas Pipeline (NGP), which will initially bring around 90TJs of gas to the east coast, and are now progressing plans to expand and extend the NGP so that it can transport*

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[5] http://jemena.com.au/about/newsroom/media-release/2018/jemena-and-senex-partner-to-fast-track-new-gas-(1)
[6] ACCC Determination AA1000398, pp5,6: www.accc.gov.au/system/files/public-registers/documents/AA1000398%20-%20Central%20and%20Macquarie%20Mereenie%20-%20Final%20Determination%20-%2029.03.18%20-%20PR.pdf
[7] https://frackinginquiry.nt.gov.au/news/?a=456788
[8] Ibid p 10-11.
[9] http://jemena.com.au/about/newsroom/media-release/2017/gas-pipeline-to-bring-northern-territory-gas-to-th
[10] http://jemena.com.au/about/newsroom/media-release/2018/jemena-and-senex-partner-to-fast-track-new-gas-sup

around 700TJs of gas – that is enough gas to meet the average daily gas needs of Sydney, Brisbane, and Adelaide combined.

29. The NGP derogation allows Jemena an unencumbered ability to set prices without any oversight by the AER for volumes equivalent to the daily gas needs of Sydney, Brisbane and Adelaide. This is clearly in direct opposition to an objective of promoting efficient investment and ensuring then prices that serve the long-term interests of consumers.

30. Under the NGP Derogation, access disputes are governed by Jemena's Access Principles. In its current form, the principles provide a tariff structure which can be changed merely by giving notice to the Northern Territory Minister. Regardless, the tariffs in the Access Principles are already high.

31. Relying on Australian Energy Market Operator (**AEMO**) data, IEEFA found that the NGP is the most expensive Australian onshore pipeline per unit of gas over a set distance. The NGP is 27% more expensive than the second most expensive pipeline, the Carpentaria Gas Pipeline. It is 575% more expensive than the Moomba to Sydney Pipeline System (p5, **Annexure 2**).

Onshore Australian Pipeline Costs Per Kilometre

Pipeline	Tariff ($/GJ)	Distance (Kilometres)	Tariff of 1 GJ/KM (cents/km)
Northern Gas Pipeline	**1.40**	**622**	0.23
Carpentaria Gas Pipeline	1.48	840	0.18
Eastern Gas Pipeline	1.21	795	0.15
Queensland Gas Pipeline	0.94	629	0.15
South West Queensland Pipeline	0.98	756	0.13
Roma-Brisbane Pipeline	0.57	440	0.13
South East Australian Gas Pipeline	0.80	680	0.12
Longford to Melbourne Gas Pipeline	0.25	250	0.10
Moomba to Adelaide Pipeline System	0.67	1185	0.06
Moomba to Sydney Pipeline System	0.90	2035	0.04
Average Tariff			0.13

Source: AEMO, Jemena

32. AEMO commissioned the Core Logic report *Gas Production and Transmission Costs and Eastern and Southern Australia*. Based on a reasonable rate of return, an indicative tariff is AUD0.11/GJ per 100km length, which equates to a $0.68 Gigajoule (**GJ**) for Jemena's 622 km NGP. Jemena's base rate is $1.40 GJ, over twice the reasonable rate.

33. The reasonable rate of return is 7% per annum. The table below is extracted from the Core Logic Report. It shows that our indicative tariff is conservative based on the pipeline diameter.

The following table provides a Low to High range of capital costs for pipelines of varying configuration for a 100km length, together with an indicative tariff based on a real rate of return of 7%.

Table 4.3 Summary

Pipeline configuration	Low AUD Million	Ref. AUD Million	High AUD Million	Ref. Tariff
8 inch Class 600, 5.6mm wall thickness	28.4	31.5	34.7	AUD0.11/GJ
14 inch Class 600, 9.1 mm wall thickness	55.9	62.1	68.3	AUD0.10/GJ

Source: Core Energy Group with Operator input for a number of areas.

34. In our view 7% is a more than reasonable rate of return. In 2016 Environmental Justice Australia wrote to the ATO asking it to investigate this arrangement. Our research into comparable projects concluded that 5% or below was an appropriate yearly rate for a long-term loan for the pipeline. We note that Jemena treats the convertible instruments as debt for accounting purpose.[11]

> *Generally, the Group's gearing rate is applied to the capitalisation rate to determine the amount of interest to capitalise, however NGP construction costs are nominated to be 100% debt funded for this purpose.*

35. SGSP (Australia) Assets Pty Ltd annual report notes on p17:

The Australian Taxation Office is currently conducting a transfer pricing audit in relation to the Company's convertible instruments. No liability has been recognised.

36. The ATO does not comment on matters under investigation.

37. The NGP will initially be capable of transporting 90 Terajoule (**TJ**) per day, with the potential to increase the capacity to 160 TJ per day with compression.[12] At the lowest flow rate, assuming a 24-hour flow,[13] and based on the reasonable rate of return in the preceding paragraph, Jemena is set to net $64,800 per day more than is reasonable. Over the 15-year exemption period as set in the NGR, this amounts to $354 million more than reasonable.

38. If we take assuming the increased flow of 160 TJ operates for 15 years, Jemena will receive over $630 million than is reasonable. If Jemena transports 700TJs of gas per day, as foreshadowed with an extension or expansion, and the tariff per kilometre remains the

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[11] SGSP (Australia) Assets Pty Ltd 2017 annual report, p40

[12] ACCC Determination AA1000398, p5: www.accc.gov.au/system/files/public-registers/documents/AA1000398%20-%20Central%20and%20Macquarie%20Mereenie%20-%20Final%20Determination%20-%2029.03.18%20-%20PR.pdf

[13] This assumption leads to a production 32.8 PJ per year. The assumption appears reasonable given Jemena itself estimates pipeline capacity at 35 PJ per year: https://jemena.com.au/documents/pipeline/negi/chapters/1-introduction

same, Jemena will benefit $184 million per year. Over 15 years it will benefit over and above $2.76 billion.

39. The NGP Derogation is for 15 years' duration. But if it were to continue to 2050, the date Jemena's 'convertible notes' expire, the NGP is expanded and the tariffs and other assumptions remain static, this unreasonable gain blows out to well over $5 billion.

40. We emphasise that our over-charge calculations are conservative. They relate to the lower end of Jemena's tariff structure under its Access Principles. They do not take into account pricing for 'as-available forward haul transportation service' being 1.3x the tariff cited above. Nor does it take into account the 'Nitrogen removal service tariff' which, under the current Access Principles, is set at $0.54 / GJ based on a 15-year term, and $0.72 / GJ based on a 10-year term.

An explanation of the expected potential impacts of the proposed change to the rules on those likely to be affected

41. Revoking the NGP Derogation would prevent Jemena from engaging in unchecked and unreasonable monopoly pricing. This would likely negatively impact the profitability of the NGP, but ultimately positively impact retailers and consumers by reducing the monopoly pricing power of Jemena.

42. The focus of the NGO is on efficient investment in, and operation and use of gas services in the long-term interests of consumers. The NGP Derogation does not provide for efficient investment in gas services. In fact, it does the opposite, and it will only reward previous inefficient behaviour in a distorted marketplace. It will provide a perverse incentive to 'expand or extend' the NGP. And over the longer term, to 2050, consumers will be overcharged, based on a reasonable rate of return, in the vicinity of $5 billion.

43. In 2015 the *Australian Consumer and Competition Commission* (**ACCC**) found evidence of monopoly pricing in the east coast gas market. The report set out the impacts of monopoly pricing.

> *Monopoly pricing by pipeline operators can adversely affect market participants because:*
> *• it results in lower ex-plant gas prices for producers and/or higher delivered gas prices for users*
> *• it can cause significant transfers of wealth from producers, users and consumers to the pipeline operators.*
>
> *Monopoly pricing can also have adverse consequences for the efficient operation of the gas market and economic efficiency in upstream and downstream markets, because it can result in:*
> *• lower than efficient levels of gas use and investment in downstream facilities*
> *• lower than efficient levels of gas production and investment in gas exploration and reserves development*

• inefficient utilisation of pipelines and potential distortions in gas flows across the market, which can prevent gas from flowing to where it is valued most.[14]

44. The impacts above result from the NGP Derogation.

45. The ACCC expanded on its findings of monopoly pricing by pipeline operators:

Monopoly pricing by a pipeline operator can result in:
• producers receiving less for the gas they supply (lower ex-plant gas prices)
• industrial users paying more for the gas they use (higher delivered gas prices)
• end-users paying more for gas and electricity and paying more for products that require gas in their production (higher prices for end-users).[15]

46. Again, these impacts apply to Jemena under the NGP Derogation.

47. Consumers of gas that is transported through the NGP, or any extension or expansion of the NGP, will benefit from the removal of the NGP Derogation. Revocation will place the NGP on a more level playing field with other pipelines. It will remove perverse incentives to develop gas fields near Tennant Creek, many of which are opposed by local communities. It will remove a market-based solution to PWC's over-contracting of the ENI Blacktip offshore gas field by the NT's PWC. That contract, a GSA or 'Gas Supply Agreement', is for 25 years.[16] That duration in itself raises significant questions about PWC officials providing a non-market based agreement, effectively a subsidy, to business, without a proven market.[17]

Yours sincerely,

David Barnden	Bruce Robertson
Principal lawyer	Analyst
Environmental Justice Australia	IEEFA

[14] www.accc.gov.au/system/files/1074_Gas%20enquiry%20report_FA_21April.pdf p111
[15] www.accc.gov.au/system/files/1074_Gas%20enquiry%20report_FA_21April.pdf p112
[16] www.accc.gov.au/system/files/Gas%20inquiry%20December%202017%20interim%20report.pdf p88
[17] A step change appears in PWC's reporting of gas supply between 2013 and 2014. PWC's 2013 annual report reveals it was seeking increased gas supply from Inpex pursuant to agreements expected to be in place by 2013, www.powerwater.com.au/__data/assets/pdf_file/0007/58417/pwc_annualreport2013.pdf p14. PWC's 2014 annual report then commences to report on 'surplus gas entitlements' under an agreement with ENI: www.powerwater.com.au/__data/assets/pdf_file/0003/88230/PW_AR_2014_Web.pdf p48.

Annexure 1 - NGP Derogation

NATIONAL GAS RULES SCHEDULE 4
VERSION 38TRANSITIONAL PROVISIONS AND DEROGATIONS FOR PIPELINE ACCESS – ARBITRATION FRAMEWORK

Part 2 Derogation applicable to Northern Gas Pipeline

3 Northern Gas Pipeline

(1) In this rule:

(a) **access principles** means the arrangements agreed between the service provider for the Northern Gas Pipeline and the Northern Territory Government under which a prospective user may gain access to pipeline services on the Northern Gas Pipeline; and

(b) **Northern Gas Pipeline** means the pipeline to be constructed between Tennant Creek in the Northern Territory and Mount Isa in Queensland the subject of Pipeline Licence 34 granted under the *Energy Pipelines Act 1981* of the Northern Territory and Pipeline Licence 2015 granted under the *Petroleum and Gas (Production and Safety) Act 2004* of Queensland, including any extension to, or expansion of the capacity of, that pipeline that is subject to the access principles.

(2) Subject to subrule (3), for section 216C(2)(a) of the *NGL* and Part 23, the Northern Gas Pipeline is excluded from the operation of Chapter 6A of the *NGL*.

(3) This rule expires on the 15th anniversary of the date the Northern Gas Pipeline is first commissioned.