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PO Box A2449
Sydney South NSW 1235

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Please find enclosed the Northern Territory Power and Water Corporation's submission in response to the Australian Energy Market Commission's discussion paper entitled "Issues Paper – Review into the scope of economic regulation applied to covered pipelines".

Two copies of the submission are enclosed, one for Public release, the other to be treated as Confidential. The Confidential versions contains information that is subject to confidentiality obligations and therefore cannot be disclosed.

The Power and Water Corporation appreciates having an opportunity to provide comment and trusts that comment will be given close consideration.

Yours sincerely

Michael Thomson

Chief Executive
Power and Water Corporation

22 August 2017

Submission of

Power and Water Corporation

to

Australian Energy Market Commission

Review into the Scope of Economic Regulation

Applied to Covered Pipelines

PUBLIC

August 2017

1. Summary

The Northern Territory Power and Water Corporation has considered the Australian Energy Market Commission's discussion paper entitled "Issues Paper – Review into the scope of economic regulation applied to covered pipelines" and makes the following observations:

i) Pipeline reference services should reflect services that are available in a gas pipeline.

ii) Information should also be provided on alternative, competitive services that may be available (even if from parties other than the gas pipeline service provider).

iii) Both forecast and actual capital expenditure items must be subject to regulatory scrutiny.

iv) A mechanism(s) is required to ensure that non-regulated bilateral contracts of foundation users of pipelines enjoy benefits equivalent to users of regulated pipeline capacity. Foundation users must not be competitively disadvantaged if/as users of reference services enjoy cost reductions or other service improvements.

v) Pipeline owners do have an incentive to offer spare capacity to market as, to do so, should generate additional revenue. There is however potential that this amount to "double – dipping" so regulatory implications need to be considered.

vi) By reference to the Amadeus Gas Pipeline in the Northern Territory, insufficient information is publicly available on the capacity of the pipeline to transport gas in multiple directions.

vii) A day-ahead auction of un-nominated capacity <u>must not</u> competitively disadvantage foundation users of pipeline capacity by undercutting their market position. In addition, foundation user contracts may not provide for this form of spot-trading.

2. Background

Power and Water Corporation (**PWC**) welcomes the opportunity to provide comment on the "Issues Paper – Review into the scope of economic regulation applied to covered pipelines", as released by the Australian Energy Market Commission (**AEMC**) in June 2017.

PWC is a multi-disciplined Government owned corporation responsible for provision of gas, electricity transmission, electricity distribution, and water supply and sewerage services within the Northern Territory (**NT**).

PWC's role in gas is to purchase and transport natural gas to meet gas requirements for generation of electricity by Territory Generation (**TGen**) and, in competition with independent gas producers, for on-sale to third party users.

PWC transports gas through the Amadeus Gas Pipeline (**AGP**), a pipeline that is covered by the National Gas Rules (**NGR**). PWC acquires gas transportation services in the AGP pursuant to a Gas Transportation Agreement (**GTA**) with APT Pipelines NT Pty Ltd (**APTNT**), the owner and operator of the AGP. The GTA was entered into April 2011, at which time PWC was the only user of, and was dependent upon, the pipeline for provision of fuel for electricity generation within the NT. The GTA, which runs until early 2034, was fundamental to the viability of the AGP. Payments made by PWC to APTNT cover <u>all</u> costs of ownership and operation of the pipeline on a full cost recovery basis through to 2034. [Confidential information has been omitted].

The following sections of this submission provide comment in relation to issues raised by the AEMC in respect of which PWC has a relevant interest.

3. Purpose of Regulatory Framework (Question 1)

Purpose and Definition of Reference Services (Question 11)

As the sole, foundation user of the AGP, PWC is contracted for and pays for the full firm capacity of the AGP. This means there is currently no firm capacity available for contract to other users in the AGP. Existing and prospective third party users of the AGP (ie, other than PWC) therefore have the following options available for transportation of gas:

i) Purchase an Interruptible Service from APTNT at a negotiated tariff - PWC understands this is the service presently used by the small number of recently contracted third party users of the AGP, with the risk of interruption currently being low since PWC does not presently use all of its contracted capacity;

ii) purchase firm capacity from PWC; or

iii) purchase firm capacity from APTNT, in which case an expansion of the capacity of the AGP would need to be carried out unless arrangements are established with PWC for some relinquishment of firm capacity (and corresponding reduction in payments from PWC).

Despite the above being the only options for procurement of gas transport services in the AGP, the Access Arrangement for the AGP specifies that the Reference Service for the AGP is a 'firm service' and the Reference Tariff is based upon the existing (ie unexpanded) pipeline configuration. It seems incongruous that the Reference Service as presently offered is a service that is not available.

On the basis (which PWC accepts) that the purpose of the regulatory framework is to "enable access to essential facilities at fair and reasonable terms", it would appear that the regulatory framework is not achieving this objective in the case of the AGP. The specified Reference Service affords no aid for a party seeking to negotiate for pipeline services.

It would be preferable for Reference Services to:

i) reflect the service(s) that are available in the covered pipeline; and

ii) be accompanied by information on alternative, competitive services that may be available. For example, in the case of the AGP, PWC could use or offer its spare capacity for transport of gas for or by (respectively) third parties.

   Offering excess, firm capacity for sale could have appeal to PWC as a means for recouping some of its pipeline costs.

   [Confidential information has been omitted]. APTNT stands to make windfall profits given all underlying costs of the AGP continue to be funded by PWC.

4. Conforming capital expenditure (Question 5)

Although not utilising regulated services in respect of the AGP, through observation of regulatory processes PWC is concerned that pipeline owners might endeavour to 'game' the regulatory system by:

i) including any and all possible capital items in their forecasts of capital expenditure so as to maximise the capital base of, and in turn tariffs applicable for, the pipeline in question; and/or

ii) not maintain focus on the optimal approach to meeting capital needs. Potential also exists for 'gold-plating' of works or for excessive allocation of project management and overhead costs.

With regard for the above PWC considers it essential that both forecast and actual capital expenditure are rigorously assessed by the regulator. The present (limited) level of regulatory scrutiny is however considered reasonable – if expenditure is compliant with regulatory criteria (particularly in terms of being prudent, efficient and consistent with achieving lowest sustainable cost) then it should be allowed.

Consideration needs however to be given to mechanisms to protect the interests of foundation users of pipelines, where those users have underwritten a pipeline project but do not enjoy automatic flow-through of benefits that may accrue to users of regulated capacity if/as a pipeline is expanded and unit costs of gas transport decline. Foundation users of pipelines should not be competitively disadvantaged if/as pipeline utilisation increases.

5. Capacity available under an access arrangement (Question 8)

Providing Information (Question 13)

The NT gas market is poised for significant change, with the Northern Gas Pipeline (**NGP**) presently being developed to interconnect the AGP (near Tennant Creek) to the Carpentaria Gas Pipeline (at Mt Isa). The NGP will establish a link between the NT and Australian east coast gas markets.

When the NGP commences operation the AGP will effectively become three interrelated pipelines flowing in different directions, as follow:

i) a pipeline delivering gas from Ban Ban Springs <u>north</u> to Darwin;

ii) a pipeline from Ban Ban Springs delivering gas <u>south</u> to the NGP; and

iii) a pipeline delivering gas <u>north</u> from the Amadeus Basin to the NGP.

The three 'pipelines' will be interdependent in that changes to the flow regime (and hence pressure profile) of one may affect the capacity of another. However, the aggregate capacity of the three 'pipelines', representing the new aggregate capacity of the AGP, will be materially increased from its present level[1] of around 120 TJ/d with little, if any, cost to APTNT.

The Reference Service presently offered in respect of the AGP is 'postage stamp' based, that is, there is a single tariff regardless of the length of pipeline used or the direction of gas flow. This tariff is determined on the basis of a pipeline capacity modelling that has no regard for the future way in which the AGP is likely to be utilised.

In consideration of the above PWC:

i) anticipates there will be incentive for APTNT to offer capacity that is spare in any particular section of the pipeline, having regard for the requisite direction of gas flow. This is because transport of additional gas will allow additional revenue to be derived, particularly after start-up of the NGP. In due course, through regulatory reset, the increased throughput would be expected to lead to a fall in Reference Tariffs; and

ii) considers there is no information publicly available regarding the capacity of the AGP to transport gas in multiple directions following start-up of the NGP, despite that fact that gas producers and customers are seeking to establish future gas sales arrangements.

Of concern to PWC however is the fact that foundation users of pipelines routinely have GTA's in place that have underwritten the cost and viability of the pipeline in question but which are not based upon published

[1] As specified by APANT in "Amadeus Gas Pipeline Access Arrangement Information", August 2015.

(Reference) tariffs and do not enjoy regulatory protection from monopoly behaviour.

PWC urges the AEMC, in its review of economic regulation of covered pipelines, to give due consideration to the interests of foundation users of pipelines. Foundation users take significant risks by investing long term and years ahead of development of a pipeline. Conceptually, an arrangement that obligates pipeline owners to pass through to foundation users benefits equivalent to those afforded to users of regulated services might afford adequate protection (i.e. a last recourse tariff should be available to foundation users as part of any government reform).

6. Other Matter: Day-ahead Capacity Auction

PWC is aware that the Gas Market Reform Group is working on development of day-ahead arrangements for auction of un-nominated pipeline capacity. PWC is concerned that such an arrangement will acutely distort gas market arrangements, particularly in the case of the AGP.

PWC has historically funded, and continues to fund, all costs of owning and operating the AGP as it is presently configured. To contemplate allowing competitors of PWC to gain access to pipeline capacity, potentially at near zero cost, is patently unreasonable. Parties seeking access to pipeline capacity will, in all likelihood, be competing with PWC. At the very least;

i) they should be required to pay no less, on a unit cost basis, than is paid by the foundation users(s) (PWC in the case of the AGP) for capacity; and

ii) the payment should accrue to the foundation user(s), rather than to the pipeline owner as a windfall profit.

If arrangements along the lines outlined above are not incorporated in a day-ahead capacity auction (if introduced) then the auction arrangement will materially discriminate against foundation users who are funding the underlying costs of infrastructure provision.

It should also be noted that foundation user contracts may not themselves provide for or allow spot-trading of pipeline capacity. A foundation user of firm capacity may be entitled to use any or all of that capacity at any time, without notice, so it will not be possible for a gas pipeline owner to know what, if any, capacity may be spare on a day-ahead basis.