NATIONAL
COMPETITION
COUNCIL

Wagga Wagga Gas Distribution Network

Application under the National Gas Law for a revocation of coverage determination for the Wagga Wagga Gas Distribution Network

Final Recommendation

8 August 2013

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Abbreviations, definitions and glossary

AAC	ACIL Allen Consulting
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
APA	APA Group
Application	Application by Envestra Ltd under s 102 of the NGL for a revocation of coverage determination, received by the Council 1 May 2013
CCA	*Competition and Consumer Act 2010* (Cth)
Core	Core Energy Group
Council	National Competition Council
criterion (a)	Section 15(a) of the NGL
criterion (b)	Section 15(b) of the NGL
criterion (c)	Section 15(c) of the NGL
criterion (d)	Section 15(d) of the NGL
Envestra	Envestra Ltd - the applicant, owner and operator of the WWGDN
ERAA	Energy Retailers Association of Australia
Gas Code	*National Third Party Access Code for Natural Gas Pipeline Systems* (Schedule 2 to the Gas Pipelines Access (South Australia) Act 1997)
IPART	Independent Pricing & Regulatory Tribunal
MSP	Moomba to Sydney Pipeline
NGL	National Gas Law, which is set out in the Schedule to the *National Gas (South Australia) Act 2008I* (SA) and applied as a law of South Australia by that Act and as a law of other States and Territories by an application Act in each jurisdiction
PJ	Petajoule. A petajoule equals 1,000,000,000,000,000 joules.
WWGDN	Wagga Wagga Gas Distribution Network

1 Recommendation

1.1 Envestra Ltd (**Envestra**) applied for revocation of coverage of the Wagga Wagga Gas Distribution Network (**WWGDN**) on 1 May 2013.

1.2 Under the National Gas Law (**NGL**), the Council is responsible for considering this application and making a recommendation to the relevant Minister.

1.3 The Council classifies the WWGDN as a distribution pipeline. It is located wholly within New South Wales. As such the relevant Minister to consider the Council's recommendation and decide on Envestra's application is the NSW Minister for Resources and Energy; the Hon Chris Hartcher MP.

1.4 Under the NGL the Council must recommend, and the Minister must make, a coverage revocation determination where one or more of the pipeline coverage criteria are not satisfied in relation to a pipeline. Where all the pipeline coverage criteria are met a revocation determination should not be made and a pipeline should remain covered.

1.5 In making this recommendation, the Council has had regard to the national gas objective in s 23 of the NGL.

1.6 The Council finds that the coverage criteria are met in relation to the WWGDN and therefore it recommends to the Minister that he not revoke coverage of the WWGDN.

2 Background

2.1 Envestra has applied to the Council under s 102 of the NGL for revocation of coverage of the WWGDN. Envestra paid the appropriate fee. The effect of the revocation of coverage would be to terminate regulation of the price and other terms of access to the network under the NGL.

2.2 The WWGDN distributes gas within the city of Wagga Wagga and the neighbouring town of Uranquinty. In 2011-12 the network delivered approximately 1.7PJ of gas to just over 20 000 end users. The network is 690 km in length. It is connected to the Moomba to Sydney Pipeline (**MSP**) via the Young to Wagga Wagga lateral[1] and is also connected to the Victorian Transmission System via 'the Interconnect'.[2] Both of these transmission pipelines are owned and operated by the APA Group (**APA**). Figure 1 illustrates the location of the WWGDN and related pipelines.

2.3 Envestra is listed on the ASX. Its shareholders comprise APA (33%), Cheung Kong Infrastructure Holdings—a Hong Kong listed infrastructure investor (18%), institutional investors (25%) and holders of smaller parcels of shares (< 100,000 shares) (24%).[3]

2.4 In addition to its shareholding in Envestra, APA owns and/or operates a range of other gas transmission and distribution assets, including both the gas transmission pipelines linking the WWGDN to eastern Australian gas supplies. APA also provides pipeline operation, maintenance and construction services to Envestra, including in relation to the WWGDN.

2.5 The WWGDN is a covered pipeline by virtue of its inclusion in the original Schedule A list of covered pipelines under the *Gas Code*.[4]

2.6 The WWGDN is currently classified as a distribution pipeline as it reticulates gas within a market. This classification is not disputed by any party. The network is wholly

1 The MSP is partially covered, with coverage of this pipeline from Moomba to Marsden having been revoked in 2003. The covered portion of the MSP runs from Marsden, through Young, to Sydney and includes the Young to Wagga Wagga lateral. In 2008 the Council determined that the covered part of the MSP should be subject to light regulation (see paragraphs 5.19-5.21]).

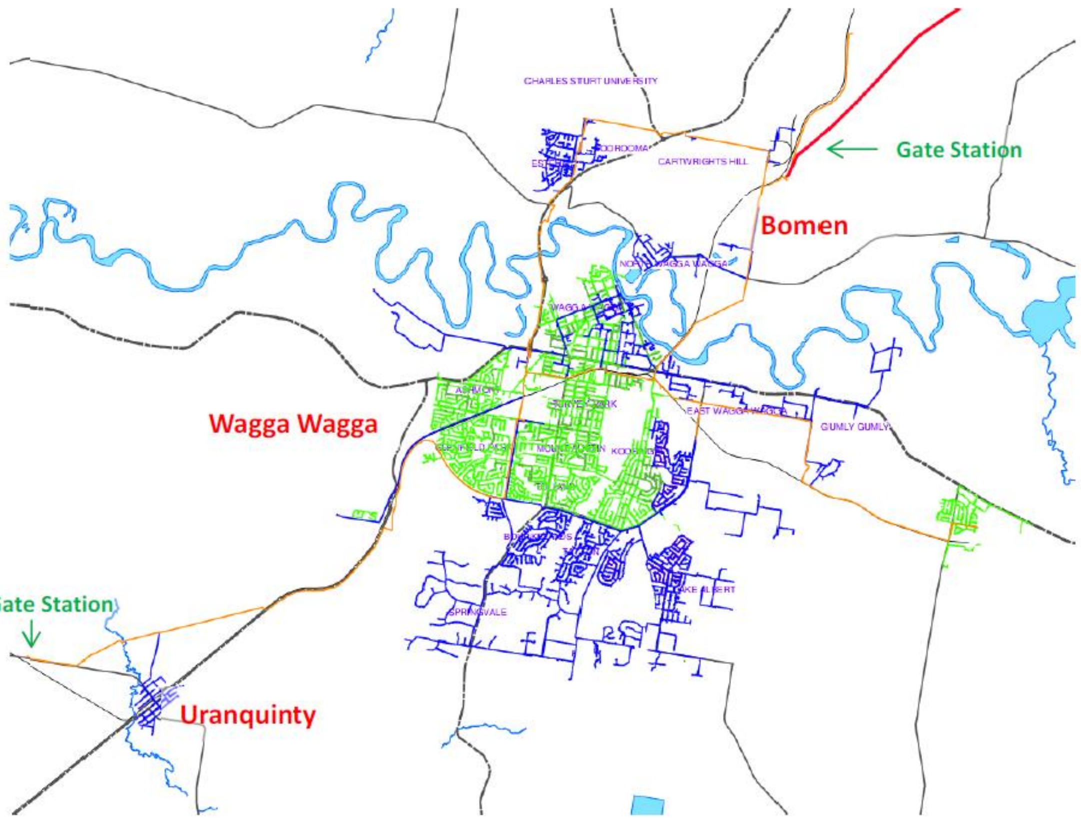
2 The Victorian Transmission System and the Interconnect are both covered pipelines subject to full regulation.

3 The Council notes that at the time of making this recommendation Envestra had received a conditional and non-binding proposal from APA to acquire all of the issued capital of Envestra that it does not already own. Should the APA proposal succeed, APA would control both transmission pipelines and the distribution pipeline serving gas customers in the Wagga Wagga area. However, it is not clear that this change would have any significant implications for this application in addition to those already addressed as a consequence of APA's existing interest in Envestra. The wider consequences of the APA proposal for competition in the gas sector may of course be a matter for assessment by the ACCC against s 50 of the CCA.

4 National Third Party Access Code for Natural Gas Pipeline Systems—set out in Schedule 2 to the now repealed *Gas Pipelines Access (South Australia) Act 1997*.

located within New South Wales. As a result of the network's classification and location, the relevant Minister to consider the Council's recommendation and decide on Envestra's application is the NSW Minister for Resources and Energy; the Hon Chris Hartcher MP.

Figure 1: Wagga Wagga Gas Distribution Network (from application)



Note: Orange pipelines are steel high pressure mains running at 900 kpa
Blue pipelines are medium high pressure mains running at 200 – 300 kpa
Green pipeline are medium low pressure mains running at 40 kpa

3 Revocation of coverage

3.1 Under s 102 of the NGL a person may apply for a determination that a covered pipeline no longer be a covered pipeline. Such an application is made to the Council which must then make a recommendation to the relevant Minister as to whether the pipeline should continue to be a covered pipeline.

3.2 In making its recommendation the Council:

(a) must give effect to the pipeline coverage criteria; and

(b) in deciding whether or not the pipeline coverage criteria are satisfied, must have regard to the national gas objective (NGL, s 105(1)).

3.3 The pipeline coverage criteria and national gas objective are set out in sections 15 and 23 of the NGL respectively. For ease of reference these sections are reproduced in Figure 2.

Figure 2: Pipeline coverage criteria and the national gas objective (ss 15 and 23 of the NGL)

15—Pipeline coverage criteria

The pipeline coverage criteria are—

(a) that access (or increased access) to pipeline services provided by means of the pipeline would promote a material increase in competition in at least 1 market (whether or not in Australia), other than the market for the pipeline services provided by means of the pipeline;

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

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

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

23—National gas objective

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.

3.4 The NGL further provides (in s 105(2)) that:

(2) The NCC gives effect to the pipeline coverage criteria as follows:

(a) if the NCC is satisfied that all the pipeline coverage criteria are satisfied in relation to the pipeline—the recommendation must be in favour of the pipeline continuing to be a covered pipeline;

(b) if the NCC is not satisfied that all the pipeline coverage criteria are satisfied in relation to the pipeline—the recommendation must be in favour of the pipeline no longer being a covered pipeline.

3.5 The provisions in the NGL relating to coverage do not differentiate between transmission and distribution pipelines.

Process

3.6 The Council must apply the *standard consultative procedure* set out in the National Gas Rules (Rule 8) in considering applications for revocation of coverage. This procedure requires that the Council generally provide its recommendation within a 4 month timeframe (see Rule 19).

3.7 As required the *standard consultative procedure* has been used in relation to this application.

- Public notice of the application was published in *The Australian* on Tuesday 7 May 2013.[5]
- Written submissions on the application were sought with a closing date of 28 May 2013.
- Four submissions were received in response to the application. All the submissions received were from energy retailers (including both companies supplying gas in the area serviced by the WWGDN) and their representative organisation, and opposed the revocation of coverage of the WWGDN.
- In addition, Envestra provided the Council with a response to the submissions and, at the Council's request, Origin Energy (**Origin**) and Energy Australia provided some additional detail in relation to some issues raised in their submissions. This information was published on the Council's website and taken into account in preparing the draft recommendation.
- The Council released its draft recommendation on 17 June 2013, proposing that the Minister determine not to revoke coverage as the Council was satisfied that all the pipeline coverage criteria were satisfied.
- The Council invited written submissions on the draft recommendation by 15 July 2013.[6] The Council received nine submissions in response and public versions of all submissions were published on the Council's website.

3.8 The submissions from Envestra and the Energy Networks Association disagree with the Council's findings in its draft recommendation. Envestra's submission amplifies a number of its earlier contentions and challenges various conclusions of the Council. The matters raised are addressed as appropriate in this recommendation. Envestra also commissioned and submitted reports from ACIL Allen Consulting (**AAC**) and the Core Energy Group (**Core**).

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5 The Council also placed this notice in *The Daily Advertiser* in Wagga Wagga on the same day.

6 Upon release of the draft recommendation, the Council initially called for submissions by 8 July 2013. It decided to extend the closing date by 5 business days to 15 July 2013 and interested parties were notified as such on 19 June 2013.

3.9 The AAC report critiques the draft recommendation and provides support for a number of contentions contained in Envestra's further submission. The AAC report and Envestra's further submission overlap significantly, with the Envestra submission drawing on the AAC report. The AAC report also draws on some assumptions and other material contained in Envestra's original application and second submission as a basis for some of its conclusions. As such, there is some mutually reinforcing circularity between the two documents. In this final recommendation, the Council generally has sought to address the various arguments and contentions in Envestra's further submission and the AAC report together.

3.10 The Core report addresses issues relating to the relative competitiveness of natural gas and electricity for residential customers in Wagga Wagga, the potential for switching from gas appliances to electric and whether switching costs are likely to be a barrier to switching. The Core report draws on a spread sheet "model" to quantify these impacts. The Council has not sought to validate the spread sheet calculations; rather it has focussed on the assumptions adopted by Core and the conclusions drawn.

3.11 The Council agreed to treat a limited amount of information provided in the Envestra submission and the Core report as commercially sensitive and confidential. This material includes spreadsheets which contain Core's modelling. The confidential material relates to more detailed assessment of the competitive position of gas relative to electricity. The general thrust of the contentions in relation to this issue is clear from the public versions of the documents and the Council does not consider its findings in this recommendation are particularly sensitive to the additional detail which is not disclosed.

3.12 In its application and further submissions, Envestra argues that the WWGDN does not satisfy criteria (a) and (d) and therefore coverage should be revoked. These coverage criteria are considered further in sections 4 and 5 of this recommendation.

3.13 Of the remaining submissions, five were made by energy retailers and a further submission was also provided from their representative body. The Australian Energy Market Commission (**AEMC**) also wrote to the Council as part of the submission process on a particular issue concerning its review of retail price regulation in New South Wales.

3.14 All of the energy retailers and the Energy Retailers Association of Australia (**ERAA**) supported the findings and conclusions in the draft recommendation. Some of these submissions were more fulsome than others in providing factual information and analysis supporting their respective claims. Such matters are addressed in the body of this recommendation as appropriate.

3.15 A full list of submissions received is included in Appendix A.

Criteria (b) and (c)

3.16 Envestra accepts that the other coverage criteria (criteria (b) and (c)) are satisfied in relation to the WWGDN.

3.17 In relation to criterion (b) Envestra accepts that it would be uneconomic for anyone to develop another pipeline to provide the services of the WWGDN, noting:

> The significant excess capacity in the network and limited prospects for growth in demand for natural gas indicates the network has sufficient capacity and ability to meet demand for natural gas in the service area for the foreseeable future. Coupled with large sunk costs a new entrant would confront, Envestra considers it would be uneconomic (unprofitable) for anyone to duplicate this network. (Application at [92])

3.18 In relation to criterion (c), Envestra notes the NGL and the licencing conditions applying to the WWGDN impose strict obligations in relation to safety which operate irrespective of whether the pipeline is covered or not.

3.19 Other parties noted that Envestra accepts criteria (b) and (c) are satisfied in relation to the WWGDN. No other party addressed these criteria.

3.20 The Council agrees that criteria (b) and (c) are satisfied in relation to the WWGDN. These criteria are not considered further in this recommendation.

The Minister's determination

3.21 On receipt of the Council's recommendation the relevant Minister must decide whether to make a coverage revocation determination. In doing so the Minister is bound by similar requirements to those applying to the Council in making its recommendation.

3.22 In essence, the Council must recommend, and the Minister must make, a coverage revocation determination where one or more of the pipeline coverage criteria is not satisfied.

4 Criterion (a) – material promotion of competition in a dependent market

4.1 Criterion (a) requires that access (or increased access) to the pipeline services provided by means of the pipeline [to which an application relates] would promote a material increase in competition in at least 1 market (whether or not in Australia), other than the market for pipeline services provided by means of the pipeline.

4.2 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.

4.3 The promotion of a material increase in competition involves a reduction in barriers to entry or other improvement in the opportunities and environment for competition such that competitive outcomes are materially more likely to occur. The promotion of competition does not require the removal of all barriers nor immediate new entry into a dependent market. Barriers to entry and competition may still exist and actual entry may still be difficult and conceivably slow, yet credible. In the words of the Tribunal in *Services Sydney*—where there is a removal of "a significant barrier to entry into at least one dependent market and that the probability of entry is thereby increased, competition will be promoted".[7]

4.4 In assessing whether criterion (a) is satisfied, the Council:

- identifies the relevant dependent market(s)
- confirms that the dependent markets are separate from the market for the pipeline services, and
- assesses the effect of access (or increased access) on each dependent market in order to determine whether access (or increased access) would materially promote competition in that market.

Dependent markets

4.5 In its application Envestra identifies dependent markets upstream and downstream of the WWGDN.

4.6 The upstream market identified is described as one for transmission services and the wholesale gas supply market (which includes gas supplied from the Gippsland, Bass, Otway, Cooper and Bowen/Surat basins). The downstream market identified is one for gas sales in the Wagga Wagga and Uranquinty area serviced by the WWGDN.

4.7 In relation to upstream markets, rather than bundling various products and services, the Council prefers to consider upstream effects of access (or increased access) to the extent necessary in the context of an eastern Australian gas wholesale market and a separate market for transmission services linking eastern Australian gas sources to

7 *Application by Services Sydney Pty Limited* [2005] ACompT 7 at [131].

the WWGDN. As will be seen from the discussion of competition in upstream markets in paragraphs 4.44 to 4.49 nothing turns on this point.

4.8 The Council agrees with Envestra's identification of a dependent downstream market for gas sales in the area serviced by the WWGDN. It is the consideration of this market that is critical to this application (see paragraph 4.50 and following).

4.9 Criterion (a) requires that the consideration of the effect of access on competition relates to markets other than the market for the pipeline services provided by, in this case, the WWGDN. It is therefore necessary to ensure that the dependent markets identified are separate from the market for WWGDN services.

4.10 The separation of the supply chain for natural gas into functional markets for production and wholesale supply, transmission, distribution and retail sale with each level being functionally and economically separable is well recognised. The nature of the business conducted, assets engaged and differences in market participation at each of these levels indicates that each is functionally and economically separate from the others.

4.11 This conclusion is reinforced by the inclusion of structural and operational separation (ie ring fencing) requirements in the NGL. The Council notes these provisions only apply to the service provider of a covered pipeline. There are, however, no indications that Envestra's business model may change such that it might seek to become involved in any dependent market as a result of coverage of the WWGDN being revoked. Furthermore, Envestra's involvement with other covered pipelines seems likely to preclude such a development.

4.12 The Council is satisfied that pipeline services provided by the WWGDN are provided in a separate market from any of the dependent markets it proposes to consider.

Effects of access on competition in dependent markets

Envestra's position

4.13 In its application, Envestra's consideration of the effect of access or increased access on competition spans a number of markets.

4.14 In responding to the draft recommendation, Envestra focuses more on the downstream market for gas sales in the area serviced by the WWGDN identified in the Council's draft recommendation. The AAC report has a similar focus.

4.15 Generally, Envestra contends that continued coverage of the network will not promote a material increase in competition in upstream or downstream dependent markets and notes that coverage to date appears to have had no material effect on competition (Application at [58]).

4.16 The company's position in its application is summarised in the following statements (Application at [87]).

- Envestra has no related retail, transmission or gas wholesale interests to which it could leverage any market power into a dependent market.
- Envestra is indifferent between the sources of gas and transmission pipelines used to supply the network given both transmission connection points are under common ownership.
- Envestra has a strong incentive to increase throughput on the network given the large sunk costs, low network utilisation and the lack of any competitive advantage relative to electricity. Increasing throughput has the effect of lowering the unit cost for access to the network, which in turn makes gas more competitive when compared against alternative fuel sources and therefore more attractive to existing and potential end users.
- Envestra's pricing decisions are constrained by the ability of customers to substitute electricity for gas (particularly given the worsening of the competitive position of gas relative to electricity in New South Wales).
- Envestra's pricing decisions are also constrained by the ability for large industrial users to bypass the distribution network and connect directly to a transmission pipeline.
- Envestra's pricing decisions are further constrained by the countervailing power of retailers given they are large, vertically integrated participants with a sophisticated understanding of the energy market.

4.17 Envestra also notes that:

> The fact that there is currently one major retailer of gas in Wagga Wagga, despite a decade of Full Retail Contestability, also suggests that coverage of the network has not facilitated competition in the downstream market to a material extent. Moreover, coverage will not impact on upstream markets given the very small size of the Wagga Wagga natural gas market, which accounts for just 0.3% of the gas consumed in the eastern Australian gas market (Application, p 4).

4.18 In its response to the draft recommendation, Envestra develops these arguments further and provides additional supporting information, including in the reports commissioned from AAC and Core.

4.19 Envestra contends that:

> the status of coverage has no bearing on the scope for the removal of retail gas price regulation or on retail gas competition more generally, and
>
> any market power Envestra may possess is significantly constrained by the ability for consumers to readily (and at a low cost) switch from gas to electric appliances (Envestra at [5]).

4.20 Envestra and AAC explore in some detail the reporting by the AEMC and the Independent Pricing & Regulatory Tribunal (**IPART**) concerning the state of competition in the NSW electricity and gas markets and the proposals by these organisations in relation to retail price regulation. AAC concludes:

> the relevant factors that will influence a decision by the NSW Government to remove retail price regulation is the extent of competition in the retail market and not how distribution networks are regulated (AAC at [30]).
>
> The Council's assertions that revocation of the WWGDN, which supplies a relatively small proportion of NSW customers, would dissuade the NSW Government from removing retail price regulation is highly speculative (AAC at [32]).

4.21 Envestra outlines a number of factors it considers represent significant barriers to retailer participation in smaller regional markets, such as Wagga Wagga (Envestra at [39]). Rather than issues relating to access to distribution pipelines, Envestra suggests it is these other factors which generate a situation where entry into such markets carries high cost and risk for the retailer with a low expected return. Envestra points to these barriers as the "key reason" for the low level of retailer participation in Wagga Wagga and also across other regional areas served by Envestra's networks (Envestra at [38]-[40]). The AAC report supports these claims.

4.22 Further, Envestra and AAC point to the mechanics of the operation of the wholesale gas supply markets in New South Wales (and Queensland and South Australia) as an additional source of difficulty for retailers seeking to enter the New South Wales (and presumably Queensland and South Australia) gas markets compared to markets in Victoria where the wholesale gas market operates through a trading platform administered by the Australian Energy Market Operator (**AEMO**)[8] (Envestra at [41]). In this regard, AAC concludes:

> The higher level of cost and risk associated with a contract carriage model, particularly in regional markets, vis a vis a market carriage model will be faced by new entrant retailers, regardless of whether the WWGDN is covered or not (AAC at [83]).

4.23 On the impact of the removal of retail price regulation, Envestra points to the experience in South Australia, Queensland and Victoria, responding to the Council's draft recommendation (at [4.27]) as follows:

> Retailer competition/participation has not become "more vigorous when retail price regulation is removed" as evidence [sic] by the modest change in the market share of the host retailer post deregulation (which reflects that markets were already considered to be competitive prior to the removal of price regulation) (Envestra at [46]).

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8 The difference between the mechanics of the Victorian and other gas markets in eastern Australia is explained by AEMO as follows:

> Most Australian gas markets are based on bilateral arrangements between producers, major users and retailers linked together through pipeline hubs connecting gas fields to gas consumers.
>
> The exception is Victoria where a wholesale gas market was established in 1999 to enable competitive, dynamic trading based on injections into and withdrawals from the transmission system that links multiple producers, major users and retailers. See, http://www.aemo.com.au/Gas/Market-Operations.

4.24 Envestra explores this further stating that should retail price regulation be removed the incentives facing retailers will change, reducing retailers' ability and incentive to pass through distribution tariffs as a matter of course. (Envestra at [86])

4.25 Envestra also compares the price changes between its unregulated and regulated networks, noting a 0.1 per cent price decrease in the unregulated tariffs compared to a 4.7 per cent increase in the regulated tariffs. Envestra suggests this is illustrative of the countervailing power of gas retailers (Envestra at [88]). Envestra also points to the recent decision by Origin to not pass on the full costs of its gas retailing to some of its customers (including those in Wagga Wagga) as further evidence of the countervailing power of retailers.

4.26 Envestra does not consider the current regime of retail price regulation to be an impediment to competition as it cannot identify "a history of regressive behaviour on the part of IPART to hold retail margins at levels that are insufficient to promote retailer participation in the Wagga Wagga market" (Envestra at [37]).

4.27 Responding to claims made by Energy Australia in its supplementary submission to the application that only covered networks featured more than one retailer, Envestra considers the point misleading as it ignores the relative market shares of each retailer and the clear dominance of the host retailer in the respective market (Envestra at [50]-[51]). Envestra makes the further point that only Origin (and not Energy Australia) appears to be actively seeking additional customers in the Wagga Wagga market at present (Envestra at [29]).

4.28 Envestra and AAC suggest that the Council's draft recommendation intimates a concern that the outcome of Envestra's application may generate further applications to revoke coverage of other distribution networks. Envestra and AAC reiterate that there are particular characteristics of the WWGDN and the market for gas in Wagga Wagga that make the network amenable for revocation. In any event Envestra contends that its application must be assessed on its individual merits (Envestra at [23]-[28]; AAC at [35]).

4.29 Envestra and AAC reiterate that should the WWGDN be uncovered the terms and conditions for access Envestra intends to apply will be the most recent terms and conditions approved by the Australian Energy Regulator (**AER**). Further, Envestra says it is investing in developing standard terms and conditions across all of its regulated and unregulated networks. The submissions highlight the risk to Envestra's reputation should it not adhere to these commitments (Envestra at [59]-[63]; AAC at [87], [92]).

4.30 The Core report, provided by Envestra in support of its contentions regarding the ability for households to switch between gas and electricity for their energy needs argues:

- residential customers place the largest weight on appliance capital and operating cost over other factors at the time of considering replacement of space heating, water heating and cooking appliances

- in the event of end of life replacement, the costs of switching from a gas appliance to an electric equivalent appliance will be negligible given electricity is already supplied to the household, and
- the cost of replacing an appliance prior to the end of its useful life is also likely to be negligible given the low likely residual value of the appliance at the time of replacement.

4.31 Core therefore does not consider for residential customers, that appliance switching costs "are likely to be substantial" as claimed by the NCC. To the contrary, and for residential customers, appliance switching costs are more likely to be negligible such that it would not provide a barrier to fuel switching (Core, p 8).

4.32 Envestra highlights the finding of Core that by June 2019 "approximately 41 per cent of total gas demand will be subject to change based on requirement for appliances to be replaced"(Core p 12). Given the findings of Core and reporting by AAC, Envestra states that it will be under significant pressure to retain its current market share given the anticipated increase in gas prices relative to electricity, which Envestra estimates could equate to a reduction in revenue of around $3 million by June 2019 (Envestra at [82]-[83]).

4.33 The cost of an application for re-coverage, with a lodgement fee of $7,500 was highlighted by Envestra and AAC to be immaterial and therefore no impediment to any such future application. The prospect of an application for re-coverage would act as a constraint on Envestra (Envestra at [93]-[95]).

Other submissions

4.34 As with the applicant, the submissions received from other parties in response to the application consider the effect of coverage on competition without direct reference to specific dependent markets. All four submissions disagree with Envestra's assertion that coverage would not materially promote competition. The submissions make a number of similar points contending that:

- in the absence of coverage network users could be exposed to inefficient (monopoly) prices and non-price terms of access which would restrict the development of competition
- only covered networks have more than one retailer supplying gas to small customers and a key factor in a retailer's decision to enter a new market is the regulatory regime
- negotiations with Envestra (and other distribution businesses) are fraught even in relation to covered pipelines and removal of coverage would significantly exacerbate this situation
- unlike transmission pipeline services (where substitute services can emerge as new pipelines are developed) gas distribution pipelines have no substitutes

- the limited competition that can be observed in some gas retail markets (including in the Wagga Wagga area) is a symptom of inadequate margins and retail price regulation which may not persist in the medium term
- removal of coverage would increase uncertainty and reduce transparency and accountability in setting access prices for gas retailers and users and potential users
- Envestra's retention of 'onerous' access terms for access to uncovered pipelines which have been disallowed in relation to covered pipelines illustrates the scope for imposition of terms and conditions of access that may restrict the development of further competition if coverage is not retained
- the costs (particularly the up-front costs of replacing appliances) faced by residential and other smaller users of gas in switching to electricity, and the large dedicated capital expenditures already incurred by large gas customers, are such that Envestra is not sufficiently constrained in setting access prices and other terms by the risk of customers switching to other energy sources (in particular electricity)
- the time and cost involved in reinstating coverage would allow price and other outcomes to deteriorate considerably before any remedy from reinstating coverage would be available and, moreover, a retailer may prefer to apply the resources required in making an application for revocation instead to entry into another market where there is an existing regulatory regime.

4.35 The submissions from retailers and from the ERAA support the Council's findings in the draft recommendation that criterion (a) is satisfied, with some parties providing limited additional information in support of the claims made.

4.36 Both AGL and Origin support the finding in the draft recommendation that the lack of competition in the downstream market reflects a lack of incentive for entry and expansion and the ability to gain market share given the available returns under retail price regulation. Origin contends:

> the introduction of cost reflective prices is a key factor in promoting increased effective competition in retail gas markets (Origin, p 2).

4.37 Retailers highlight the link between coverage and new entry. AGL and Momentum Energy contend that not having an access agreement in place will deter new entry. Momentum Energy submits:

> the lightening of regulation of the [WWGDN] would simply make retailing of gas in NSW less viable. Retailers today are at a considerable disadvantage when 'negotiating' any use of service agreements with any distribution business, on the basis that there is no impact on the distribution business's customer numbers if an agreement cannot be struck, while for the retailer this means that it cannot access the market.

> Revocation of coverage would lead to limited recourse to contest onerous terms and conditions. Second tier retailers would be even less likely to seek to operate in such a market.

4.38 AGL considers that if the WWGDN is uncovered users will be exposed to inefficient pricing and a potential transfer of risk.

4.39 Energy Australia draws on its past experience submitting that its ability to negotiate terms and conditions different to those put forward by the pipeline owner has been negligible, despite the favourable nature of its pre-existing relationship with the pipeline owner. Negotiations in an uncovered environment can also be protracted and result in deadlocks and considerable expense. This leads to erosion of the benefits from not being regulated. Re-coverage is not viable. Energy Australia contends that the expense and time involved in mounting a successful case for re-coverage is unlikely to be cost effective for a retailer. Energy Australia points to the risk to incumbent providers where the access terms or pricing for distribution become unreasonable. In such a situation, a retailer will limit its exposure to this market and seek opportunities elsewhere. However, brand damage means a retailer cannot automatically withdraw, but must limit its offerings and gradually withdraw from this market.

4.40 Origin contends that competition will not be impacted by upstream developments concerning gas supplies and the projected price increase for gas. Origin considers the east coast energy market to be integrated and underpinned by robust market mechanisms to enable it to respond to supply restrictions importing into New South Wales the required gas volumes. Origin does not consider that changes in gas prices relative to electricity will necessarily limit competition for retailing gas and points to the significance of switching costs and the need to examine relative price variations (Origin p 2). Constraints on Envestra's market power and pricing should the WWGDN be uncovered are also refuted; Origin states that "with high gas penetration and flat population projection, it would seem that Envestra will have limited opportunity to increase throughput and so this claimed incentive is unlikely to exist, much less constrain pricing" (Origin p 2).

4.41 The Energy Networks Association supports Envestra's application submitting that Envestra's vertical separation means it is unable to seek monopoly rents upstream or downstream and has a strong incentive to increase throughput. Furthermore, its pricing is constrained by the risk of declining consumer demand for gas and switching to electricity. Envestra is further constrained by the countervailing power of industrial users to substitute alternative fuels for gas.

Council consideration

4.42 The Council must consider the promotion of competition required by criterion (a) in relation to the relevant dependent markets discussed in paragraphs 4.5 to 4.12. It appears to the Council that most of the contentious issues raised in the application and submissions are appropriately considered in the context of the market for gas sales in the area serviced by the WWGDN (see paragraph 4.50 and following).

4.43 For completeness it is necessary to consider the effects of access to the WWGDN on the conditions for competition in the upstream markets for wholesale gas supply and gas transmission.

The eastern Australian wholesale gas market and the market for gas transmission services

4.44 Envestra has no interests in the upstream eastern Australian wholesale gas market.

4.45 Envestra also has no relevant interests in gas transmission, although it acknowledges that APA (Envestra's largest shareholder)[9] owns and operates both of the transmission pipelines[10] that connect the WWGDN to eastern Australian gas supplies.

4.46 Envestra argues that without vertical interests, it has no scope or incentive to exert market power to limit competition in the upstream market, for example by refusing or minimising supply from a particular transmission pipeline.[11]

4.47 The Council accepts that Envestra has little or no scope or incentive to limit competition in any upstream market.

4.48 The Council also considers the value and volume of gas that might be transported on the WWGDN is insufficient for access to that pipeline to have any material impact on the state of competition in these upstream markets or for the state of coverage of the WWGDN to affect competition in these markets.

4.49 Even if this application were to be regarded as a precursor to the removal of coverage of other gas distribution pipelines in New South Wales or eastern Australia more broadly,[12] given the relative size and significance of the WWGDN it is unlikely that the Council would conclude that access (or increased access) to the WWGDN would materially promote competition in any upstream dependent market.[13]

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9 Refer also footnote 3 above.

10 The Moomba to Sydney Pipeline (via the Young to Wagga Wagga lateral) and the Victorian Transmission System (via the Interconnect).

11 Should APA acquire Envestra the WWGDN would become part of a vertically integrated transmission/distribution business.

12 AGL expresses a concern that "the revocation of the Wagga Wagga Network would introduce a precedent that could open the way for networks in other regional towns to follow a similar process of revocation". Energy Australia raises this matter also. Envestra and AAC submit that the precedent effect is not to be considered in assessing the application.

13 The Council notes Envestra's submission that no other applications for revocation of coverage of gas distribution networks are contemplated and this application must be assessed on its merits. Given the Council's conclusions in relation to the effect of coverage of the WWGDN on upstream markets and the focus in this recommendation on the downstream market for gas sales in the Wagga Wagga area (where coverage of other networks is of little or no relevance), it is unnecessary to consider the possible revocation of coverage of other pipelines in this recommendation.

The downstream market for gas sales in the area serviced by the WWGDN

4.50 It is the market for gas sales in the area serviced by the WWGDN that is critical to whether criterion (a) is satisfied for this application. The Council focused on this market in its draft recommendation and parties making submissions in response to the draft recommendation addressed the effect on competition in this dependent market.

4.51 The Council accepts that competition in the market for gas sales in the area serviced by the WWGDN is limited. One seller has the vast majority of gas sales. The only other seller has a minor share of the market and no new entry has occurred. This situation has persisted for some time.

4.52 The Council is of the view that the limited competition in this (relatively small) market reflects to a significant extent the lack of incentives for new market entry or expansion given available margins and the difficulties of competing for new customers in the presence of retail price regulation.

4.53 The Council acknowledges that there are other barriers and factors that affect competition in this market. These include some of the factors identified by Envestra and referred to above in paragraph 4.21. However, the Council notes that some of these barriers, and the difference between the mechanisms of the Victorian and other eastern Australian gas markets (see paragraph 4.22), are not specific to the Wagga Wagga market. As such, they represent matters that a retailer needs to address in developing any new business, whether in Wagga Wagga or elsewhere.

4.54 The Council considers it likely that additional incentives for competition in gas supply will emerge in New South Wales (including in the area serviced by the WWGDN) in the short to medium term. Both the AEMC in a recent draft report (AMEC 2013) and IPART in its final report on its review of regulated retail prices and charges for gas (IPART 2013), conclude that competition in gas supply in New South Wales is sufficiently effective to allow the regulation of retail prices to be removed.

4.55 Acknowledging the findings of these agencies, the Council considers that the environment for competition will be enhanced when retail price regulation is removed. The Council recognises, however, that the development of further competition in the market for gas sales in the area serviced by the WWGDN (and more generally) may be limited by the availability of gas supplies and increases in gas prices (both in absolute terms and perhaps relative to electricity), although the Council also notes that some parties do not agree that there will be any such constraints (see matters raised by Origin at paragraph 4.40 above).

4.56 The Council does not accept that the current lack of competition notwithstanding coverage of the WWGDN justifies revoking coverage on the basis that it has not lead to greater levels of competition.

4.57 Importantly, in considering the promotion of competition under criterion (a) the Council not only examines the effect of access or increased access on the current state of competition but also considers the effect of access on competition in the future. This is particularly necessary where changes in the regulatory landscape such as offered by the anticipated removal of retail price regulation are in prospect.

4.58 Downstream, Envestra holds no interest in gas supply at the retail level and is prevented from doing so by the ring fencing requirements in s 139 of the NGL.[14]

4.59 The Council accepts Envestra's position that the lack of involvement in gas retailing removes incentives to leverage the market power it has through ownership of the WWGDN.

4.60 The Council also accepts in principle Envestra's contention that the nature of the capital and operating costs associated with a distribution pipeline and the availability of spare capacity make additional throughput desirable and that this may constrain Envestra's access pricing. However, the strength of that constraint depends on the prospects for increasing throughput and the relative contribution to Envestra's profits from reducing (or limiting) prices to attract additional throughput or raising prices to gas retailers. The Council agrees with Momentum Energy that if the prospects for increasing throughput are limited it puts a potential new retailer at a competitive disadvantage in negotiating with the distributor as the distributor's throughput may not be affected, let alone increased, if a new retailer enters the market.

4.61 It is not clear to the Council that the prospects for attracting additional throughput are such that access prices will be constrained in the absence of coverage.[15] Even if access prices are constrained, perhaps by historic levels and the risk of re-regulation, the Council is concerned that non-price access terms, and measures to transfer risk between a pipeline owner and other parties, may adversely affect the prospects for competition in the sale of gas in the area serviced by the WWGDN.

4.62 The Council has similar concerns about Envestra's suggestion that the decline in gas consumption and the consequent declining use of the WWGDN is a further constraint on its ability to increase prices.

4.63 The Council acknowledges that Envestra has indicated its intention to pass back to customers some of the regulatory costs it will avoid in the event that coverage of the WWGDN is revoked. It proposes to do this by: not applying an already approved increase in regulated distribution prices; limiting future price increases to no greater than the CPI; and continuing marketing incentives such as appliance rebates. Envestra also foreshadows its intention to continue to publish its tariffs for access to the WWGDN to demonstrate that it is not discriminating among energy retailers and to apply the most recent terms and conditions for access approved by the AER. Envestra is also developing standard terms and conditions it intends to use across all of its

[14] Given Envestra's interests in other covered distribution pipelines, it seems likely the company will remain subject to the ring-fencing provisions in the NGL even if coverage of the WWGDN is revoked.

[15] The population of Wagga Wagga, for example, is projected to grow only minimally in the period to 2031.

regulated and unregulated networks.[16] Envestra states that given it has made these undertakings in its application and in further information to the Council, there is a risk to its reputation if it does not proceed.

4.64 The Council accepts the bona fides of Envestra's stated intentions to return some of the savings in regulatory costs to customers, limit future price increases and engage with retailers transparently and with a standard approach in respect of access terms and conditions. However, these intentions can only be given limited weight given difficulties in enforcing such promises in relation to an uncovered pipeline. The Council accepts that were Envestra, or any other company in a similar position, to renege in relation to such intentions the company would likely damage its reputation. However, in a sector where significant regulatory, ownership and other changes occur often there is considerable scope to mitigate such effects—by, for example, attributing any reversal to changed regulatory requirements or industry structure—such that this undertaking too can only be given limited weight.

4.65 In this regard, the Council notes the comment by Energy Australia questioning whether gas distribution network prices, rather than rising in line with the CPI, should not be falling as they are said to have done recently in Victoria. As well as proposed changes in prices, the starting point is also a critical component in assessing the appropriateness and relevance of any price movements.

4.66 Envestra argues that any ability it may have to price above efficient costs is constrained by the availability of alternative fuels—electricity and LPG—and also the prospect that industrial users could bypass the WWGDN and connect directly to a transmission pipeline via a new lateral pipeline.

4.67 The Core report for Envestra states the costs to the consumer to be negligible when replacing an appliance at the end of its life (or even earlier)[17] and that such costs do not present a barrier preventing consumers switching fuels. Accordingly, Envestra says users have a degree of countervailing power as they can switch to alternative energy sources.

4.68 The Council has some concerns with the assumptions underpinning Core's analysis. The Council is concerned that the Australian Tax Office depreciation allowances used to estimate the useful life of various appliances is likely to understate the replacement intervals for such goods, especially in a domestic situation. Even if Core's findings are not particularly sensitive to the estimated replacement periods, it seems to the Council that it is gas retailers that are particularly exposed to the effects of

16 The Council considers that adopting standard terms and conditions already approved by the regulator in relation to other distribution pipelines is a positive development which should reduce the costs of regulation if coverage of the WWGDN is continued.

17 Core considers the cost of replacing an appliance prior to the end of its useful life is also negligible "given the low likely residual value of the appliance at the time of replacement, which value is likely to be offset relatively quickly by the cost differential between fuel types" (Core, p 17).

switching. Distribution pipeline operators are exposed to the derivative effect on demand for the pipeline services but have at least some ability to offset reductions in throughput by increasing prices and forcing gas retailers to narrow margins.

4.69 The Council also considers it is important to distinguish between changing from a gas appliance to an electric appliance at the point when it becomes necessary to install a new appliance because the old one ceases operating and at other points in time.

4.70 The Council does not dispute Envestra's contention that the gas retailers possess countervailing power as both the existing retailers operating in the district (Origin and Energy Australia) are experienced and sophisticated energy market participants.

4.71 The Council considers that, while in principle the matters outlined above could be expected to constrain gas prices, their effect on Envestra's ability to raise prices for the distribution of gas on the WWGDN is more diluted. Distribution costs make up only part (albeit a significant part) of final gas prices.

4.72 Furthermore the purported alternatives for end users are not without costs. For example, installing new appliances or machinery that use an alternative source of fuel to gas requires up front expenditure by the user which may be paid back over an extended period.

4.73 For an industrial user, constructing a lateral to connect directly to an available transmission pipeline involves substantial planning, approval processes, engagement of appropriate contractors and not insignificant cost. While this does not deny the prospect of an industrial user bypassing the WWGDN it does suggest this avenue is probably a medium term prospect rather than something readily at the disposal of the industrial user. Further, the Council notes that should APA acquire Envestra, the WWGDN and the two transmission pipelines in the area would come under common ownership. This would be likely to significantly limit opportunities to bypass the WWGDN.

4.74 The Council also notes that while gas prices to end users are likely to be constrained by the cost of gas relative to other energy sources, this constraint may not prevent some parties in the supply chain increasing margins at the expense of others. As noted above, distribution cost make up only part of the final price of gas. Further, given significant monopoly elements in the supply of other energy sources, it is unclear that the prices of other energy sources are cost reflective.

4.75 The Council agrees that the two existing retailers, Origin and Energy Australia can be expected to have some countervailing power due to their experience and knowledge of the gas sector. Any new entrant retailer would also be likely to possess some countervailing power as it is more likely than not that it will be a retailer operating in some other energy market that can use its knowledge and experience to negotiate with Envestra to start operating in the Wagga Wagga region.

4.76 The Council considers that the costs and risks of competing in the market for gas sales in the area serviced by the WWGDN, especially for smaller second tier gas retailers, are likely to be lower if the conditions for access to the WWGDN (and the basis for the determination of these in the future) are known in advance. The ex ante regulation associated with a covered pipeline is more likely to provide for this, and also provides greater certainty to retailers in deciding to enter a new market, than would be the case for an uncovered pipeline (or perhaps a pipeline subject to light regulation). These factors are conducive to promoting competition in the relevant dependent market and increasing the probability of entry.

4.77 The Council is aware that the AEMC is to report to the NSW Government on competition in electricity and gas markets in New South Wales including whether and how price caps should be removed. The AEMC is seeking submissions on its draft report (AEMC 2013) before making its final report and recommendations by 30 September 2013. In the Council's draft recommendation the Council noted that if the revocation of coverage of the WWGDN (perhaps as a precursor to other revocation action) were to discourage the removal of retail price regulation then continued coverage of the WWGDN would materially promote competition in gas sales markets, including in the relevant dependent market.

4.78 In its letter responding to the draft recommendation the AEMC advised that "any decision concerning the coverage status of the Wagga Wagga natural gas distribution network is unlikely materially to affect our findings or recommendations" on the effectiveness of competition in the NSW gas retail markets and whether retail price regulation should be removed. The Council accepts that the decision on coverage of the WWGDN will not affect the AEMC's recommendation and is unlikely to be material to the NSW Government's decision making in relation to removal of retail price regulation for gas supply.

4.79 The Council is, however, still concerned that retail gas customers in the area serviced by the WWGDN are significantly less likely to gain the benefits of increased competition following a removal of retail price controls if coverage of the WWGDN is revoked now. The Council accepts, as the retailers have argued, that a gas access arrangement available under a coverage regime is more likely to facilitate new entry into the gas retail market. In this regard, the Council notes that retailers highlight the difficulties experienced in negotiating access to uncovered distribution pipelines and go so far as to say they would not seek entry to such markets because negotiating the terms and conditions of access is prohibitive and costly (Momentum Energy and AGL). An access arrangement gives the retailer (incumbent or potential) certainty about the terms and conditions of access, promotes transparency and thus promotes increased competition.

4.80 The Council accepts that revocation of coverage of the WWGDN does not preclude a future application to reimpose coverage. However, the Council does not accept any suggestion by Envestra that the $7,500 application fee for such an application is a meaningful indicator of the costs of a coverage application. In the Council's view reimposing coverage would be a costly exercise that extends well beyond the application fee prescribed in the NGL. Moreover, the Council considers that if coverage is revoked as a result of this application, the prospect of the WWGDN being re-covered provides only a limited constraint on setting access prices and other terms in relation to the WWGDN, especially in the shorter term. The Council believes that an application to reimpose coverage of a pipeline for which coverage has been revoked would face difficulties, not least spirited opposition from the pipeline owner.

4.81 In the Council's view removal of retail gas price regulation in New South Wales is likely in the short to medium term and such a development will increase the scope for competition in downstream gas sales markets including in the market served by the WWGDN. The Council considers a future competitive environment where retail price regulation has been removed is more likely than any other scenario (including, in particular, continuation of the status quo).

4.82 In such an environment, were coverage of the WWGDN revoked, the Council considers that it is significantly less likely that new gas retailers will seek to participate in the Wagga Wagga market or that existing suppliers will seek to compete more vigorously. Rather, if the WWGDN is not covered it is more likely that a gas retailer will focus on other markets where the regulatory arrangements are more favourable and gas users in the Wagga Wagga area will be less likely to benefit from additional competition that would otherwise emerge.

4.83 The Council considers that in a future environment where the competitive environment and the prospects of competition are expected to be enhanced as a result of the removal of price regulation, continued coverage of the WWGDN will promote a material increase in competition in the market for gas sales in the area serviced by the WWGDN.

4.84 Were the removal of retail gas price regulation not to be in prospect in at least the medium term, the Council considers that competition in the market for gas sales in the Wagga Wagga area is likely to remain stagnant irrespective of whether the WWGDN is covered. In such a circumstance criterion (a) could not be satisfied and coverage should be revoked.

4.85 The Council is satisfied that access (or increased access) would promote a material increase in competition in the market for gas sales in the area serviced by the WWGDN.

Conclusion on criterion (a)

4.86 The Council considers that criterion (a) is satisfied in respect of the market for gas sales in the area serviced by the WWGDN.

5 Criterion (d) – Access not contrary to the public interest

5.1 For criterion (d) to be met in relation to the WWGDN it is necessary that access (or increased access) to the pipeline services provided by the network not be contrary to the public interest.

5.2 This criterion allows for coverage to be revoked (or denied—when considering a coverage application) where access would be contrary to the public interest, notwithstanding that the other coverage criteria may be met.[18]

Approach to the assessment of criterion (d)

5.3 The coverage criteria in s 15 of the NGL serve the same function as the declaration criteria in ss 44G and 44H of the *Competition and Consumer Act 2010* (Cth) (**CCA**). Satisfaction of the declaration criteria allows for infrastructure services to be subject to access regulation in the same way as satisfaction of the coverage criteria in the NGL allows for coverage (and hence access regulation) of pipeline services. Despite some wording differences, Australian Competition Tribunal and court decisions in respect of one set of criteria have been routinely cited and applied in relation to the equivalent provisions of the other.[19] Declaration criteria (a) and (b) in the NGL are the equivalent to coverage criteria (a) and (b) in the CCA. Coverage criterion (d) is the equivalent to declaration criterion (f).

5.4 In its *Pilbara Rail* decision,[20] the High Court overturned the previous interpretation of declaration criterion (b)[21] which had linked the word "uneconomical" to the presence of natural monopoly characteristics in the supply of a service. Instead the High Court held that "uneconomical" meant "unprofitable" and that:

> If the Minister is satisfied that it would be uneconomical (in the sense of unprofitable) for anyone to develop an alternative facility, criterion (b) is met. (at [109])

5.5 The Council sees no basis for distinguishing the interpretation of coverage criterion (b) from the effect of the High Court's interpretation of declaration criterion (b) or for not taking into account the implications of the *Pilbara Rail* decision for the declaration process as a whole in considering the coverage process in the NGL.

5.6 The satisfaction of criterion (b) in relation to the WWGDN is not at issue (see paragraph 3.20). However, when one turns to the consideration of whether access (or

18 This criterion does not allow for coverage of a pipeline on 'public interest grounds' when any other coverage criterion is not satisfied; it can only operate to override coverage being available in situations where all other coverage criteria are satisfied.

19 Some key precedents in relation to regulation of gas pipelines predate the NGL and relate to the coverage criteria contained in the *Gas Code* (see footnote 4). Those criteria are identical to those in s 15 of the NGL.

20 *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* (2012) 290 ALR 750.

21 Sections 44G(2)(b) and 44H(4)(b) of the CCA.

increased access) to the WWGDN is contrary to the public interest under coverage criterion (d), the scope of benefits that can be taken to arise from access due to the satisfaction of criterion (b) is, as a result of the High Court's interpretation, narrower than would have been the case under the previous interpretation, where avoidance of the costs from the unnecessary duplication of infrastructure facilities would likely have resulted in a significant public benefit from access.

5.7 To the extent that the consideration of coverage criterion (d) focuses on a comparison of the costs of access with the benefits that follow from access such a comparison is likely to disregard benefits not captured in the assessment of criteria (a) and (b). Alternatively a fuller examination of the benefits of access may be required if coverage criterion (d)[22] is to involve a fully developed cost benefit analysis. However, this latter approach seems inconsistent with other statements by the High Court in the *Pilbara Rail* decision.

5.8 In the *Pilbara Rail* decision the High Court also directly considered the application of declaration criterion (f). In particular, the Court stated:

> … It is well established that, when used in a statute, the expression "public interest" imports a discretionary value judgment to be made by reference to undefined factual matters. As Dixon J pointed out in Water Conservation and Irrigation Commission (NSW) v Browning, when a discretionary power of this kind is given, the power is "neither arbitrary nor completely unlimited" but is "unconfined except in so far as the subject matter and the scope and purpose of the statutory enactments may enable the Court to pronounce given reasons to be definitely extraneous to any objects the legislature could have had in view". It follows that the range of matters to which the NCC and, more particularly, the Minister may have regard when considering whether to be satisfied that access (or increased access) would not be contrary to the public interest is very wide indeed. And conferring the power to decide on the Minister (as distinct from giving to the NCC a power to recommend) is consistent with legislative recognition of the great breadth of matters that can be encompassed by an inquiry into what is or is not in the public interest and with legislative recognition that the inquiries are best suited to resolution by the holder of a political office. (at [42]) [footnotes omitted]

5.9 The High Court also noted that, like declaration criterion (c) in the CCA (which deals with the national significance of an infrastructure facility) consideration of declaration criterion (f) "may also direct attention to matters of broad judgment of a generally political kind" (*Pilbara Rail* at [43]). The High Court contrasted this sort of judgment with that involved in consideration of other of the criteria which it regarded as of "a more technical kind" (*Pilbara Rail* at [44]).

5.10 The Council considers that a detailed technical examination of the costs and benefits of access is inconsistent with the High Court's view of the judgment involved in considering declaration criterion (f) and by implication the equivalent public interest provision in the NGL– coverage criterion (d).

22 and declaration criterion (f)

5.11 The Council also questions whether a situation where one criterion is not satisfied simply because another criterion is also not satisfied is consistent with the schemes for determining coverage under the NGL and declaration under the CCA. This is particularly the case where the costs or difficulties associated with regulated access are unremarkable and would not alone engage the public interest considerations of criterion (d).

5.12 Furthermore, in circumstances where access would not promote competition coverage or declaration will not be available because the criterion that addresses that issue (criterion (a)) will not have been satisfied. In the Council's view it is unnecessary and inappropriate to also find that criterion (d) is not satisfied, essentially because criterion (a) is unable to be satisfied.

5.13 The Council considers that the preferable approach to coverage criterion (d)[23] 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.[24] The Council considers that this approach is consistent with the *Pilbara Rail* decision in that it involves a judgment that the Council is well able to advise on, and a Minister is well placed to make, rather than a detailed technical examination of costs and benefits for which only partial information is likely to be available.

5.14 The Council has taken this approach in considering whether criterion (d) is satisfied in relation to this application.

Envestra's position

5.15 Envestra's approach involves an assessment of the relative costs and benefits associated with access. Envestra contends that there are no benefits to offset the regulatory costs associated with coverage of the WWGDN and that as a result continued coverage is contrary to the public interest and criterion (d) is not satisfied.

5.16 The benefits of coverage are taken to be those that arise as a consequence of the satisfaction of criterion (a)—that is benefits from the promotion of competition in dependent markets "as well as any other benefits not captured by this criterion" (Application at [96]). Envestra identifies the costs of coverage as including direct regulatory costs, disruption costs and adverse impacts on investment and economic efficiency arising from regulation.

5.17 On this approach Envestra argues that where criterion (a) is not satisfied there are no competition benefits arising from coverage. Envestra also states that in relation to access to the WWGDN it is unaware of any other public benefits arising from coverage.

[23] And declaration criterion (f).

[24] Ultimately it will be for a Court to determine the proper interpretation of the coverage criterion (d) (and declaration criterion (f)) and the approach to be taken to assessing whether those criteria are satisfied.

5.18 Although Envestra notes that an absence of public benefits may of itself prevent satisfaction of criterion (d) it goes on to consider the regulatory costs flowing from coverage. Envestra notes that it has limited its consideration to the direct costs of regulation.

5.19 The NGL provides for two forms of regulation of covered pipelines—*full regulation* and *light regulation*. The Council is responsible for determining the form of regulation applicable to a covered pipeline, either in conjunction with a coverage application or through a separate application for a light regulation determination.[25]

5.20 *Full Regulation* centres on ex ante approval by the relevant regulator (generally the AER) of an access arrangement put forward by a pipeline operator relating to the terms and conditions for access to a pipeline. As described by Envestra, development and approval for an access arrangement can take up to two years to complete with any merits review adding further to the time and resources required.

5.21 *Light Regulation* is intended to be a less expansive and less costly form of regulation which involves the option to submit a limited access arrangement (largely dealing with non-price terms of access) and if necessary ex post determination of access prices or other terms and conditions of access through a negotiate/arbitrate process similar to that for services declared under Part IIIA of the CCA.

5.22 The cost of regulation under each form may differ significantly, with light regulation anticipated to be associated with lower base costs. However, the costs of light regulation can increase substantially where a number of access disputes require arbitration.

5.23 As the WWGDN is currently subject to full regulation Envestra's application, unsurprisingly, focuses on the costs associated with that form of regulation. However, helpfully, Envestra also discusses the costs that might arise under light regulation.

5.24 Envestra notes that under full regulation the main cost is the requirement to submit and have approved by the AER a full access arrangement in accordance with the specific and detailed requirements of the National Gas Rules. Importantly, Envestra in the application contends that:

> [104] … the costs associated with a full Access Arrangement review process are to a large extent independent of the size of the network due to the prescriptive nature of the NGR – the requirements of the NGR are the same irrespective of the size of the network. For example, the Queensland network has an annual revenue of approximately $70 million compared to South Australia of $240 million and yet incurred similar regulatory costs.
>
> [105] For example, determining the appropriate input values to be used when deriving the weighted average cost of capital (WACC) is independent of network

25 For more information on the form of regulation of pipelines see the Council's Guide: Light regulation of covered pipeline services—A guide to the function and powers of the National Competition Council under the National Gas Law, Part C–Light regulation of covered pipeline services, July 2011.

size. Twenty consultant reports were submitted to the AER by Envestra supporting its WACC derivation as part of the Victorian network's recent full Access Arrangement review (and indeed a similar number were submitted for the South Australian and Queensland reviews that were finalised just prior to the commencement of the Victorian review process). Envestra would expect to submit a similar number of reports for Wagga Wagga if revocation is not granted.

5.25 Envestra accepts that some other regulatory costs are sensitive to the size of the network. Costs of preparing capital and operating cost forecasts should, for example, be lower than for larger networks.

5.26 Envestra further contends that regulatory costs are unlikely to diminish over time and may increase as additional regulatory requirements are imposed.

5.27 In relation to the WWGDN, under full regulation Envestra estimates a regulatory cost of $2.8 million for each five year regulatory period. Envestra notes that this equates to approximately $100 per customer.[26] The elements of Envestra's cost estimate are shown in Figure 3.

5.28 Envestra says that this estimate is conservative as, for example, it does not include the costs to retailers or consumers of participation in the regulatory process. It also notes the recent changes to the National Gas Rules to allow greater use of benchmarking in the AER's decision making. Envestra considers that these changes are likely to further increase its regulatory costs if the WWGDN remains covered.

Figure 3: WWGDN Expected regulatory costs per (5 year) regulatory period (Application at [114])

	$000
Envestra Costs	
consultants	700
Internal staff costs	1500
Access Arrangement Process	**2200**
Avoided compliance reporting	100
Total	**2300**
AER Costs	
Access Arrangement process	500
Total	2800

5.29 In relation to light regulation of the WWGDN, noting it has no direct experience of this form of regulation, Envestra estimates that the relevant approval processes could cost around $0.25 million, although it argues that the cost of light regulation could

26 The Council notes that the costs of regulation also need to be considered in the context of the revenues and profits Envestra earns from the WWGDN. In the regulatory period 2010-15 Envestra is expected to receive revenues of $50 million from the WWGDN (AER 2012, Table 4.2).

rise significantly (up to and including the level associated with full regulation) if disputes arise leading to access arbitration proceedings.

Submissions

5.30 Submitting parties dispute Envestra's estimate of the costs of regulation and Envestra's claims that there are no benefits from coverage that could be considered to offset such costs in any event.[27]

5.31 Origin states that based on its experience, a smaller network is likely to require a less onerous access arrangement. The ERAA also queries Envestra's claims that the cost of an access arrangement is independent of the size of the network. Origin also notes the WWGDN is a less complex system and a smaller proportion of Envestra's overall business, particularly when compared to Envestra's South Australian and Queensland networks. Origin considers that developing an access arrangement for the WWGDN should be less onerous and costly.

5.32 Origin submits that it would expect synergies across Envestra's business such that in preparing for and undertaking an access arrangement for the WWGDN Envestra is unlikely to be starting from scratch and would be able to use the consultants' reports already obtained for other networks along with existing legal advice. Origin says Envestra should be able to use reports commissioned for compliance on other covered networks and apply them to the regulatory needs of the WWGDN before starting anew. Energy Australia also takes up this point noting that "there is no company in a better position than Envestra to maximise the economies of scale and leverage the review data used in [its] larger networks to offset the [access arrangement] costs to the Wagga Wagga network."

5.33 Submissions made a range of comments in relation to Envestra's actual cost claims and returns to users should coverage be revoked.

- Origin "notes that the $2.3 million represents more than total capital expenditure on the network over the current regulated period, and over two thirds of the operational expenditure budget." Origin queries "how it can be a commercial undertaking for Envestra to spend as much on the network's five year capital outlay solely on one regulatory application."[28]
- Origin and Energy Australia query the utility in considering the $0.5 million Envestra nominates as the costs to the AER in reviewing its access arrangement as the AER is unlikely to be able to avoid such costs whether or not the WWGDN is covered.

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27 The effects of access on competition and consequent public benefits are canvassed in the Council's consideration of criterion (a) in section 4 of this recommendation.

28 The Council notes that Origin's claims inappropriately compare figures across different timeframes. The capital and operating costs have been misread as being for a five year period as opposed to a period of only one year.

- AGL considers that revocation would introduce financial uncertainties for customers, particularly those that have invested in new connections or equipment. While AGL supports Envestra's claims that it could return the costs of regulation to users via a reduced tariff, AGL prefers a move to review the process of regulation rather than to remove regulation itself. AGL also states that it considers that Envestra is to some extent able to control the costs of regulation.
- Energy Australia submits that both the AER and Envestra could investigate how the costs of regulation can be reduced. Energy Australia considers that, over the long term, without coverage, the costs to consumers could be higher.

Council consideration

5.34 The Council accepts that the costs of full regulation of the WWGDN are significant although the quantum may be disputed. The Council notes that applications put to it for light regulation of covered pipelines put the costs savings from removing the requirement to have an access arrangement within the range $400 000–1.5 million. While direct comparisons cannot be made the Council considers Envestra's estimate of $2.3 million for preparing and gaining approval for an access arrangement to be excessive.

5.35 Noting that under the NGL uncovered pipelines remain subject to some level of ongoing regulation the Council also considers that Envestra may have overstated the reduction in regulatory costs attributed to the revocation of coverage. The Council is of the view that some of the regulatory costs identified by Envestra may not evaporate if coverage is revoked. In particular, it is conceivable that information gathering to support greater use of benchmarking by the AER could extend to uncovered as well as covered pipelines to provide a fuller data set. On the other hand the Council accepts that there are likely to be some other costs of regulation that are not captured in Envestra's calculations (including at least some of those noted in the application).

5.36 The Council agrees with the various submissions that state many of the costs to Envestra of full regulation of the WWGDN are within its control and should be able to be reduced due to synergies that are likely to exist across Envestra's business. However the Council acknowledges that the incentives to manage the costs of regulation may not be as sharp as they need to be.

5.37 The Council also notes that if the WWGDN is not covered, Envestra and the existing and potential users of the WWGDN will need to negotiate the full range of access terms and conditions—a process which may involve significant costs. It may well be that the costs of negotiating access on a commercial basis will increase should coverage be revoked, which will in turn erode the regulatory cost saving suggested by Envestra.

5.38 Although the WWGDN is subject to full regulation, in considering whether the costs of regulation are such that access may be contrary to the public interest, the Council is of the view that if the prospect for light regulation exists, then the costs of this form of regulation may be the more relevant comparator.

5.39 Envestra's estimate of its likely costs under light regulation appears reasonable. However, the nature of light regulation means that regulatory costs may rise depending on the number of disputes (if any) that occur under the regime.

5.40 The Council notes that no application for light regulation of the WWGDN has been made and it is not necessary or appropriate to consider the likely outcome of such an application here.

5.41 As discussed in paragraphs 5.3 to 5.13 the Council has approached its consideration of criterion (d) by seeking 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.

5.42 While both full and light regulation involves costs, in relation to the WWGDN these costs are not out of the ordinary and are unlikely to exceed the benefits which would flow from the promotion of competition due to continued or increased access on fair and reasonable terms through continued coverage of the WWGDN.[29]

5.43 The Council does not regard the cost of regulation of the WWGDN, whether under the full or light regulation to be such as to make access (or increased access) contrary to the public interest.

5.44 Furthermore, other than the cost-benefit reasoning already discussed, no party has suggested, and the Council itself has not identified, any reason why access (or increased access) to the WWGDN would be contrary to the public interest.

5.45 The Council is satisfied that access (or increased access) to the pipeline services provided by the WWGDN would not be contrary to the public interest.

Conclusion on criterion (d)

5.46 In the Council's view criterion (d) is satisfied.

[29] Even if criterion (a) were not satisfied, and the benefits from increased competition in a dependent market could therefore be assumed to be immaterial, it does not necessarily follow that criterion (d) cannot be satisfied, although this would involve a search for other benefits to be considered against the costs of access. Such an exercise is of course moot as coverage is not available as a result of criterion (a) not being satisfied.

Appendix A Information taken into account by the Council

A.1 Application and submissions

Author	Date	Title	Confidentiality
Envestra Limited	1 May 2013	*Wagga Wagga Network Revocation Submission*	Yes. Separate confidential and publication versions provided to Council.
Energy Australia Pty Ltd	27 May 2013	*Submission re application for revocation of coverage – Wagga Wagga gas distribution system*	
Energy Retailers Association of Australia	28 May 2013	*Submission re application for revocation of coverage – Wagga Wagga gas distribution network*	
AGL Energy Limited	28 May 2013	*Submission, letter to NCC re revocation of Wagga Wagga gas network*	
Origin Energy Limited	28 May 2013	*Submission*	
Envestra Limited	5 June 2013	*Letter to National Competition Council*	
Energy Australia Pty Ltd	5 June 2013	*Energy Australia Response to Envestra's Application for Revocation of Coverage – Wagga Wagga Gas Distribution System, Supplement 1*	
Origin Energy Limited	6 June 2013	*Application for revocation of coverage of the Wagga Wagga natural gas distribution network – response to NCC request for additional information*	
AGL Energy Limited	8 July 2013	*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 and confidential attachment*	Yes. Confidential material provided separately to the Council.
Energy Australia Pty Ltd	10 July 2013	*Submission re draft recommendation – application under the National Gas Law for a revocation of coverage determination for the Wagga Wagga Gas Distribution Network*	

Author	Date	Title	Confidentiality
Australian Energy Market Commission	11 July 2013	*Submission - Revocation of Coverage of the Wagga Wagga Natural Gas Distribution Network (Draft Recommendation)*	
Origin Energy Limited	12 July 2013	*Submission – application for revocation of coverage of the Wagga Wagga natural gas distribution network*	
Simply Energy	15 July 2013	*Letter re application for revocation of coverage of the Wagga Wagga gas distribution network*	
Momentum Energy Pty Ltd	15 July 2013	*Submission re Draft recommendation: Application under the National Gas Law for revocation of coverage of the Wagga Wagga Natural Gas Distribution System*	
Energy Retailers Association of Australia	15 July 2013	*Submission re Application under the National Gas Law for revocation of coverage determination for the Wagga Wagga Gas Distribution Network – Draft Recommendation*	
Envestra Limited	15 July 2013	*Response to the National Competition Council Draft Recommendation, including reports from ACIL Allen Consulting and Core Energy Group*	Yes. Confidential material provided separately to the Council.
Energy Networks Australia	15 July 2013	*Submission re NCC Draft Recommendation – Revocation of coverage determination for the Wagga Wagga Gas Distribution Network*	

A.2 References

Author	Date	Title	Confidential
AEMC	2013	*Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales, Draft Report, 23 May 2013, Sydney*	No
AER	2012	*State of the Energy Market 2012*	No
IPART	2013	*Review of regulated retail prices and charges for gas, From 1 July 2013 to 30 June 2016, Final Report, June 2013*	No

A.3 Legal sources

Tribunal and court decisions
The Pilbara Infrastructure Pty Limited v Australian Competition Tribunal (2012) 290 ALR 750 (***Pilbara Rail***) *Application by Services Sydney Pty Limited* [2005] ACompT 7 (***Services Sydney***)
Legislation
Competition and Consumer Act 2010 (Cth) (**CCA**)
National Gas Rules 2009 (**NGR**)
National Gas (South Australia) Act 2008 (SA) (**NGL**)