NT Gas Pipelines

Applications to Revoke Coverage Under The National Gas Access Regime

Recommendations
July 2000

National Competition Council

Contents

1 Recommendations

On 20 April 2000, the National Competition Council (the Council) received applications from Envestra Limited to revoke coverage under the *Gas Pipelines Access (Northern Territory) Act 1998* (NT Act) of the following natural gas pipelines owned by Envestra:

- the Palm Valley to Alice Springs (transmission) pipeline; and
- the Alice Springs gas distribution network.

The effect of revocation is to remove a pipeline from regulation under the National Third Party Access Code for Natural Gas Pipeline Systems (National Code).[1] In effect, the owner of the pipeline is relieved of any obligation to grant access to third parties.

The Council hereby releases its recommendations that coverage of each pipeline be revoked. The Council's reasons are set out in section 3 of this document. In essence, the Council is not satisfied that regulated access to the pipelines would promote competition in another market or confer net public interest benefits.[2]

The applications will now be decided by the Hon Daryl Manzie, MLA, in his capacity as the NT Minister for Resource Development. Under the National Code, the Minister has 21 days to decide the matter.

Variation from draft recommendations

The Council's *draft* recommendation (June 2000) on the *Palm Valley to Alice Springs pipeline* was to retain coverage under the National Code. This followed evidence provided by Energy Equity Limited that access to the pipeline would promote competition in the markets in which gas sales and electricity sales take place, with public interest benefits.

The Council understands that Energy Equity Limited has since held discussions with Envestra and is now of the view that, on balance, its access requirements can be satisfied through commercial negotiation. The company's position also reflects its understanding that it can apply for coverage of the pipeline in the future should the need arise.

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1 The National Code is applied in the Northern Territory by the Act.

2 These issues are raised under coverage criteria (a) and (d). See Section 3 of this paper.

In the light of this information, the Council is no longer satisfied that regulated access under the National Code would promote competition in another market, or that coverage of the pipeline would be in the public interest.

The Council's recommendation on the *Alice Springs distribution network* reflects no significant changes from its draft position.

The Council's process

While the Council considered each application[3] separately, the Council ran joint public consultation processes and presents its recommendations in a single report. The Council sees efficiencies in this approach, given that the applications were received simultaneously from the same company; and that the applications cover inter-related facilities. Further information on process matters is available at Appendix 1 of this document.

A list of submissions received by the Council regarding the Envestra applications is provided at Appendix 2. Copies of Envestra's applications, the Council's Recommendations, Draft Recommendations and formal submissions received are available to interested parties on the Council's web page at **www.ncc.gov.au**

3 The Council received two applications: one relates to the Palm Valley to Alice Springs pipeline; the other relates to the Alice Springs distribution network.

2 Background

2.1 The applications

The revocation applications relate to the following gas facilities owned by Envestra[4]:

- the Palm Valley to Alice Springs gas pipeline; and
- the Alice Springs gas distribution network, comprising:
  - the Alice Springs Town reticulation pipeline system (downstream of the first flange after the processing plant); and
  - the Alice Springs Metering and Pressure Station.

Details of these gas pipeline systems are set out in Table 1. The arguments advanced by the applicant are set out in the applications (available on the Council's web page at **www.ncc.gov.au**) and noted in section 3 of this paper.

TABLE 1

Pipeline Licence	Location / Route	Operator	Length (km)	Regulator
NT: PL1	**Palm Valley to Alice Springs gas transmission pipeline**	Origin Energy Asset Management Ltd	146 (Diameter 200 mm)	ACCC
Not licensed	**Alice Springs gas distribution network** (a) Alice Springs Town reticulation pipeline system (downstream of the first flange after the processing plant)	as above	30 km	ACCC
NT:PL5	(b) Alice Springs Metering and Pressure Station	as above	Not applicable	ACCC

[4] While Envestra owns the pipelines, they are operated by Origin Energy Asset Management Ltd.

2.2 The Northern Territory Gas Access Act

Currently, the Envestra-owned facilities listed above are 'covered pipelines' under the *Gas Pipelines Access (Northern Territory) Act 1998*. The Act applies the *National Third Party Access Code for Natural Gas Pipeline Systems* (National Code) to gas pipelines in the Northern Territory (NT).

The National Code is a central element of National Competition Policy reforms aimed at promoting free and fair trade in gas. Under the Code, owners of certain gas pipelines (known as 'covered pipelines') must submit access arrangements for approval to an independent regulator (in the Territory, the regulator is the Australian Competition and Consumer Commission, ACCC). These access arrangements set efficient benchmark prices for third parties to seek access to spare capacity in a pipeline.

Interested parties can find the National Code on the Code Registrar's website at: www.coderegistrar.sa.gov.au

Schedule A of the National Code lists pipelines which are covered by the Code from the commencement of its operation. The pipelines which are the subject of Envestra's applications are listed in Schedule A.

2.3 Revocation of coverage

The Code recognises that the public benefits of regulating access to a service may change over time due to such factors as changes in market conditions (for example, the emergence of competition) or technological changes affecting the economic viability of new infrastructure. In time, the benefits of regulating a particular pipeline may be outweighed by the cost of regulation and other factors.

For this reason, the Code allows parties to seek revocation of coverage of a pipeline under the National Code. Applications are made to the National Competition Council. Following consideration of issues raised in public consultations, the Council conveys a recommendation to the relevant Minister (in this case, the Hon Daryl Manzie, MLA, in his capacity as the NT Minister for Resource Development), who decides the matter. Both the Council and the Minister must observe the criteria for revocation set out in Section 1.9 of the National Code (discussed in Section 3 of this paper). The steps involved in a revocation application, including timeframes for the current applications, are set out in Appendix 1.

If revocation is granted, the owner and operator are released from their obligations under the Act and the National Code. The owner and operator are no longer required to submit an access arrangement for the pipeline to the ACCC, to set efficient benchmark prices for access, or to respond to access requests by third parties. However, a person seeking access in the future could apply to the Council to have coverage of the pipeline reinstated under the National Code.

The NT Act includes a process for reviewing a decision to revoke coverage. The process is set out in section 38 of the *Gas Pipelines Access Law (GPAL)*, which applies as a schedule to the NT Act. In the Northern Territory, applications for review are heard by the Australian Competition Tribunal.

The GPAL can be viewed on the Code Registrar's website at: www.coderegistrar.sa.gov.au

2.4 The pipelines: background information

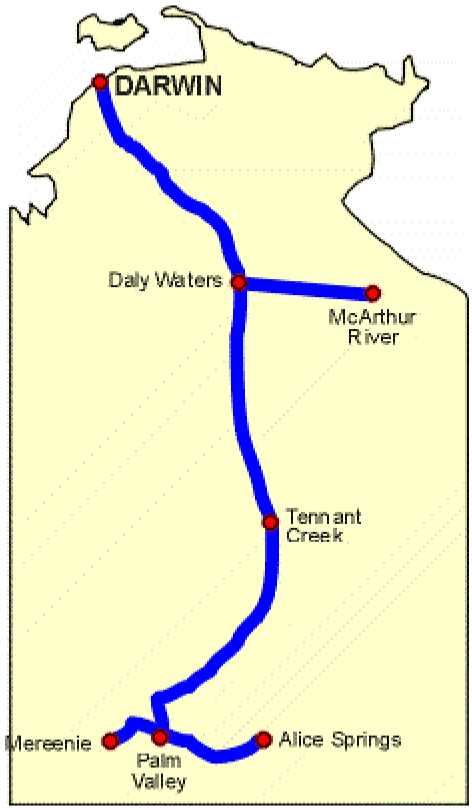

Fig 1: Northern Territory transmission pipelines

Palm Valley to Alice Springs gas pipeline

Envestra provided the following background information on this pipeline:

- owned by Envestra Limited ('Envestra'), which purchased the pipeline from Holyman Limited in January 1999.

- capacity of approximately 10 PJ per annum, with current throughput of approximately 3 PJ per annum.

- transports gas 146km from Palm Valley gas field to the Alice Springs gate station (see map) for one customer, the Northern Territory Power and Water Authority (PAWA). PAWA uses the majority of the natural gas (2.7 PJ per annum) for power generation in Alice Springs and sells small amounts to Energy Equity Ltd (0.2 PJ per annum[5]) for power generation and to Origin Energy for its Alice Springs retail operations (0.1 PJ per annum).

- there is a significant amount of uncontracted capacity (50% – 70% per annum).

- currently subject to the National Code and regulated by the ACCC. An extension of time to submit an Access Arrangement until 30 June 2000 has been granted by the ACCC.

Alice Springs gas distribution system

Envestra provided the following background information on this pipeline.

- owned by Envestra.

- primarily designed to supply domestic and small commercial customers. The network consists of 30 km of pipe that distributes 0.1 PJ of natural gas annually to 642 customers.

- currently subject to the National Code and regulated by the ACCC. An extension of time to submit an Access Arrangement until 30 June 2000 has been granted by the ACCC.

5 Energy Equity Ltd informs the Council that this figure understates the company's use of the pipeline.

3 Revocation Issues

This section outlines the criteria in the National Code against which Envestra's applications must be assessed, and the reasons underlying the Council's recommendations.

First round of consultation

The Council advertised the applications in *The Australian* and the *Northern Territory News* on 4 May 2000; and the *Centralian Advocate*, Alice Springs on 5 May. In addition, the Council consulted directly with a number of parties, including the service provider, gas producers in the Territory, gas users in the Alice Springs region, the Northern Territory Chamber of Commerce and the NT Department of Mines and Energy. Only one formal submission was received – from Clayton Utz, representing the Northern Territory Power and Water Authority (PAWA).[6]

Second round of consultation

On release of its Draft Recommendations, the Council notified all of those parties previously consulted. Further submissions were received from:

- Envestra (two submissions)
- PAWA; and
- Energy Equity Limited.

Submissions can be viewed at **www.ncc.gov.au**

The revocation criteria

Under section 1.31 of the National Code, the Council *cannot* recommend revocation of coverage if it is satisfied that a pipeline meets all of the criteria set out in section 1.9 of the Code. From another perspective, the Council *must* recommend revocation where a pipeline fails to meet one or more of the section 1.9 criteria.

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[6] PAWA's submission refers to the Palm Valley to Alice Springs pipeline only. It does not cover the Alice Springs distribution pipeline network.

The criteria set out in section 1.9 are:

(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;

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

(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; and

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

In applying the criteria, the Council considers that greater clarity flows from considering criterion (b) first. In essence, criterion (b) considers whether duplication of the infrastructure in question is inefficient, while criterion (a) considers whether this gives the facility owner leverage to restrict competitive outcomes in another market.

3.1 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 National Code (as applied by the NT Act) envisaged that access regulation should be limited to infrastructure where it is not viable to develop competing facilities. As such, access regulation should normally be confined to infrastructure with entrenched 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. In these circumstances, development of another facility can be considered a 'wasteful' or inefficient use of the community's resources.

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 continue to decrease across the range of output sought by the market.

In revocation applications, the Council must consider whether natural monopoly characteristics or other restrictions currently inhibit the construction of competing pipelines. For example, a pipeline may have been covered under the National Code at a time when it exhibited natural monopoly characteristics. However, the position may have changed due to such factors as technological innovation or growth in the market to the point where construction of another pipeline is economic.

In considering whether it is economic to build another pipeline, the Council adopts a social test rather than a private test. While a private test would consider whether it is viable for an individual to invest in a new facility, a social test considers whether building a new facility represents an efficient use of resources from the viewpoint of the community.

The Envestra applications – views put to the Council

This criterion was not addressed in the applications or in views put to the Council by stakeholders.

The Council considers that the Palm Valley to Alice Springs pipeline provides services involving the transport of gas from the Palm Valley gas fields to Alice Springs (and potentially to places along the route). The Alice Springs distribution network provides services involving the transport of gas to end users in the vicinity of Alice Springs.

In considering whether it is would be uneconomic to develop another pipeline to provide these services, the Council notes that gas pipelines typically have high construction costs and low operating costs, making the marginal cost of transporting a unit of gas very low. Moreover, up to the point of fully expanded capacity, average costs of transport per unit of gas decline. These features are indicative of natural monopoly characteristics. In lay terms, 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 gas. Duplication of a gas distribution network that services a city or town may face additional obstacles of urban town planning and environmental restrictions.

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. From a pipeline company's point of view, it is often prudent 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.

In considering the services of the pipelines that are the subject of the Envestra applications, the Council has found no evidence to suggest that these pipelines deviate from the typical characteristics noted above. The Council notes in this regard that the Palm Valley to Alice Springs pipeline is currently operating at around 30 to 50 per cent of capacity[7], suggesting that the most efficient way of satisfying any future expansion in demand would be through the services of the existing pipeline.

Recommendations

The Council recommends that the Palm Valley to Alice Springs pipeline and the Alice Springs distribution network satisfy criterion (b).

3.2 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 flow through to at least one market

7 Envestra's application.

beyond the market for the services of the particular gas pipeline. In other words, while criterion (b) considers whether a natural monopoly occurs, criterion (a) looks at whether this creates a bottleneck that allows the monopolist to inhibit competition in another market.

To satisfy this criterion, two requirements must be satisfied:

(a) regulated access must be shown to promote competition in a market separate from the market for the regulated service; and

(b) regulated access must promote a more competitive environment in that separate market, conducive to outcomes such as lower prices and/or improved service to customers.

The Envestra applications: views put to the Council

Envestra claims that there is little scope for competitive benefits to flow from regulated third party access to the pipelines. The applicant argues that:

1. No third parties have sought access, or indicated a desire to seek access, to the pipelines.

2. The market for natural gas in the Alice Springs region is miniscule on a national scale and not expected to grow significantly because:

   - Major industrial gas users do not exist in the vicinity of the pipelines, and are not forecast to do so[8];

   - In the case of the Palm Valley to Alice Springs pipeline, the gas is currently shipped for one customer, the Northern Territory Power and Water Authority (PAWA). PAWA uses 2.7 PJ per annum for its own electricity generation. The balance is on-sold to Energy Equity (0.2 PJ[9]) for power generation and Origin Energy (0.1 PJ) for its Alice Springs retail operations. Envestra argues that current and medium term regional power generation requirements will be satisfied by the existing system of four electricity generators (three owned by PAWA and one owned by Energy Equity). Envestra

8 In support of this statement, Envestra cites: Australia's Northern Territory, *Major Projects June 1998*, produced by the Department of Asian Relations, Trade & Industry and the Ministry of Regional Development.

9 Energy Equity Ltd informs the Council that this figure understates the company's use of the pipeline.

claims that additional generation capacity has not been planned for Alice Springs in the short term[10];

3. The gas transported in the pipelines is sourced from the Palm Valley field, with Mereenie used as a secondary supply source. Both fields are jointly owned by Santos Ltd and Magellan Petroleum Australia Ltd.[11] Envestra states that these fields have economic lives in excess of 25 years at current production levels, which discourages further exploration. On this basis, Envestra argues that, in the medium term, all gas transported through the Palm Valley to Alice Springs pipeline will be provided by the current producers. Envestra notes that an alternative field (Dingo, located 75 km south of Alice Springs[12]) has to date proved uneconomic to develop.

4. Gas from the Alice Springs distribution network is used predominantly by consumers for domestic heating and cooking purposes, not as an input into products for sale in a competitive market. There were 642 customers that consumed 95 TJ in 1998-99, with only one customer (the Alice Springs hospital) consuming more than 10TJ. There were 82 small commercial and industrial customers consuming less than 10 TJ per annum.

PAWA disputed the information provided by Envestra on gas reserves at Palm Valley. According to PAWA, Envestra's estimates are 1999 figures, which have since been significantly downgraded by Magellan – one of the project partners at Palm Valley. PAWA has provided a Media Release by Magellan, dated 25 January 2000, in support of this claim. PAWA claims that even the revised estimates may be too high:

> According to expert advice PAWA has received... those revised estimates are also likely to be optimistic. Given the likelihood of offshore gas becoming available in the next 5 to 9 years as an alternative supply source, and the fact that Gasgo's contract with the Palm Valley producers expires in 2012, it may be that the life of the Palm Valley field will be considerably less than the 25 years suggested by Envestra in its application.

PAWA supports Envestra's argument that third parties are unlikely to seek access to the Palm Valley to Alice Springs pipeline, citing a lack of available gas at Palm Valley as a constraining factor:

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10 In support of this statement, Envestra cities: Australia's Northern Territory, *Major Projects June 1998*, produced by the Department of Asian Relations, Trade & Industry and the Ministry of Regional Development.

11 The ownership ratios vary. Magellan is the majority owner of the Palm Valley field, while Santos is the majority owner of Mereenie. Kufpec Australia Ltd has a small minority interest in Palm Valley.

12 See diagram in Envestra's application for the Palm Valley to Alice Springs pipeline.

> ...the Pipeline was built to ship gas from the Palm Valley field to PAWA's generating facilities in the Alice Springs region and the Palm Valley field is declining. The Palm Valley Producers are unlikely to be in a position to sell gas to any third party.

PAWA notes that its current contract with Envestra expires on 1 September 2008. While PAWA supports revocation, it notes that it reserves the right to apply for the pipeline to be covered once its contract expires in 2008.

Energy Equity Ltd is a company that buys gas from PAWA to generate electricity, all of which is currently sold to PAWA. In the first round of consultation, Energy Equity informed the Council that it is considering options for expanding its generation capacity in the short to medium term. This would increase the company's demand for gas and would require access to the Palm Valley to Alice Springs pipeline. The company indicated that it would be in a position to sell the additional electricity generated into the recently deregulated market.

In the second round of consultation, Energy Equity Limited notified the Council that it had held discussions with Envestra and believes that, on balance, its access requirements can now be satisfied through commercial negotiation.

Analysis

Does a separate market exist?

The first step in satisfying this criterion is to determine whether there is a separate market in which access promotes competition. The information supplied by Energy Equity Ltd suggests that markets in which access *could* promote competition are the markets in which *electricity sales* and *gas sales* take place in central Australia.

It needs to be established whether these markets are separate from the market(s) in which *gas transportation services* are provided. In determining whether a separate market exists, the Council considers four market dimensions:

- the *product* market, which considers the types of goods and services produced.

- the *functional* market, focussing on a different stages in a production process. In considering whether functional separation exists, the Council has regard to:

    - whether the transaction costs of separate provision would act as an obstacle to separate provision such that vertical integration is not inevitable; and

    - whether each activity uses assets that are not readily substitutable.

- the *geographic dimension* of the market; for example, the market may be national or specific to a region.

- the *temporal dimension* of the market, especially relevant where market conditions are changing over time.

The Council notes that *electricity sales* can be separated from *gas transportation services* in the sense that the products of these markets are different and are not substitutable.

Gas sales can be separated from *gas transportation* services on a functional basis. In central Australia, gas transport services tend to be provided by separate businesses, using separate types of assets, from businesses that buy and sell gas.

Is competition promoted in another market?

Palm Valley to Alice Springs pipeline

In considering whether access would promote competition in the market in which gas sales take place, the Council noted in its Draft Recommendation that PAWA – the sole customer of this pipeline – is under contract with Envestra for its current needs until 2008. In the meantime, regulated access would bring no competitive benefit to PAWA and its customers unless PAWA can grow the market to ship gas above and beyond its current contractual arrangements.

The Council noted that an alternative route by which access could promote competition is through an independent party buying gas from the Palm Valley or Mereenie fields (or perhaps a new field such as Dingo) and then seeking access under the National Code to buy transport services from Envestra. This would promote competition in the market in which gas take place.

Currently, the only significant users of gas other than PAWA in Alice Springs are Origin Energy (which retails gas to Alice Spring customers), and Energy Equity (which uses gas for electricity generation). These customers currently buy their gas and gas transport services as a bundled product from PAWA. According to PAWA, Energy Equity Ltd's generating capacity is 8.5 MW, compared with 50 MW for PAWA.

In its Draft Recommendation, the Council commented on prospects raised by Energy Equity Ltd for expanding its electricity generation activities in Alice Springs, which would increase the company's demand for gas. The Council further understands that under third party access reforms in electricity, the company may be in a position to sell electricity generated above current contractual commitments. In this sense, access to the Palm Valley to Alice Springs pipeline may be needed to ship gas that would promote competition in the market in which electricity sales in central Australia take place.

The Council took note of the recent downgrading of Palm Valley gas reserves in the sense that availability of gas would be necessary for competition benefits to be realised. However, the Palm Valley to Alice Springs pipeline also interconnects with another gas field – Mereenie. The Council further noted that, given the uncertainty over future gas availability at Palm Valley, alternative fields such as Dingo may become more feasible to develop.

While ownership of gas fields in central Australia appears to be fairly concentrated at present, the Council noted PAWA's claim that natural gas from offshore should be available as an alternative supply source between 2005 and 2009. This raised the possibility of greater competition between gas suppliers. The Palm Valley to Alice Springs pipeline would presumably remain the principal means of shipping offshore gas from the Palm Valley junction to Alice Springs. The Council noted that, in this sense, access may promote competition in the market in which gas sales take place in central Australia.

For these reasons, the Council's draft recommendation was that the Palm Valley to Alice Springs transmission pipeline satisfies criterion (a). The Council noted, however, that consultation with stakeholders was continuing.

Issues raised in second round of consultation

Upstream competition in gas

In a submission on the Council's Draft Recommendation, PAWA cast doubt on prospects for greater competition in the supply of gas to central Australia. PAWA argued that while reserves are declining, the Amadeus Basin is likely to have sufficient gas to supply Alice Springs after current contracts expire. PAWA claims that possible alternatives noted in the

Draft Recommendation (offshore gas and the Dingo field) are unlikely to compete in the central Australian market. According to PAWA:

> ... it is unlikely that offshore gas will compete with Central Australian gas for the Alice Springs market, given the cost of shipping the offshore gas and in view of the small expected volumes (approximately 3-4PJ per annum) and vast distances involved (1652 km from Darwin to Alice Springs and 146 km from Palm Valley to Alice Springs).

Regarding Dingo, PAWA cites the field's low proven reserves and states that:

> for the foreseeable future, it would not be economically viable to supply gas from this field to Alice Springs or any other market.
>
> In any event, if the Dingo field was developed, given its location, the Pipeline would not be used to ship the gas to Darwin and only a small proportion of the Pipeline could possibly be used to ship gas to Alice Springs.

The Council took note of these comments and the implications for upstream competition between gas suppliers servicing central Australia.

Competition in the market in which electricity sales take place

A significant case for coverage, as initially raised by Energy Equity Limited, was the prospect of regulated access promoting competition in the market in which gas sales and electricity sales take place in central Australia.

Following release of the Draft Recommendation, Energy Equity Ltd informed the Council that it had held discussions with Envestra and now believed that its access requirements were likely to be satisfied through commercial negotiation. The company believed that, on balance, regulated access under the National Code would no longer be necessary to accommodate its needs. The Council understands that this position reflects the company's understanding that it can apply for coverage of the pipeline in the future should this position change.

A submission from Envestra in response to the Draft Recommendation indicates a willingness to negotiate with access seekers. According to the company:

> ... offering access to the pipeline is not an issue with us and we would do whatever we could to ensure it was available to any party wishing to use it. It is, after all, running at less than 50% of its capacity.

> We have consulted with all current users (Santos, Magellan, PAWA, Energy Equity and Origin Energy) and can confirm that none have raised concerns with us. In particular, we have held discussions as recently as Wednesday with Energy Equity, who, we are confident, have accepted our assurances that we would be most supportive of any endeavour on their part to increase gas throughput for additional power generation.

The company acknowledges the ongoing discipline imposed upon it by the coverage process:

> We acknowledge and accept that should any party, at some time in the future, consider coverage is necessary or even desirable, they are at liberty to seek coverage and would not meet with opposition from us.

Given that identified concerns by stakeholders now appear to have been addressed, the Council is no longer satisfied that regulated access to this pipeline is needed to promote competition in another market. The Council considers that, at present, commercial negotiation may provide an efficient means of facilitating access. Should this position change over time, the Council notes that stakeholders are free to apply for coverage to be reactivated.

Alice Springs Distribution network

In theory, regulated access to the Alice Springs distribution network could promote competition in the gas sales market by enabling customers to buy gas directly from a producer, and contract separately with Envestra to transport the gas through its transmission and distribution pipelines.

To determine the likelihood of these benefits materialising, the Council held telephone discussions with significant gas users and representative bodies: the Alice Springs Town Council, the Alice Springs hospital, and the Northern Territory Chamber of Commerce. The Chamber fax streamed its members with details of the Envestra applications. No concerns about revocation of coverage were raised with the Council.

The potential benefits to individual consumers of undertaking their own third party access arrangements are likely to be minimal, given the small volumes involved. The potential may be more significant in the case of an energy retailer. Currently, all gas shipped through the Alice Springs distribution network is sold by Origin Energy Ltd, which purchases gas from PAWA.

Regulated access would allow Origin Energy to purchase gas directly from a producer and negotiate separately on transport prices under the National Code. The potential for consumers to benefit may be limited, however, in the sense that Origin Energy is related to Origin Energy

Asset Management Ltd, which operates the pipeline on behalf of the applicant.[13] In this sense, the interests of the two companies may not be consistent.

Another possible source of competition in the gas sales market is through the entry of an independent retailer. However, the Council has received no indication that this is under consideration. The size of the Alice Springs retail market appears to limit the potential for retail competition.

Recommendations

The Council recommends that the Palm Valley to Alice Springs pipeline and the Alice Springs distribution network do not satisfy criterion (a).

3.3 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 access might pose an undue risk to human health or safety.

The Envestra applications – views put to the Council

This criterion was not addressed in the applications or in views put to the Council by stakeholders.

The Council therefore concludes that on the evidence available, access (or increased access) to the pipelines can be provided safely.

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[13] The Council understands that Origin Energy Ltd and Origin Energy Asset Management Ltd are legally distinct companies, observing the ring fencing obligations of the National Code.

Recommendations

The Council recommends that the Palm Valley to Alice Springs pipeline and the Alice Springs distribution network satisfy criterion (c).

3.4 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.

The Envestra Applications: views put to the Council

The applicant argues that regulated access to the pipelines would be contrary to the public interest because of the large regulatory costs relative to any potential benefits.

According to Envestra:

1. *Regulatory costs* for each pipeline would be about $150,000 - $250,000 for Envestra, with similar costs to the Regulator and the Northern Territory Government. These costs are ultimately recovered from the end users of gas pipeline services. Envestra argues that for pipelines with large throughput and large customer bases, third party access costs are generally not material relative to a customer's total gas cost, and the benefits of access outweigh the costs. But according to Envestra, these conditions do not apply here. Envestra states that:

   - The *Palm Valley to Alice Springs pipeline* has a relatively low throughput (3 PJ/a) and only one customer (PAWA). This means that all of the regulatory costs would be recovered from PAWA, and ultimately, from PAWA's customers.

   - The *Alice Springs distribution network* has a small throughput and a small number of customers – 559 domestic consumers, 82 small commercial/industrial (less than 10 TJ p.a.) and one customer consuming more than 10 TJ per annum (the Alice Springs hospital). The small market makes regulatory costs a significant portion of the distribution tariff (approximately $0.30 to $0.50 per GJ). The cost per consumer would be in the order of $230 to $390 for the preparation of the initial Access Arrangement, with further costs at each reset.

2. Envestra argues that the potential benefits of access are limited as no third party has requested access to the pipelines and no other significant user(s) of transportation services are likely to commence operations in the vicinity of the pipelines in the medium term.

On this basis, Envestra argues that regulatory compliance costs on Envestra, the customer, the Regulator and the Northern Territory Government would outweigh the benefits of access to these pipelines. Envestra argues that *negotiated access* (ie outside the National Code) would be the most efficient form of access for small pipeline systems such as the Palm Valley to Alice Springs Pipeline and Alice Springs distribution network.

Analysis

In response to a request from the Council for evidence in support of estimated regulatory costs cited in the applications, Envestra informed the Council that the figures are based on the experience of preparing access arrangements for other Envestra pipelines under the National Code. As examples, Envestra noted the following costs:

Pipeline	**Regulatory costs**
Mildura Transmission System	$188, 484
Riverland Transmission System	$154,215
South Australian Distribution Network	$1,154,537

Envestra notes, in a submission to the Council (available on the Council's web site) that the costs referred to cover internal labour and external consultancies:

> Internal labour relates to the time spent collecting data, tariff design, financial analysis, consultations and drafting documentation. Consultants

> are used to provide expert advice on a range of legal, economic and technical matters (*e.g.* engineering analysis for DORC). The above costs do not take into account the on-going expenses that will be incurred in managing the regulatory obligations for each asset.
>
> It should be noted that Access Arrangements for distribution networks require significantly more analysis than Access Arrangements for transmission pipelines, which is reflected in the above table.

Envestra points out that the regulatory costs estimated by Epic Energy for coverage of the South East Pipeline System in South Australia were about $150,000.[14] Envestra claims that this provides an appropriate external benchmark.

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

In addition, the Council considers that there are likely to be significant economies of scale in the preparation of access arrangements. As such, the work previously undertaken by Envestra for its other pipelines may help to cushion regulatory costs.

The quantum of regulatory costs faced by a company is also affected by the degree to which relevant information has been previously generated for internal purposes, and how much must be created specifically for regulatory purposes.

The Council accepts, however, that there would be significant costs imposed if the pipelines are regulated. These costs would include the direct costs to Envestra, the regulator, and third parties that would arise form the preparation and use of an access arrangement, and 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.

Palm Valley to Alice Springs pipeline

In its draft recommendation, the Council noted that it had found evidence of benefits from regulation under criterion (a) in the sense of access promoting competition in another market. The Council noted the difficulty in quantifying these benefits, but considered that they may be of potential significance in the context of economic conditions in central Australia.

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[14] See the Council's Final Recommendation, *Application for Revocation of South East Pipeline System (SA)*, March 2000, available on the Council's website.

The Council noted that future demand for access may be contingent on proposed investments occurring in the future. In this sense, the Council considered that there was some merit in the argument that coverage be revoked until a party is in a position to demonstrate a current need for access. The Council noted however, that coverage may be a factor encouraging marginal investments that may not otherwise proceed, in the sense that the National Code creates obligations on a pipeline company to:

- provide information to interested parties and;
- establish efficient benchmark prices.

The Council further noted that, once revoked, there may be considerable costs and delays in seeking re-coverage.

In its draft recommendation, the Council considered there to be sufficient prospect in the medium term that demand will arise for access to this pipeline to suggest that the public benefits of access outweigh the costs. However, the Council noted that it was continuing its consultation with a number of parties.

In the light of subsequent discussions with Energy Equity Ltd (see criterion (a)), the Council notes that the benefits identified now appear likely to be attained through commercial negotiation, without requiring regulation under the National Code. For this reason, the Council considers that any benefits of regulated access under the National Code may not be sufficient to outweigh the significant regulatory costs imposed through coverage.

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

Alice Springs distribution network

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

Once again, submissions did not raise any other matters to support the view that the pipeline 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.

Recommendations

The Council recommends that the Palm Valley to Alice Springs pipeline and the Alice Springs distribution network do not satisfy criterion (d).

Appendix 1: The Revocation Process

The procedure for seeking revocation of coverage of a pipeline is set out in sections 1.24 – 1.39 of the National Code. The Code can be viewed at : www.coderegistrar.sa.gov.au

In summary, the procedure is as follows:

1. Any person may apply to the Council for revocation of coverage of a pipeline.

2. If the Council considers that the application has been made on trivial or vexatious grounds, it may reject the application. In all other cases, the Council must, within 14 days of receipt of the application, inform the service provider and other interested parties, and will call for submissions by advertising the application in a national daily newspaper.

   The Council advertised the applications in *The Australian* and the *Northern Territory News* on 4 May 2000; and the *Centralian Advocate*, Alice Springs (on 5 May).

3. The closing date for the initial round of consultation was **25 May 2000**.

4. The Council must prepare a draft recommendation within 14 days of the close of the consultation period, and circulate it to the applicant, the service provider, and other interested parties (including those parties that made submissions). For this application, the Council released a draft recommendation on 8 June 2000.

5. Parties had an opportunity to make further submissions to the Council within fourteen days after the draft recommendation is made publicly available. The closing date for further submissions was **22 June 2000**.

6. The Council must consider any further submissions received and convey its final recommendation on revocation to the Relevant Minister within 28 days of the release of its draft recommendation.

   For these applications, the Council's final recommendations were sent to the Northern Territory Minister for Resource Development on 6 July 2000.

7. The Council must recommend that coverage be revoked if it is satisfied that the pipeline does not meet one or more of the criteria set out in section 1.9 of the National Code.

8. The Minister must make a decision on revocation of coverage on the basis of the same criteria applied by the Council. The Minister has 21 days from receipt of the Council's recommendations to decide the matter.

9. The Minister's decision may be appealed to the relevant appeals body (in this case, the Australian Competition Tribunal).

Appendix 2: Submissions Received

Round One

1. Northern Territory Power and Water Authority, PAWA (through Clayton Utz)

Round Two

2. Northern Territory Power and Water Authority, PAWA (through Clayton Utz)
3. Envestra (2 submissions)
4. Energy Equity Limited