

Final Recommendation

Application for Revocation of South East Pipeline System (SA) from Coverage under SA Gas Access Regime

March 2000

National Competition Council

Final Recommendation – Application to revoke Coverage of the South East Pipeline System

Introduction

This document contains the National Competition Council's Final Recommendation regarding an application for revocation of coverage of the South East Pipeline System from the provisions of the South Australian gas access regime. The South East Pipeline System runs between Katnook Processing Plant and Safries (PL3), and between Katnook and Kalangadoo, Snuggery, and Mount Gambier (PL4). In Mount Gambier it supplies gas to a local gas distribution system that is not part of this application for revocation.

The Council's Final Recommendation is that coverage of the South East Pipeline System be revoked. The Council considers the pipeline does not meet criteria (a) and criteria (d) of the criteria against which coverage is assessed.

The document comes in two parts.

Part A explains:

- the legislative background to the SA gas access regime;
- the concepts of coverage and revocation under the regime;
- details of the application, including specification of the relevant pipeline; and
- the process to be followed in deciding the application, focussing on what occurs after issue of this Final Recommendation.

Part B contains the Council's detailed consideration of the South East Pipeline System against the criteria on which the Council's Final Recommendation is made.

The application will now be decided by The Hon. Rob Kerin, MP, Deputy Premier of South Australia, and Minister for Primary Industries, Minerals and Energy, and Regional Development. Under the National Code, the Minister has 21 days to decide the matter.

Part A – Coverage and Revocation under the Gas Access Regime

Legislative Background

In 1997, South Australia enacted a gas access regime to provide parties with a method for seeking access to certain gas transmission and distribution pipelines located in South Australia. The regime is contained in the *Gas Pipelines Access (South Australia) Act 1998* (the **SA Gas Pipelines Act**), the Gas Pipelines Access Law (**GPAL**), at Schedule 1 of the SA Gas Pipelines Act, and the *National Third Party Access Code for Natural Gas Pipeline Systems* (the **National Code**), at Schedule 2 of the SA Gas Pipelines Act.

The regime assists parties wishing to transport gas through gas transmission and distribution pipelines in SA to negotiate a fair and reasonable contract of transport with pipeline owner/operators. For example, a mining company may wish to buy gas from a gas producer at a particular production site and transport it to a gas-fired power station at its mining site. Under the SA gas access regime, it has the opportunity to negotiate a contract for transport of the gas with the owners/operators of pipelines covered by the regime in accordance with the rules laid down by the regime. In the absence of the SA gas access regime, the owners/operators of pipelines might, by virtue of any monopoly powers over the transport of gas between the particular geographic regions, refuse to transport gas or demand a monopoly price for the transport of gas.

The revocation process is designed to determine whether it is appropriate for particular pipelines to continue to be covered by the SA gas access regime. The regime provides that applications for revocation must be examined against four coverage criteria. The coverage criteria look at such matters as whether the pipeline confers monopoly power, and whether access to the pipeline would promote competition in another market.

Coverage of Pipelines

The South East Pipeline System became covered by the SA gas access regime when it was listed in Schedule A to the National Code. Pipelines listed in Schedule A were covered from the commencement of the SA gas access regime.¹

Where pipelines are covered, the owners/operators of the relevant pipelines must comply with certain obligations under the SA Gas Pipelines Act and the National Code. The SA Gas Pipelines Act and the National Code contain rules determining whether pipelines should be covered by the gas access regime, the operation and content of access arrangements (which specify the terms, conditions, and prices on which owners/operators must offer access), the provision of information by the owner

¹ Pipelines can become covered in three other ways.

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and/or operator of a pipeline to parties seeking access, dispute resolution principles, and pricing principles.

Revocation of Coverage of a Pipeline

The National Code permits any party to seek revocation of coverage of a pipeline. The party must apply to the Council asking the Council to recommend to the relevant Minister that coverage of a pipeline be revoked. On receipt of the Council's recommendation, the relevant Minister must then decide the matter. In this case, the relevant Minister is The Hon Rob Kerin, MP, Deputy Premier of South Australia, and Minister for Primary Industries, Minerals and Energy, and Regional Development.

In reaching its recommendation, the Council is required to consider the criteria for coverage in section 1.9 of the National Code. Where it considers that a pipeline does not meet all the criteria in section 1.9, it must recommend revocation of coverage of that pipeline.

Where revocation is granted, the owner/operator of the pipeline is released from its obligations under the SA Gas Pipelines Act, the GPAL, and the National Code.

The Council's detailed assessment of the application against the criteria in section 1.9 of the National Code is contained in Part B of this document.

The Application²

The revocation application relates to the South East Pipeline System in the South East corner of SA. The South East Pipeline System transports gas from the Katnook Processing Plant along one pipeline to Safries (Pipeline Licence 3 or PL3), and along another pipeline from Katnook to Glencoe, Mt Gambier, Kalangadoo, and Snuggery (PL4). The South East Pipeline System is classified as a transmission pipeline in Schedule A.

The application seeks revocation of coverage of both pipelines in the South East Pipeline System, that is PLs 3 and 4.

The applicant is the Epic Energy South Australia Pty Ltd (**Epic**), the owner and operator of the South East Pipeline System.

Table 1 summarises details of the South East Pipeline System.

² Much of the information in this section is drawn from the application by Epic Energy.

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TABLE 1 Pipeline System for which Revocation is sought

Pipeline Licence	Location/ Route	Operator	Length (km)	Pipe Diameter (mm)	Regulator
	South East Pipeline System	Epic Energy Pty Ltd			ACCC
SA: PL 3	Katnook to Safries		4.5	60.3	
SA: PL 4	Katnook to Glencoe Glencoe to Mt Gambier Glencoe to Snuggery		26.7 18.9 19.4	168 168 168	

The joint venture producers based at Katnook and led by Boral (the **Boral joint venture**) produce the gas supplied to the South East Pipeline System. The Boral joint venture hold a contract for all the capacity of the pipeline in its current configuration until 2011.

Having said this, it may be possible to free up some capacity in the pipeline to meet the needs of other parties interested in seeking access. While the Boral joint venture has contracted for all the capacity of the South East Pipeline, the Council understands from the application and the Boral joint venture submission that not all of this capacity is currently utilised by the Boral joint venture, and that the South East Pipeline System in its current configuration has the capacity to carry additional gas to that currently transported in the pipeline. The National Code contains certain provisions for parties to obtain access to capacity that has been sold to existing users. Additionally, it may be possible for the capacity of the pipeline to be expanded to create spare capacity to meet the needs of other parties interested in contracting for transport capacity.

Revocation Process to be followed under National Code

The process for dealing with revocation applications is specified in sections 1.24 to 1.39 of the National Code.

The Council received the application for revocation of the South East Pipeline System from Epic on the 3 December 1999. The Council advertised the call for submissions on its internet site, in the *Australian Financial Review*, in *The Advertiser*, and in the *Mount Gambier Borderwatch*. It also wrote to selected interested parties and organised a mail-out to members of the South Australian Chamber of Employers in the Mt Gambier region as they represent the most significant actual or potential users of gas supplied by the South East Pipeline System.

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In recognition of the Christmas holiday period, the Council extended the date by which submissions were due to the 28 January 2000.

The Council received three submissions in response to its call for submissions, from the Boral joint venture, from Boral's head office (**Boral Head Office**), and from Envestra. Each of these three submissions supported revocation of the pipeline. The Council also discussed the application with officers of the Department of Primary Industries and Resources, and some companies using gas supplied by the South East Pipeline System.

Following finalisation of the Draft Recommendation, the Council circulated it among parties who had made submissions, the service provider, and other identified interested parties. The Council received two submissions in response to its Draft Recommendation, from Envestra, and from Kimberly-Clark Australia Pty Ltd (which is a major user of gas from the South East Pipeline System). Envestra's submission reiterated its support for revocation of coverage. Kimberly-Clark's submission expressed concern at potential revocation. It recognised the lack of competition at present in production of gas, but suggested that greater competition may arise in the future due to gas finds in the Bass Strait and the construction of new pipelines passing through or near the region of the South East Pipeline System.

Following release of this Final Recommendation, the following steps are due to be taken:

- the Council will provide copies of its final recommendation to relevant parties, including the owner/operator and any party who made a submission;
- the Minister must make a final decision to revoke or not revoke coverage within 21 days of receipt of the Council's final recommendation;
- the Minister must provide copies of his decision and reasons to relevant parties, including the owner/operator and any party who made a submission.
- the Minister's decision (if it is to revoke coverage) takes effect on the day specified, which date must not be earlier than 14 days after the day the decision is made.
- under section 38 of the GPAL, any person adversely affected by the Minister's decision may appeal to the South Australian Gas Review Board.

Part B – Consideration of the Criteria under Section 1.9 of the National Code

Under the National Code, the Council must consider whether the relevant pipeline meets the criteria for coverage contained in section 1.9. The Council must recommend revocation in respect of the South East Pipeline System unless it meets *all* of the criteria.

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

Background

The rationale for this criterion is that access regulation is only warranted where access is likely to generate tangible benefits (for example, reduced prices or improved quality) which will flow through to at least one market beyond the market for the services of the particular gas pipeline.

Before it concludes that a pipeline meets this criterion, the Council must be convinced that:

- the service to which access is sought is *not* in the same market as the market or markets in which competition is promoted; and
- access would actually promote more competitive *outcomes* – such as lower prices – in that other market. Greater competition in another market will be less likely where that other market is already highly competitive, or where the other market is a monopoly (in the second case because cost savings are unlikely to be passed on to consumers).

The Council must also consider whether access charges are a sufficiently significant input into the other market or markets to have a material effect on competition. In general, while a trivial increase in competition would not be sufficient, the Council considers access would not need to substantially promote competition in order to satisfy this test.

The Council's approach is to:

- verify that the market or markets in which competition is said to be promoted is separate from the market for the service; and (if so) then

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- determine if access (or increased access) would promote competition in this separate market or markets.

Views put to the Council

The applicant contended that significant competition in the energy market already constrained the ability of gas producers and pipeline operators to extract monopoly charges from energy users:

The only shipper on the SE System, Boral Energy, is actively promoting gas supply in the South East against strong competition from LPG, electricity and wood waste.

The applicant also argued that it was unlikely that parties would seek interconnection of interstate or intrastate pipelines with the South East Pipeline System for the purpose of competing for the business of gas users in the South East of SA (or elsewhere). This was because:

The location and limited capacity of the SE System is such that it is most unlikely to play any part in interstate or intrastate gas competition.

The Boral joint venture submission considered access to the pipeline would not promote upstream competition.³ In its view, it “is unlikely that any party would, in the short to medium term, seek access to the SE System” because:

There is only production joint venture group in the south east of South Australia [where the pipeline is located] despite exploration programs in the area by third parties.

The Boral Head Office submission argued that access to the pipeline would not promote downstream competition, because there was already “significant competition between alternative energy sources, such as LPG, wood waste and electricity”, and therefore access to the South East System “would not produce a material change in energy prices in the region”.

The Boral Head Office submission also argued that the “upstream market for natural gas production will not change in the foreseeable future as there is no other party that has discovered commercial gas reserves in the region”. It considered that, if a new gas reserve were found, it would take several years lead time to develop and this would “provide ample opportunity for the developers to assess the competitive effect that coverage of the South East System would produce and seek coverage if warranted”.

³ Upstream competition is competition upstream of the pipeline, such as competition among gas producers to develop new fields, or to acquire exploration rights over particular acreage.

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Neither of Envestra's submissions directly addressed this criterion.

Kimberly-Clark's submission in response to the Council's Draft Recommendation expressed some concern at the possibility of revocation of the South East Pipeline System. The submission said that at the present the market conditions did not exist such that access would promote competition in another market. However, the submission went on to suggest that with a change in market conditions, such as discovery of a new gas field and the construction of new pipelines, circumstances might develop such that access or increased access to the services of the South East Pipeline System would promote competition in another market.

Analysis

Submissions did not precisely identify particular markets in which access might promote competition. The most likely market or markets in which access *might* promote competition are the market or markets in which gas sales take place. This market or these markets may encompass sales of other energy sources available in the South East of SA, such as electricity, wood waste, or LPG, to the extent that these other sources can meet the requirements of energy users in the region.

The first issue for the Council is whether this market or these markets in which gas sales take place are separate from the market in which access would be sought.

In considering this issue, the Council has been guided by a test developed by Professor Henry Ergas.⁴ In essence, the Ergas test points to separate markets if:

- the services supplied by the gas pipeline are separable, from an economic point of view, from the other service or services. This involves an assessment as to whether the transaction costs in separate provision at the two layers would not be so great as to prevent such separate provision from being feasible; and
- the assets used to provide the gas pipeline services are sufficiently specialised that supply side substitution is not achievable so readily as to unify the field of rivalry between the two layers.

The primary market served by the South East Pipeline System is the market for gas transport services in the South East region of SA.⁵ This is the market to which access would most likely be sought under the SA gas access regime.

The Council considers the market occupied by gas transportation services is separable from the market or markets in which gas sales take place. First, the market in which gas transportation services are provided involves the use of specialised pipeline

⁴ Ergas, H, submission to the NCC in support of an application by Carpentaria Transport Pty Ltd, pp. 1-3.

⁵ although the services of the South East Pipeline System may not be limited to gas transport.

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facilities that are distinct from those required in the gas sales market or markets. Second, the Council observes that different parties typically participate in the gas transportation and gas sales market or markets. Parties can and do trade gas without entering the gas transportation market. For example, in the case of this pipeline, Boral rather than Epic retails gas to large users.

The next issue is whether access to the services of the South East Pipeline System would promote competition in this other market or these other markets to a non-trivial extent.

If access enabled parties to secure transport of gas at cheaper tariffs then it might promote competition in a number of ways, including:

- encouraging new gas producers to enter this other market or these other markets and compete with existing gas producers for the business of gas users, thus producing cheaper prices or better services for users;
- enabling gas producers to offer gas at a cheaper price to users, encouraging them to switch from other energy sources (such as LPG, wood waste, or electricity) to gas; or
- encouraging other pipelines to seek interconnection with the South East Pipeline System, either to supply gas to users in the South East corner of SA, or to draw locally produced gas to other areas, or to assist in transport of gas between two other regions via the South East Pipeline System.

In terms of the first of these sources of potential greater competition, both Boral submissions argued that due to the lack of alternative commercial gas discoveries, there was little real prospect of competition from new producers in the short to medium term.

The Council confirmed by examining the petroleum information sheets for the South East corner of SA and through discussions with the SA Department of Primary Industries and Resources that there were at present no commercially developable gas discoveries in the region (apart from those at and around Katnook currently under production), and it would take at least two years to develop a new discovery if one were made tomorrow.

The Council recognises the possibility that the prospect of access on regulated tariffs and other terms and conditions under the SA Gas Pipelines Act might stimulate greater exploratory work, leading to fresh discoveries and greater competition in gas sales. However, the Council was not presented with any evidence to suggest that this might occur in the case of this pipeline. Further, gas exploration companies, when undertaking exploration, would know that they would be able to apply for re-coverage of the South East Pipeline System if they were to make a discovery. Re-coverage would then depend, among other matters, on whether development of the

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new discovery, in conjunction with access to the South East Pipeline System, would promote competition.

Kimberly-Clark suggested that new discoveries of gas in the Bass Strait, together with construction of new pipelines to the Adelaide market, could bring new sources of gas to the region served by the South East Pipeline System. If these new pipelines connected with the South East Pipeline System, then access or increased access to the South East Pipeline System might provide greater competition among gas producers or in downstream markets that rely on cheap sources of energy.

Changes such as new discoveries and construction of new pipelines that interconnect with the South East Pipeline System might lead to a situation where access or increased access to the services provided by the South East Pipeline System would promote competition in another market or markets. As the submission from Boral Head Office points out in relation to new discoveries, it is open to parties in this case to apply for re-coverage of the South East Pipeline System.

The second source of potential greater competition, greater downstream competition, must be evaluated in light of the short to medium term supply arrangements. The Boral joint venture based at Katnook is the only source of gas in the short to medium term, and has secured the right to all the capacity of the South East Pipeline System in its current configuration until 2011. This means Epic, as the owner of the South East Pipeline System, has little opportunity to extract higher transport tariffs from Boral than those it presently charges, and therefore access is unlikely to promote cheaper tariffs.

Having said this, the Council recognises that the above reasoning assumes that the current tariffs do not contain a monopoly element which access under the SA Gas Pipelines Act might address. It also assumes Boral will not need additional transport capacity (which could be provided by expansion of the pipeline) in the period until 2011. Nonetheless, the Council is prepared to accept there is insufficient evidence at this time to come to this view, particularly in view of Boral's submission supportive of revocation of coverage.

The third source of potential greater competition, through interconnection of the South East Pipeline System with other pipelines, is not supported by the evidence as to current patterns of demand and supply of gas in SA and nearby States. Due to the South East Pipeline System's relatively isolated location, it is unlikely other parties will seek to interconnect their pipelines with it in the foreseeable future.

The Council concludes, on the basis of the evidence available to it, that the South East Pipeline System does not satisfy criterion (a).

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

Background

The rationale for the SA Gas Pipelines Act and the National Code is that access regulation should be limited to infrastructure where it is not economically viable to build competing facilities. As such, access regulation should normally be confined to infrastructure with monopoly power, and usually to infrastructure exhibiting *natural monopoly* characteristics – that is, where a single facility can meet market demand at less cost than two or more facilities. Such a facility is normally characterised by large up-front investment costs and low operating costs, resulting in economies of scale across a broad range of output – that is, as output increases, average costs per unit of output continue to decrease across the range of output sought by the market.

The Council has interpreted this criterion consistent with its previous interpretations of section 44(G)(2) of the *Trade Practices Act 1974* (Commonwealth). The Council notes that section 44G(2) contains slightly different wording in that it provides for declaration of facilities where “it would be uneconomical for anyone to develop another facility to provide the service”. However, the Council considers the words in this criterion are consistent with the Council’s interpretation of the words in section 44G(2), particularly since the Gas Reform Implementation Group (in formulating the coverage criteria under section 1.9 of the National Code) indicated that they intended to replicate the words of section 44G.⁶

In examining whether it is economic to develop another facility, the Council applies a *social* test rather than a *private* test of the costs and benefits of developing another facility. The social test looks at whether all of the benefits associated with the development of another pipeline outweigh all of the costs, for example, whether it would be better for an industry to share infrastructure because new investment would substantially raise industry costs and therefore affect the prices paid by consumers or Australia’s competitiveness overseas. Where construction of a new facility might proceed in the absence of access, but would be socially wasteful because existing facilities can fully and more efficiently meet demand, the social test indicates that the development of another facility is uneconomic.

Some of the factors relevant to a consideration of whether it is uneconomic to develop another pipeline are:

- whether there is significant excess capacity in existing pipelines;

⁶ See GRIG Policy Paper on the National Gas Access regime, p. 7, quoted in *National Gas Access Regime: Recommendation to the Gas Reform Implementation Group on the National Third Party Access Regime for Natural Gas Pipeline Systems*, (National Competition Council) at p. 13.

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- whether current and projected levels of demand are most cheaply supplied by one party;
- whether average and marginal costs of production per unit continue to decline for all likely levels of demand;
- whether the costs of developing another pipeline to provide the transport capacity sought by the third party outweigh the costs of expanding the capacity of the existing pipeline to meet the third parties' needs while ensuring the owner/operator and existing users do not lose amenity;
- the number of pipelines currently supplying the market for transport of gas between the regions sought by third parties;
- the height of barriers to entry (such as large upfront costs of developing another pipeline, particularly costs that cannot be recovered if the new investment were to be abandoned).

Gas pipelines are typically characterised by high construction costs and low operating costs such that the marginal cost of transporting a unit of gas is very low. Moreover, up to the point of fully expanded capacity, average costs of transport of a unit of gas decline. This means that gas pipelines exhibit natural monopoly characteristics. In lay terms, this means it is almost always cheaper to transport gas through existing pipelines (if spare capacity exists or can be added) than it is to build another pipeline to transport the gas.

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

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

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

Views put to the Council

Neither the application, nor the submission from Envestra or Boral Head Office, debated whether the South East Pipeline System met this criterion.

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The submission from the Boral joint venture argued that, given the small size of the gas market served by the South East Pipeline System, it was unlikely to be economic to construct another facility to provide the services provided by the South East Pipeline System.

The Boral joint venture submission also argued that the public interest was not served “by construction of an additional pipeline when infrastructure already exists with unused capacity”.

Analysis

The Council considers that it is *not* likely, on present evidence, that any party would find it economic to build another facility to provide the services provided by the South East Pipeline System. The application states, and this view was supported by the Boral joint venture submission, that the South East Pipeline System is currently underutilised. It is likely to be cheaper to provide (or expand) capacity in the South East Pipeline System than to construct another pipeline or facility to provide the transport services provided by the South East Pipeline System. The Council recognises that this situation might change at some future time due to changes in demand and supply of gas.

The Council concludes that the South East Pipeline System meets criterion (b).

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

Background

The rationale for this criterion is that the National Code should not be applied to pipelines where this may pose a legitimate risk to human health or safety.

Analysis

Only the submission from the Boral joint venture addressed this criterion. It said “increased access will not necessitate significant changes to the existing pipeline structure nor will it give rise to additional health or safety risks”.

The Council has not been provided with any evidence that access (or increased access) to the pipeline could not be provided safely. The Council notes that access is currently being provided to Boral, and has no evidence that this poses a risk to safety.

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The Council concludes that access (or increased access) could be provided safely, and that the pipeline meets criterion (c).

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

Background

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

Applicant's and Submitters' Views

The application argued that access to the pipeline was not in the public interest because access to the pipeline would necessitate preparation of an access arrangement, and the costs of preparation of an access arrangement outweighed any benefits of coverage.

The applicant estimated that, on the basis of its previous experience in preparing access arrangements for other pipelines, the cost of preparing an access arrangement would be at least \$150,000, or around 13 per cent of one year's annual revenue. The applicant estimated additional costs incurred by the regulator and third parties might amount to a further \$150,000.

Envestra argued that these estimates were conservative, and the direct costs to Epic might be over \$200,000.

Envestra stated that these costs would be passed on to users to the extent that this was not constrained by the price of alternative energy sources, in which case it would be absorbed by Epic.

Envestra argued that:

To spread the costs associated with preparation and administration of an Access Arrangement and Access Arrangement Information across the market serviced by the South East Pipeline System would impose an unreasonable financial penalty on gas users in the region.

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In Envestra's view:

Third party access under the National Code is more likely to generate net public benefits when the assets subject to this form of “regulation” are high volume transmission pipelines and distribution networks with large customer bases. These characteristics enable regulatory costs to be apportioned across large volumes of gas so that they represent a small component of the cost of service. Negotiated access may be the most efficient form of access for small pipeline systems such as the South East Pipeline System.

Envestra made a further submission in response to the Council's Draft Recommendation. This submission reiterated and expanded upon the above points. Envestra also argued in its further submission that a further cost of coverage might be to “cloud the focus of management … away from its core activities of continual improvement, strategy, growth and innovation”.

The submissions from the Boral joint venture and Boral Head Office argued that the costs of regulation outweighed the benefits, consistent with their view that access to the pipeline would not promote competition in another market.

Analysis

The Council accepts that there would be significant costs imposed if the pipeline were regulated. These costs would include the direct costs to Epic, the regulator, and third parties that would arise from the preparation and use of an access arrangement (discussed above), but more generally may include any unintended effects of regulation, such as stifling of incentives and a switch in focus for management from its core activities to managing its relationship with regulators.

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

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

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

The Council considers that in the short to medium term, the costs of regulation are likely to outweigh the benefits, and concludes that the South East Pipeline System does not meet criterion (d).

Appendix 1: Criteria for Coverage in Section 1.9 of National Code

The Council must recommend revocation of coverage of a pipeline – either to the extent sought, or to a greater or lesser extent than sought in the application⁷ – if the pipeline does *not* satisfy one or more of the criteria for coverage in section 1.9 of the National Code.

The criteria in section 1.9 are:

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

⁷ Taking account of any part of the pipeline that is necessary to provide services that potential users may seek access to (section 1.29).