Hydro Tasmania
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Hydro Tasmania: Submission on the AEMC's issues paper: Review into the scope of economic regulation applied to covered pipelines

1. Introduction

This submission has been prepared by Hydro Tasmania in response to the invitation for stakeholder input into the AEMC's review into the economic regulation of covered gas transmission and distribution pipelines.

Hydro Tasmania has significant involvement in the east coast gas market as a wholesaler of gas and a user of gas for power generation in both Tasmania and Victoria. Hydro Tasmania also retails gas in Victoria through its wholly owned subsidiary Momentum Energy. With regard to pipeline access, Hydro Tasmania is the largest shipper on the Tasmanian Gas Pipeline as well as a shipper on the Eastern Gas Pipeline, APA's Victorian Transmission System and Victorian gas distribution networks.

The first sentence of the AEMC's Issues Paper says that "Australia's gas markets are in a period of significant change" and Hydro Tasmania has experienced this at first hand. Over recent years, upstream gas markets have become tight, prices have increased very considerably and gas contracting has moved from long-term and flexible to short-term and inflexible.

In order to keep up with these changes, gas pipeline infrastructure needs to be flexible and responsive to shipper requirements. However, this has not always been the position adopted by the pipelines or required by regulators. Hydro Tasmania is well aware that several recent reviews into the gas market have found evidence of monopoly pricing and practices by pipelines in Australia which have had an adverse impact on the efficiency of gas markets.

Hydro Tasmania recognises that Australian governments are striving to improve the situation. Hydro Tasmania is strongly supportive of the recent introduction into the NGL and NGR of the Information disclosure and arbitration framework (Framework) for non-scheme pipelines. Hydro Tasmania considers that the underlying objective of the Framework, that prices, terms and conditions reflect as far as practicable the outcomes of a workably competitive market, should also be the primary basis for regulating covered pipelines. Hydro Tasmania is also supportive of the increasing transparency of services and costs required under the Framework and of government moves to standardise and facilitate utilisation and trading of capacity.

This submission relates mainly to transmission pipelines and to lessons that Hydro Tasmania believes can be learned from the recent gas market reviews and introduction of the Framework and applied to the regulation of covered pipelines. In summary, Hydro Tasmania recommends that:

- A consistent approach be taken across all pipelines towards listing all services offered, standard pricing, information disclosure, the negotiation process and arbitration for non-reference services
- "Forum shopping" not be allowed
- Pricing principles give primacy to likely outcomes in a workably competitive market
- It is recognised that a shift to more restrictive or onerous terms and conditions by pipelines results in costs to users, either directly or as a degradation of service quality.

1.1 Consistency of approach towards services offered, standard and average pricing, information disclosure and the negotiation process

Of over 50 transmission pipelines across Australia only nine are currently economically regulated (5 fully regulated, 4 lightly regulated). Even after taking into account potential exemptions, the introduction of the

Framework has meant that a significantly greater number of transmission pipelines are now subject to the requirements of the Framework than those subject to full or light-handed regulation.

Each of the current levels of regulation (full, light, Framework) currently requires different levels of information disclosure and negotiation processes. For example, fully regulated pipelines need provide information only about one or more reference services, while the Framework requires that all services available be listed and demand for and standard pricing of these services be made available, together with the basis of pricing if required and historical average prices.

Given the increasing demand for services other than the standard firm forward haul, Hydro Tasmania believes that there needs to be consistency of approach towards provision of information about the full range of services offered and demand and standard pricing for these services. Hydro Tasmania expects that the information disclosure requirements under the Framework would act as a reasonable template for all pipelines to be required to follow, apart from those pipelines which are exempt.

Similarly, the Framework has also established processes for negotiation which Hydro Tasmania considers reasonable to adopt as a template across all (non-exempt) pipelines. Such processes include the basic process to be followed and allowable timing for responses by pipelines.

Finally, Hydro Tasmania believes that access to the type of commercial arbitration introduced under the Framework should be available for all services other than the reference services which are an outcome of full regulation.

1.2 No "forum shopping"

Prior to and during the Gas Market Reform Group's review which led to the introduction of the Framework, there was mention by some parties that coverage would be preferable to the type of regulation contemplated under the Framework.

While Hydro Tasmania is not certain whether such statements are realistic, given the time and resource-intensive nature of regulation, it believes AEMC will need to ensure that pipelines are not able to "forum shop" for regimes which they consider will be more favourable to them, to the possible detriment of users.

1.3 The economic basis of pricing

Full price regulation of transmission pipelines has generally required initial establishment of a regulatory asset base and then use of a building block approach to calculate allowable revenues largely related to that asset base. The asset base thus determined was then considered largely sacrosanct, with changes only for capital expenditure, depreciation and specific assets identified as redundant.

While such an approach may have worked in the past in a less dynamic gas market structure it is unclear whether this will remain the case over the medium to longer term, given the fundamental changes that are taking place in gas and broader energy markets.

In particular, Hydro Tasmania considers that such an approach is unlikely to result in both efficient and equitable outcomes for pipelines which are facing declining demand[1]. Declining demand is a challenge which is currently confronting regulators and utilities across services such as postal and fixed-line telecommunications and may also need to be faced by regulators of energy utilities in the foreseeable future.

Hydro Tasmania is concerned that, unless the asset base has some flexibility, declining demand will inevitably result in increasing prices. Hydro Tasmania does not believe that such an outcome, which could for example see prices doubling if demand halves, properly reflects outcomes under workable competition. Hydro Tasmania is of the view that in a workably competitive environment, a fall in demand

[1] And also where demand initially forecast has not eventuated.

would lead to lower rather than higher prices (and associated lower asset values) to promote demand growth.

Hydro Tasmania believes that any review of the economic basis of regulated pricing should confirm the primacy of the requirement that outcomes reflect those of a workably competitive market. While any of a number of methodologies can be initially adopted to calculate the asset base, these should be subordinate to the requirement that prices should reflect outcomes under workable competition.

1.4 Terms and Conditions

In Hydro Tasmania's experience, terms and conditions for access to pipelines have become increasingly restrictive over time. Such changes include substantial increases to pricing of overrun and imbalance charges, long "standard" contract durations and reduced pipeline tolerances including changing definitions of maximum daily quantity with regard to maximum hourly quantity. Such changes often result in the value of the primary service, for example firm forward haul, being degraded. The historical building block approach to pricing typically does not take into account the cost of such restrictive terms and conditions to users, when determining the headline price.