Application for revocation of coverage of the Mildura distribution system under the National Gas Access Regime

Final Recommendation

December 2002

National Competition Council

Recommendation

This document contains the National Competition Council's (the Council) final recommendation in respect of an application for revocation of coverage of the Mildura distribution system under the *Gas Pipelines Access (Victoria) Act 1998* (Victorian Act). The application seeks revocation of the entire distribution system pursuant to sections 1.24 and 1.25 of the National Third Party Access Code for Natural Gas Pipeline Systems (National Gas Access Code).

The Council's final recommendation is that coverage under the National Gas Access Code of the Mildura distribution system should be revoked. The Council is not satisfied that all four of the criteria in section 1.9 of the National Gas Access Code are met for the whole of the Mildura distribution system.

This final recommendation is divided into two main parts:

Part A, which explains the legislative background to the National Gas Access Code; the concept of coverage under the regime and the Council's approach to the revocation criteria under the Code. It also examines details of the application, including specifications of the distribution system, and the structure of the natural gas industry and the state of competition in the relevant markets.

Part B, which contains the Council's detailed consideration of whether the Mildura distribution system meets each of the criteria against which revocation of coverage must be assessed (the coverage criteria).

Abbreviations and glossary of terms

$/GJ	Australian dollars per Gigajoule
$/TJ	Australian dollars per Terajoule
ACCC	Australian Competition and Consumer Commission
AGA	Australian Gas Association
Access Arrangement	A statement of policies and the basic terms and conditions that apply to third party access to a Covered Pipeline
Application	Application for revocation of coverage of the Mildura distribution system lodged by Envestra Limited dated September 2002
Council	National Competition Council
Coverage Criteria	Criteria set out in section 1.9 of the National Third Party Access Code for Natural Gas Pipeline Systems
Covered Pipeline	A pipeline covered under the National Gas Access Code
EGP	Eastern Gas Pipeline
Gas Access Acts	The Acts in each State and Territory which provide for third party access to the services of natural gas pipelines. The Acts apply the Gas Pipelines Access Law and the National Gas Access Code as law in those jurisdictions
Gas Pipelines Access Law	In conjunction with the National Gas Access Code and the Gas Access Acts, sets out provisions of the regime for third party access to the services of gas pipelines
GJ	Gigajoule, a unit of measurement for measuring the energy content of natural gas or other energy sources
GST	Goods and services tax
National Gas Access Code	National Third Party Access Code for Natural Gas Pipeline Systems

Pipeline	Defined in the National Gas Access Code and the GPA as a pipe or system of pipes for transporting natural gas and tanks, machinery, etc attached to the pipes, but does not include any facilities of the upstream processing plant, or anything downstream of the connection point to the consumer
PJ	Petajoule (equal to 1,000,000 GJ or 1,000 TJ)
PJ/a	Petajoules per year
PJ/d	Petajoules per day
TJ	Terajoule (equal to 1,000GJ)
TJ/a	Terajoules per annum
TJ/d	Terajoules per day
Victorian Act	*Gas Pipelines Access (Victoria) Act 1998*. The act which applies the National Gas Access Code to gas pipelines in Victoria.

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Part A–Legislative background

The National Gas Access Code

The Victorian Act applies the National Gas Access Code to gas pipelines in Victoria.

The National Gas Access Code entitles parties to negotiate access to the transport capacity in natural gas transmission pipelines and distribution networks which are covered by the National Gas Access Code within an independent regulatory framework. The National Gas Access Code sets out the rights and obligations of service providers, pipeline users and access seekers. It includes coverage rules, the operation and content of access arrangements, ring-fencing arrangements, information parameters, dispute resolution and pricing principles.

Mechanism for revoking coverage

The National Gas Access Code allows parties to seek revocation of coverage of a pipeline under the Code. Applications for revocation of coverage must be made to the National Competition Council. Following consideration of issues raised in public consultations, the Council issues a draft recommendation, conducts a further public consultation process then conveys a final recommendation to the relevant Victorian Minister, who decides the matter. Both the Council and the Minister must consider the criteria set out in Section 1.9 of the National Gas Access Code. Those criteria are set out in Appendix 2.

If the Minister decides to revoke coverage of a pipeline, the owner and operator of that pipeline are released from their obligations under the Gas Access Act of the applicable state or states and the National Gas Access Code.

The Victorian Act includes a process for administrative (merits based) reviews of decisions to revoke coverage. The process is set out in section 38 of the Gas Pipelines Access Law. The Australian Competition Tribunal would hear any application for review.

The revocation criteria

Under section 1.31 of the National Code, the Council cannot recommend revocation of coverage unless it considers the pipeline in question does not meet one of the criteria set out in section 1.9 of the Code. From another perspective, where a pipeline does not meet all of the criteria set out in section 1.9 of the Code, the Council must recommend revocation of that pipeline.

The Council may recommend revocation either to the extent sought, or to a greater or lesser extent than sought in the application.[1]

The criteria in section 1.9 are:

(a) **that access (or increased access) to services provided by means of the pipeline in question 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 in question;**

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

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

Process for considering the criteria

For the Council to recommend against revocation of coverage it must be affirmatively satisfied of all the matters set out in section 1.9.

AGA submitted that the Council bears a burden of proof “in relation to the imposition of intrusive access pricing regulation on infrastructure assets” (AGA 2002, p. 3). They refer to a statement from Ordover where he commented:

> *For competition to thrive, regulators need to let the market processes work…to facilitate the transition to competition managed by market*

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

> *forces instead of regulations, maximal forbearance should be the guiding regulatory principle. The scope of regulatory remedies ought to be reduced, not expanded, as competition develops. Regulators should face a strong burden of proof to show that there is a significant risk of abuse of a substantial degree of market power before imposing regulatory restraints and burdens on the incumbent firm.* (Ordover 2000, p. 5) (emphasis added)

The Council considers that Governments have already taken these concerns into account through the coverage criteria in section 1.9. These criteria are designed to ensure that regulation is only imposed on pipelines with the ability to affect competition in dependent markets, i.e. with significant market power.

In interpreting the National Gas Access Code criteria, the Council has used general principles of statutory interpretation and has accorded primacy to the language of the coverage criteria. In addition, the Council has regard to the following matters:

1. Relevant decisions of the Tribunal. The criteria have been considered by the Tribunal in the *Eastern Gas Pipeline decision*.

2. The objectives underlying the National Gas Access Code.

3. Decisions of the Tribunal in relation to applications for declaration under part IIIA of the *Trade Practices Act 1974*. This is because, apart from some minor variations (the significance of which will be discussed where relevant), the words of the coverage criteria in section 1.9 of the Gas Code are the same as the words of the declaration criteria in section 44G(2) of the TPA.

4. Previous applications for coverage, and revocation of coverage, of gas pipelines by the Gas Code considered by the Council. The Council also has had regard to the work of Janusz A Ordover and William Lehr, *Should Coverage of the Moomba to Sydney Pipeline be Revoked?* (Ordover and Lehr 2001), which focused specifically on the East Australian Pipeline Limited's application for the revocation of coverage of two pipelines within the Moomba to Sydney Pipeline System (MSP) by the Gas Code.

It should be noted that, in their submission, the AGA states that they are unclear on what basis the Council can legitimately rely on the Ordover and Lehr analysis commissioned in relation to the MSP revocation application as a general guidance (AGA 2002, p. 2). They state that:

> *[T]he AGA does not believe that the commissioned advice in that matter was appropriately sought or relied upon, or that the advice itself accurately described or assisted the process of determining coverage of assets under the National Gas Code. The continued inappropriate use of this advice as a guide to the interpretation of the coverage provisions of the National Gas Code may lead to a substantial risk of regulatory error in Council deliberations. Reliance*

> *on the advice of academic commentators as to the interpretation of the Code's coverage criteria would also appear to be unnecessary given the substantial guidance given to the Council on this matter by the Australian Competition Tribunal in the Duke Eastern Gas Pipeline Pty Ltd decision.* (AGA 2002, pp. 2-3)

Though the work done by Ordover and Lehr was commissioned in the context of the MSP revocation application, the report proposed a generic model for analysing criterion (a): focussing on the ability and incentives open to a pipeline owner to exploit market power in a dependent market. The report draws on this framework to develop the Tribunal's approach in the Eastern Gas Pipeline decision into a model for assessing competitive conditions in dependent markets. The model provides a broad analytical framework that encompasses each factor identified by the Tribunal, as well as other relevant factors, and may be applied in a wide range of circumstances. Consequently the Council considers it appropriate to adopt this framework in considering whether the Mildura distribution system satisfies criterion (a). The Council reiterates that the Ordover and Lehr framework is wholly consistent with the Tribunal's approach, but further develops that approach by providing a robust theoretical framework that may be applied to any coverage matter under the Code.

This recommendation considers the criteria in a different order from that laid out in the National Gas Code. Conceptually, the Council considers it logical to begin with criterion (b), as it focuses on the issue of the service to which access is sought and the pipeline providing that service and asks whether that pipeline exhibits natural monopoly characteristics. Criterion (a) is wider in scope as it requires consideration of industry structure, the related but distinct markets dependent on the service and whether the service provider is able to exercise market power in those related markets because the provision of the service has natural monopoly characteristics. This approach is consistent with the approach adopted by the Tribunal in the *Eastern Gas Pipeline decision*.

The process adopted by the Council for considering the criteria can be broadly summarised as follows:

- define the service provided by means of the Mildura distribution system, delineate the physical assets that comprise it and identify the "provider" of the "service". In the Council's Final Recommendation on the application from Roma Town Council to revoke coverage of the Roma distribution system from the provisions of the *Gas Pipelines Access (Queensland) Act 1998*, the Council defined the service as being "a gas transportation service to gas consumers in the Roma area.";

- examine whether it is economic to develop another pipeline to provide the service. Coverage is confined to facilities exhibiting natural monopoly characteristics – that is, where for a likely range of reasonably foreseeable demand for the service, it would be cheaper for the Mildura distribution system to provide those services rather than two or more pipelines. Such an assessment is relevant to whether criterion (b) is met;

- if development of another pipeline to provide the service would be uneconomical, for the purposes of criterion (a) assess whether coverage of the service will improve the conditions or environment for competition in a dependent market. Whether the conditions for competition will be enhanced depends critically on whether the natural monopoly characteristics associated with the provision of the service confer substantial market power on the service provider that can be exercised to adversely affect competition in a dependent market(s). As part of this evaluation, dependent markets will need to be identified, as will factors affecting the ability and incentive to exercise market power to adversely affect competition in a dependent market(s). Such an assessment is relevant to whether criterion (a) is met;

- assess whether access to the service can be provided safely. This is relevant to criterion (c); and

- determine whether access would not be contrary to the public interest. This is relevant to criterion (d). This criterion comes into play if the other criteria are satisfied and enables account to be taken of other factors not raised under the other three criteria, e.g. regulatory costs involved in providing access, transitional pricing arrangements.

Submissions

The Council received the application on 23 September 2002. In accordance with section 1.26 of the National Gas Access Code, the Council advertised the application in *The Australian Financial Review* and in the *Sunraysia Daily* (a regional newspaper covering the Mildura region) on 7 October 2002, and wrote to interested parties calling for submissions. The Council also published a copy of the application, and invited submissions, on its website. The Council received 2 submissions, which have been published on the Council's website. Both submissions consider that coverage of the Mildura distribution system should be revoked (AGA 2002, p. 2).

In accordance with section 1.26 of the National Gas Access Code, the Council released its draft recommendation on 11 November 2002 and called for submissions in relation to it. The Council received no submissions.

The application

The applicant, Envestra Limited, owns and operates the Mildura distribution system. The applicant seeks revocation from coverage for the entire Mildura distribution system under sections 1.24 and 1.25 of the National Gas Access Code.

The pipeline

According to the application, the Mildura distribution system serves customers in the area of the city of Mildura and the nearby townships of Merbein, Red Cliffs and Irymple. The distribution system supplies gas to a total of 890 customers through approximately 100 km of small diameter polyethylene pipe. Gas for the Mildura distribution system originates in the Cooper Basin and is transported through the Moomba to Adelaide Pipeline and then the Riverland and Mildura Transmission pipelines. The Mildura distribution system delivers an annual volume of gas of about 254 terajoules (TJ). Origin Energy is responsible for retailing the gas (Envestra 2002, p. 2).

According to the application, the customer profile for 2000/2001 was:

Table 1: Customer profile in 2000-2001 of the Mildura distribution system

Category	No. Customers	%	Annual Load (TJ)	%
Domestic	788	88	14	6
Commercial	96	11	57	22
Industrial	6	1	183	72
Total	890	100	254	100

Source: Envestra 2002, p. 2

The pipeline is a distribution pipeline that became covered through a competitive tender process approved by the Office of the Regulator-General (now the Essential Services Commission) under transitional provisions of the Victorian Act.

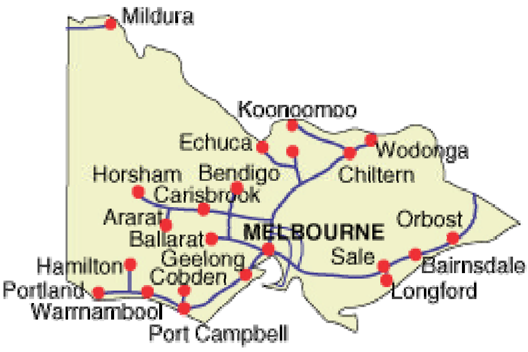
Natural gas in Victoria

Approximately 94 percent of Victoria's gas comes from the Gippsland Basin. It is transmitted through a transmission pipeline grid owned by GPU International. The remainder comes from gas reserves in the Otway Basin. As sated, gas for Mildura comes from the Cooper Basin and is piped through the Moomba to Adelaide Pipeline and then the Riverland and Mildura Transmission pipelines (AGA 2001, p. 32)

Most natural gas in Victoria is distributed by TXU Networks, Envestra and United Energy (which manages Multinet Gas). Approximately 1.56 million domestic customers in Victoria are supplied with gas through 25,121 km of mains, while industrial and commercial consumers accounted for 49.4 percent of gas sales in 1999-2000. The Essential Services Commission regulates gas distribution and retailing in Victoria pursuant to the *Gas Industry Act 2001*, the *Essential Services Commission Act 2001*, and the National Gas Access Code. Access Arrangements are in place for these distributors and set out fair and reasonable terms and conditions for third parties to access the monopoly distribution gas networks.

It should be noted that the Mildura distribution system is not interconnected to these distribution systems. To this extent, regulatory instruments such as the Tariff Order and the Gas Distribution System Code do not apply to it.

Full retail competition was extended to all natural gas customers in Victoria from October 2002. Suppliers issued with a licence to retail natural gas in the State comprise AGL Energy Sales & Marketing, BHP Billiton Petroleum, CitiPower, ENERGEX Retail, EnergyAustralia, Ergon Energy Gas, Esso Australia Resources, Gascor, Origin Energy (Vic), Origin Energy Retail, Pulse Energy and TXU.



source: Australian Gas Association website - http://www.gas.asn.au

Part B - Coverage criteria

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

The Council's approach to criterion (b)

In analysing this criterion, the Council will:

- define the service provided by the Mildura distribution system; and
- assess whether it is economic to develop other pipelines (including both existing pipelines and new pipelines) to provide that service.

Service

In the *Eastern Gas Pipeline decision*, the Tribunal decided that the "service" provided by means of the Eastern Gas Pipeline was a haulage service for the transport of gas between one point on the pipeline and another:

> *The question of what constitutes the services provided by the pipeline is fundamentally a mixed question of fact and the proper construction of criterion (b), rather than a matter of economic analysis. Every haulage service will of necessity be from one point to another. That is the commercial service actually provided by the pipeline operator to its customers.* (Eastern Gas Pipeline decision 2001, paragraph 69)

In the Council's Final Recommendation on the application from Roma Town Council to revoke coverage of the Roma distribution system from the provisions of the *Gas Pipelines Access (Queensland) Act 1998*, the Council defined the service as being "a gas transportation services to gas consumers in the Roma area."[2] On this approach the service provided by the Mildura

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[2] Similarly, in the Council's Final Recommendation on the application from Dalby Town Council to revoke coverage of the Dalby distribution system from the

distribution system could be described as a "gas transportation service to gas consumers in the Mildura area".

The applicant submits that the service can be described as the "gas transportation service to gas customers in the Mildura area" (Envestra 2002, p. 3).

Conclusion on service definition

The Council considers that the service provided by the Mildura distribution system is the transportation of natural gas to gas consumers in the Mildura area.

Uneconomic to develop another pipeline

In considering whether it is uneconomic to develop another pipeline, it is appropriate to have regard to pipelines that have already been developed (Eastern Gas Pipeline decision 2001, paragraph 57).

The term "develop" is sufficiently broad to encompass modifications or enhancements to existing pipelines. Thus, if an existing pipeline does not presently provide the services provided by the pipeline in question, but could economically be modified or expanded to do so, then criterion (b) is not met. This is consistent with the Tribunal's approach in the *Eastern Gas Pipeline decision* (paragraphs 55-57).

In the present case, the Council must therefore have regard to whether it would be uneconomic to develop either new or existing pipelines to provide the services of the Mildura distribution system.

Uneconomic

The Tribunal explained the concept of uneconomic as follows:

> *... if a single pipeline can meet market demand at less cost (after taking into account productive, allocative and dynamic effects) than two or more pipelines, it would be "uneconomic", in terms of criterion (b), to develop another pipeline to provide the same services.* (Eastern Gas Pipeline decision 2001, paragraph 64)

The Tribunal cast the test for whether it was uneconomic to develop another pipeline "in terms of costs and benefits to the community as a whole" (Eastern Gas Pipeline decision 2001, paragraph 137). By emphasising efficiency "in

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provisions of the *Gas Pipelines Access (Queensland) Act 1998*, the Council defined the service as being "a gas transportation services to gas consumers in the Dalby area."

terms of costs and benefits to the community as a whole", the Tribunal endorsed a 'social' approach to the assessment of whether development of another pipeline was uneconomic.[3] This approach follows from that adopted by the Tribunal in the *Sydney Airport decision*.[4]

The social approach to the test therefore takes account of all relevant costs and benefits faced by society rather than being limited to private costs and benefits faced by the party considering development of another pipeline. The Tribunal has explained the rationale for this approach as follows:

> *…the uneconomical to develop test should be construed in terms of the associated costs and benefits of development for society as a whole. Such an interpretation is consistent with the underlying intent of the legislation, as expressed in the Second Reading Speech of the Competition Policy Reform Bill [which inserted Part IIIA into the Trade Practices Act 1974], which is directed at securing access to "certain essential facilities of national significance". This language and these concepts are repeated in the statute. This language does not suggest that the intention is only to consider a narrow accounting view of "uneconomic" or simply issues of profitability.*
>
> *… If "uneconomical" is interpreted in a private sense then the practical effect would often be to frustrate the underlying intent of the Act. This is because economies of scope may allow an incumbent, seeking to deny access to a potential entrant, to develop another facility while raising an insuperable barrier to entry to new players (a defining feature of a bottleneck). The use of the calculus of social cost benefit, however, ameliorates this problem by ensuring the total costs and benefits of developing another facility are brought to account. This view is given added weight by Professor Williams' evidence of the perverse impact, in terms of efficient resource allocation, of adopting the narrow view.* (Sydney Airport decision, paragraphs 204 - 205)

Ordover and Lehr provide guidance on the social interpretation of 'uneconomic' in the context of the Moomba-Sydney pipeline:

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3 The Tribunal in the *Eastern Gas Pipeline decision* later confirmed its social costs approach to criterion (b) when it concluded that the Eastern Gas Pipeline met criterion (b) "because it would be uneconomic in a social costs sense to develop [another pipeline] to provide the services provided by means of the [Eastern Gas Pipeline]" (*Duke Eastern Gas Pipeline case*, para 144).

4 The *Sydney Airport decision* was concerned with interpretation of the term "uneconomical" in the declaration criterion in Part IIIA of the Trade Practices Act. The Tribunal in the Duke Eastern Gas Pipeline case stated that nothing turned on the difference between the term "uneconomic" in criterion (b) and the term "uneconomical" in Part IIIA of the Trade Practices Act (*Duke Eastern Gas Pipeline case*, para 58).

> *When [criterion (b)] is met, the total cost of transporting gas is minimized (and the goal of economic efficiency is served) when the activity is undertaken by one firm rather than by two or more firms. In the instant case, firms demanding transportation of natural gas between the production fields in Cooper Basin and the retail markets in NSW/ACT could not efficiently develop another pipeline that could compete with MSP without the overall cost of gas transport increasing. Such wasteful duplication of assets would engender inefficiencies to the detriment of the consuming public. Therefore, when criterion (b) is satisfied, it is efficient for firms wishing to ship gas between Cooper Basin and the NSW/ACT retail markets to avail themselves of the services provided by the MSP rather than constructing another pipeline. Coverage, if mandated, assures third parties access to the MSP.* (Ordover and Lehr 2001, p.6)

Noting the findings of the Tribunal and the views of Ordover and Lehr, the Council considers that criterion (b) is satisfied if a single pipeline can satisfy demand for relevant services at lower cost than two or more pipelines. The pipeline is then a natural monopoly[5], and competition between two or more pipelines offering the same services would be inefficient (Ordover and Lehr 2001, p.4).

Thus, for the purpose of criterion (b), a natural monopoly exists if for a likely range of reasonably foreseeable demand it is always cheaper for a single pipeline to provide the service under consideration rather than multiple pipelines. In determining whether such a natural monopoly exists the Council is required to:

- determine the reasonably foreseeable demand for the service provided by the Mildura distribution system; and

- assess whether the Mildura distribution system can serve the reasonably foreseeable demand for the service under consideration at lower costs than two or more pipelines.

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5 Ordover and Lehr 2001 provide the following technical description of “natural monopoly” at p.4: Formally, a provision of a particular product or service is a natural monopoly if, over the entire relevant range of outputs, the firms’ cost function is subadditive. A cost function C(q) is subadditive at q if it is always cheaper to produce a vector of outputs, q, in a single firm then by partitioning the output among two or more firms. For further discussion of these technical characteristics, see Sharkey, William, *The Theory of Natural Monopoly*, Cambridge University Press: Cambridge, (1982) and W J Baumol, J C Panzar, and R D Willig, *Contestable Markets and the Theory of Industry Structure*, HBJ Publishers: New York (1982).

Demand for natural gas in Mildura and the capacity of the Mildura distribution system to provide for it

Empirical data showing the current and forecast demand for gas from the Mildura distribution system is limited. Hence, the Council has attempted to derive the relevant demand from the following information:

- the current demand for gas in the Mildura area;
- the current levels of gas supplied by the Mildura distribution system;
- the current contracted capacity of the Mildura distribution system;
- estimates of the foreseeable demand for Mildura distribution system gas and
- the current economic population of the Mildura area and future projections of the growth of the area.

Currently, the Mildura distribution system transports 254TJ/a (Envestra 2002, p. 2).

It is estimated that the Mildura Rural Council area will increase its residential population by approximately 9% in the next 10 years (Department of Infrastructure 2000). Although empirical data of estimated demand for Mildura distribution system gas in the foreseeable future is unavailable, for the applicants, there "is a significant shortfall between forecast and actual load, meaning that the Network has an abundance of spare capacity that will be available for many years". (Envestra 2002, p. 4) This is reflected in the tables below:

Table 2. Forecast versus actual load

Gas Load (TJ)		*99/00*	*00/01*	*01/02*
Industrial	F/cast	227	257	257
	Act	51	164	183
Commercial	F/cast	118	182	186
	Act	18	61	57
Domestic	F/cast	35	103	133
	Act	0.4	5	14
Total	F/cast	379	541	575
	Act	69	230	254

Source: Envestra 2002, p. 4

Table 3. Forecast versus actual customer numbers

No. Customers		*99/00*	*00/01*	*01/02*
Industrial	F/cast	6	6	6
	Act	3	5	6
Commercial	F/cast	126	241	253
	Act	33	69	96
Domestic	F/cast	1736	5137	6639
	Act	147	440	788
Total	F/cast	1868	5384	6898
	Act	183	514	890

Source: Envestra 2002, p. 4

Envestra has orally advised that the Mildura transmission pipeline, which feeds into the system, is only running at 30% capacity.

Given the current under use of the Mildura distribution system and the projected industrial growth and growth for natural gas demand in the Mildura area, the Council considers that the Mildura distribution system has sufficient capacity to cope with future demands for natural gas to consumers in the Mildura area.

Developing a new pipeline

The applicant does not submit that it would be economic to develop a new pipeline to provide the services provided by means of the Mildura distribution system.

Investment in gas distribution 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 entry and exit costs to provide these services are high, and that incremental or gradual entry – a common form of entry in other industries – is not feasible in gas distribution.

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.

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. Moreover in the case of distribution systems, such as this one, there are additional obstacles of additional obstacles of urban town planning and environmental restrictions.

In summary, therefore, it is generally not economic to develop another pipeline where an existing pipeline has 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 Mildura distribution system, the Council has found no evidence to suggest that it deviates from the typical characteristics noted above. The Council notes in this regard that the Mildura distribution system is currently servicing only 13% of forecast customers (and 44% of forecast load), suggesting that the most efficient way of satisfying any future expansion in demand would be through the services of the existing distribution system. The Council notes that the applicant has conceded that it is uneconomic to develop an existing pipeline.

Develop existing pipelines

As noted by the Tribunal in the *Eastern Gas Pipeline decision*, section (b) includes consideration of whether it would be economic to develop another existing pipeline to provide the services provided by the Mildura distribution systems. There is no evidence to suggest that there is another pipeline that could be developed to provide a substitute service to that of the Mildura distribution system.

Conclusion on criterion (b)

The Council is affirmatively satisfied that, for the likely range of reasonably foreseeable demand for the transportation of gas on the Mildura distribution system to the Mildura area, it is more efficient, in terms of the costs and benefits to the community as a whole, for the Mildura distribution system to provide those services rather than for those services to be provided by more than one pipeline.

The Council is therefore satisfied that criterion (b) is met.

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.

The Council's approach to criterion (a)

Criterion (a) specifies that coverage is only warranted if regulated access would create the conditions or environment for improving competition in at least one market other than the market for the services of the gas pipeline.

To conclude that a pipeline meets criterion (a), the Council must be satisfied that:

(a) the service to which access is sought is not in the same market as the market or markets in which competition is promoted; and

(b) access would promote a more competitive environment in that other market.

Market

In considering market definition, the Council is guided by the decisions of the Federal Court, the Tribunal and the High Court in their consideration of markets for the purposes of Part IV; as well as the Tribunal's and the Courts' consideration of Part IIIA.

The Tribunal has defined "market" in the following way:

> *"A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them (if there is no close competition there is of course a monopolistic market). Within the bounds of a market there is substitution - substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive. ... Whether such substitution is feasible or likely*

> *depends [on a number of factors] ... in determining the outer boundaries of the market we ask a quite simple but fundamental question: If the firm were to `give less and charge more' would there be, to put the matter colloquially, much of a reaction?"* (Re Queensland Co-operative Milling Association Ltd (1976) 25 FLR 169 at 190).

This view of market has been accepted by the High Court in the Queensland Wire decision (*Queensland Wire Industries Pty Ltd* v *The Broken Hill Proprietary Ltd and Another* (1989) 167 CLR 177) and was adopted by the Tribunal in the *Sydney Airport* and *Eastern Gas Pipelines* decisions.

Dimensions of markets

The relevant dimensions of markets include the following:

- The product market, that is the types of goods and services in a market. Separate product markets exist if their respective products are not substitutable in demand or supply. Products are demand substitutes (and are therefore in the same product market) if consumers will substitute one product for the other following a small but significant change in their relative prices. Substitution in supply occurs when a producer can readily switch its assets from producing one product to another. Market entry can be distinguished from supply side substitution by the requirement for significant investment in production, distribution or promotion.

- The functional market. Functional market definition focuses on the different steps in a production process. In defining functional markets, the Council has had regard to the Tribunal's approach to functional market delineation in the *Sydney Airport case*[6] which is consistent with the approach used by the High Court in *Queensland Wire* and developed by Mr Henry Ergas (Ergas 1997, pp. 1 - 3). The Council considers that the two following conditions must be satisfied before markets can be regarded as functionally separate.

  – The layers at issue must be separable from an economic point of view (*economically separable*). This involves an assessment as to whether the transaction costs in the separate provision of the good or service at the two layers are so large as to prevent such separate provision from being feasible. In effect, to be in different markets, vertical integration must not be inevitable.

  – Each layer must use assets sufficiently specific and distinct to that layer such that the assets cannot readily produce the output of the other layer (*economically distinct*). In effect, supply side substitution must not be so readily achievable as to unify the field of rivalry between the two layers.

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6 See paras 91 – 99.

Markets may be functionally separate even though there is a *one for one* relationship, that is to say, perfect supply and demand side complementarity. However, where complementarity is associated with economies of joint production or consumption such that separate provision or consumption was not economically feasible, the services will not be in functionally separate markets.

- The geographic dimension of the market. This refers to the area covered by the market such as national, intrastate or regional markets. The reference to 'other markets' in criterion (a) includes markets outside Australia.
- The temporal dimension of the market. refers to the period over which substitution possibilities should be considered. The temporal dimension may impact on how broadly the market is defined. With a longer time dimension, the ability of consumers to substitute to other sources of supply in response to a price increase is likely to be greater. For example, with a sufficiently long time dimension, gas consumers can switch to alternative fuels (e.g. oil) or sources of power (e.g. electricity) in response to an increase in the price of natural gas. The Council has considered each of these factors in its assessment of criterion (a).

Market analysis

The market likely to be affected by a decision to revoke coverage of the Mildura distribution system is the market(s) encompassing gas sales in the Mildura region.

The application states that:

> *In determining what the "market" is, Envestra notes that there is no fundamental difference in respect of the markets in the Mildura, Dalby or Roma networks, the latter two networks having been granted revocation* (Envestra 2002, p. 3)

The relevant downstream markets identified in those latter cases were the markets for the provision of natural gas to meet the demands of gas consumers in the respective towns. In defining the scope of this market(s) the Council focuses on the market dimensions identified above.

The Tribunal has previously considered that the relevant product market is the market for natural gas; and there are a number of functional levels in the natural gas market including transmission, exploration, sales and distribution (Eastern Gas Pipeline decision 2001, paragraph 77).

The Council considers that the geographic scope of the market is defined by the dimensions of the distribution system in the City of Mildura and the nearby townships of Merbein, Red Cliffs and Irymple.

Conclusion on markets

The Council is satisfied that the gas sales market in the City of Mildura and surrounding towns is separate from the market for gas distribution services in the City of Mildura and surrounding towns.

Promotion of competition

Criterion (a) requires consideration of whether regulated access under the National Gas Access Code would promote competition in a dependent market.

The notion of competition is central to Australian trade practices law. Competition is a dynamic process, generated by market pressure from alternative sources of supply and demand. In this sense, competition expresses itself as rivalrous market behaviour. The key feature of effective competition is that no one seller (or group of sellers) or buyer (or group of buyers) has sustained and substantial market power.

The Federal Court, in the QCMA decision, described “competition” as follows:

> *“Competition expresses itself as rivalrous market behaviour … In our view effective competition requires both that prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers and customers.*
>
> *Competition is a process rather than a situation. Nevertheless whether firms compete is very much a matter of the structure of the markets in which they operate.* (Re Queensland Co-operative Milling Association Ltd; Re Defiance Holdings Limited (1976) 25 FLR 169,188).

Promotion of competition refers to improving the opportunities and environment for competition such that competitive outcomes are more likely to occur. In considering s.44H(4)(a) of the TPA, on which criterion (a) of the National Gas Code is based, the Tribunal in the *Sydney Airport decision* made the following observations on the promotion of competition test:

> *The Tribunal does not consider that the notion of “promoting” competition in s 44H(4)(a) requires it to be satisfied that there would be an advance in competition in the sense that competition would be increased. Rather, the Tribunal considers that the notion of “promoting” competition in s 44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration.*
>
> *We have reached this conclusion having had regard, in particular, to the two stage process of the Part IIIA access regime. The purpose of an*

> *access declaration is to unlock a bottleneck so that competition can be promoted in a market other than the market for the service. The emphasis is on "access", which leads us to the view that [section] 44H(4)(a) is concerned with the fostering of competition, that is to say it is concerned with the removal of barriers to entry which inhibit the opportunity for competition in the relevant downstream market. It is in this sense that the Tribunal considers that the promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial.* (Sydney Airport decision, paragraphs 106 - 107)

The Tribunal added:

> *The Tribunal is concerned with furthering competition in a forward looking way, not furthering a particular type or number of competitors. In this matter, therefore, the Tribunal must be reasonably satisfied that declaration would, looking forward, improve on the competitive conditions in the relevant markets that are likely to exist as a result of the [Sydney Airports Corporation Limited] tender process as compared with a situation where there was no declaration.* (Sydney Airport decision, paragraph 108)

The Tribunal in the *Eastern Gas Pipeline decision* endorsed this approach:

> *The Tribunal* [in the Sydney Airport decision] *concluded that the TPA analogue of criterion (a) is concerned with the removal of barriers to entry which inhibit the opportunity for competition in the relevant downstream market. It is in this sense that the notion of promotion of competition involves a consideration that if the conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial. We agree.* (Eastern Gas Pipeline decision 2001, paragraph 75).

Consistent with the Tribunal's findings, the Council concludes that "promotion of competition" refers to improving the environment or conditions for competition. This may, for example, involve removing barriers to entry that inhibit opportunities for competition. Similarly, it may involve removing barriers that limit the ability of small players to expand their level of operations within a market.

In the *Eastern Gas Pipeline decision*, the Tribunal found that the ability to exercise market power in a dependent market is a key factor in determining whether coverage would promote competition:

> *Whether competition will be promoted by coverage is critically dependent on whether EGP has power in the market for gas transmission which could be used to adversely affect competition in the upstream or downstream markets. There is no simple formula or mechanism for determining whether a market participant will have sufficient power to hinder competition. What is required is*

consideration of industry and market structure followed by a judgment on their effects on the promotion of competition (Eastern Gas Pipeline decision 2001, paragraph 116).

Ordover and Lehr describe the economic definition of market power as follows:

In economics, market power is defined as the ability to profitably raise prices above marginal cost. Any firm – other than a firm operating in a perfectly competitive market – can have, in principle, some ability to raise price above marginal cost: all that is required is that the firm faces a downward-slopping demand curve. Indeed, under some cost conditions, pricing at marginal cost would ruin the firm and is thus a precondition for financial viability.[7] *Regulatory concerns arise only if the firm possesses significant and durable market power leading to prices that substantially deviate from proper economic costs and which generate persistent supracompetitive returns. When a firm possesses substantial and durable market power, it is often said to possess "monopoly power." Additionally, a firm with market power may have both an incentive and ability to engage in market strategies designed to protect its monopoly profits and power to the detriment of competition and consumers.*[8] (Ordover and Lehr 2001, p.7)

With or without coverage

As has been noted, the Tribunal found in the *Sydney Airports decision* that the "promotion of competition" test requires an assessment of whether regulated access would improve the competitive conditions in relevant markets, compared with the conditions likely to exist absent regulation (Sydney Airport decision, paragraph 108).

The Tribunal endorsed this approach in the Eastern Gas Pipeline decision:

... the question posed by criterion (a) is whether the creation of the right of access for which the Code provides would promote competition in another market. The enquiry is as to the future with coverage and without coverage. We agree with the approach adopted by the Tribunal in Sydney International Airport in this respect. The Tribunal must have regard to the position as it now stands, insofar as it provides a reliable guide to the future without coverage. Thus, (assuming the present is a reliable guide to the future without) account is to be taken of the EGP as an open access pipeline, and of any other pipelines

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7 "For example, marginal cost pricing will fail to recover total costs if there are substantial fixed costs."

8 "Of course, firms generally strive to protect or enhance their market positions. Such quest for profits and market share is, indeed, an engine of competition and should not be discouraged. See, for example, Jeffrey Church and Roger Ware, *Industrial Organisation*, Irwin/McGraw Hill, Boston (2000)."

> *supplying the upstream or downstream gas markets, in order to determine whether coverage of the EGP would promote competition in at least one of those markets* (Eastern Gas Pipeline decision, para 74).

Council's consideration

Therefore the Council needs to consider whether Envestra has an ability and incentive to exercise its market power in the market for gas sales in the City of Mildura and surrounding towns.

In the *Eastern Gas Pipelines decision*, the Tribunal considered a range of factors in assessing whether the Eastern Gas Pipeline could exercise market power in a dependent market, including:

- the commercial imperatives on Duke Energy to increase throughput, given the combination of high capital costs, low operating costs and spare capacity;
- the countervailing market power of other participants in the dependent markets;
- the existence of spare pipeline capacity; and
- competition faced by Duke Energy from alternatives to the use of the Eastern Gas Pipeline in the dependent markets (i.e. the services of the Moomba to Sydney Pipeline and the Interconnect).

Following its consideration of these factors, the Tribunal concluded that the Eastern Gas Pipeline did not have market power in the dependent markets.

The Tribunal did not indicate that the list of factors on which it based its decision was necessarily an exhaustive one for assessing competitive conditions in dependent markets in all instances. Rather, the Tribunal focussed on pertinent aspects of industry and market structure of specific relevance to the Eastern Gas Pipeline.

There are two plausible reasons why a service provider with monopoly power over the provision of a service (provided by means of a pipeline) might use this power to impact competition in a dependent market or markets. First, it may seek to do this to exploit its monopoly position in the provision of the service. Second, insofar as it is (or plans to be) vertically integrated, it may seek to extend, protect or exploit whatever market power it may have in a dependent market or markets.

It is only where the service provider has both the incentive and ability to use its presumed monopoly power to adversely effect competition in the dependent market(s) that coverage will be likely to improve the conditions for competition in the market(s). The Ordover and Lehr model proposes three lines of inquiry for assessing whether a pipeline owner has the incentive and ability to exploit market power (i.e., inhibit competition) in upstream and/or downstream markets. The lines of inquiry are:

(a) the ability of the relevant pipeline owner to charge monopoly prices for transport services;

(b) the ability of the relevant pipeline owner to engage in explicit or implicit price collusion; and

(c) other incentives and opportunities for the relevant pipeline owner to distort competition in adjacent markets.

Whether the service provider will engage in the conduct described above depends upon it having both the ability and incentive to do so.

The service provider may have an incentive to engage in strategies designed to pro-competitively impact on competition in the dependent market(s). For example, if the service provider has no ownership interests in the dependent market(s) and if the pipeline has excess capacity, it may be profit maximising to promote increased competition in the dependent market(s) to reduce margins and prices in the dependent market(s) and increase incremental demand for the services provided by the pipeline. In these circumstances, the service provider will not have an incentive to engage in the conduct described above.

This was the case in the Council's Final Recommendation on the application for revocation of the Roma distribution system, a small regional distribution system similar to the Mildura distribution system. In that case, the Council agreed, relying on the statement of the Tribunal in the *Eastern Gas Pipelines decision* concerning regional markets, that the Roma Town Council did not have the ability or incentive to exercise market power to hinder competition because of the very small size of the market. Nor did it have the ability or incentive to use its vertical linkages to distort competition in the downstream market, as it was in its interest to promote increased throughput into the gas sales market.

Envestra submits that the sale of gas to customers on the Mildura distribution system is currently undertaken by Origin Energy. Although there is already strong competition with other fuels, Envestra believes that the market in which competition may be promoted is the gas sales market in Mildura, and that this is separate from the market for gas distribution services in Mildura.

Envestra further submits that revocation will not lead to a change in opportunities or environment in relation to competition, mainly because revocation will not affect the price that Envestra will charge for haulage services. This is because the price that Envestra is able to charge for haulage services is constrained by the market's ability to pay. The bundled price of gas in conjunction with the cost of gas connection and gas appliances must be sufficiently attractive for customers to convert to, or use, natural gas.

For the majority of customers in Mildura a significant cost component of the bundled price of gas is the haulage charge. This charge must be sufficiently low to enable the delivered price of gas to be competitive. In order to be competitive, Envestra claims it must minimise its haulage cost, and this is best done by maximising the penetration/sale of gas so that the unit cost of gas haulage is minimised. Envestra therefore claims to have an incentive to grant access to its network to all parties willing to transport gas to the market. This is particularly so because gas penetration in the network is significantly short of initial projections. Their application shows statistics demonstrating the spare capacity that will be available for many years.

Envestra argues that it does not have the ability or the incentive, to charge monopoly prices or to exploit or exercise market power to hinder competition. Envestra believe they are subject to competitive market influences.

In relation to competition in adjacent markets, Envestra acknowledges that a pipeline with monopoly power over transport may seek to leverage its market power into downstream markets, e.g. when the pipeline has vertical linkages with the downstream market. In the case of the Mildura distribution system, Envestra state that they and Origin Energy are separate companies, but working with a common goal of increasing gas penetration. With the onset of full retail contestability, other retailers may also be involved in the gas sales market, and Envestra states in their application that they welcome the opportunity to work with other retailers in the same way.

Envestra rely on a statement of the Australian Competition Tribunal in the *Eastern Gas Pipeline decision*, where the Tribunal noted that gas infrastructure in regional areas where gas penetration is growing face pressures from other fuel sources, such as LPG and electricity. The Tribunal took the view that these pressures represented a sufficient constraint on the price of gas in these townships and that regulated third party access was unnecessary. The Tribunal noted that in relation to gas infrastructure in regional energy markets:

> *...the ability to monopoly price would be restricted because potential users have bargaining power, the costs of conversion to enable use of gas are significant....In other words, the prices of existing forms of energy will be a countervailing force on the price of gas and pipeline services.* (para 129)

The AGA supported this, stating that Mildura is a “characteristic small regional gas market”, characterised by:

- strong inter-fuel competition from incumbent energy sources (i.e. electricity, LPG, wood);

- low initial uptake of natural gas by residential customers due in part to cost of conversion of appliances;

- small number of large industrial customers;

- gas transportation costs are a significant proportion of the final cost of gas supply. (AGA 2002, p. 4)

For the AGA this means that the owners have strong incentives to maximise throughput of gas in the system to:

- win customers from competing energy sources;
- lower the gas transportation component of the delivered price of gas which is largely driven by fixed network costs by growing the total gas market;
- seek to improve network utilisation by lowering spare capacity (AGA 2002, p. 4).

Origin Energy state that it is in Envestra's interests to keep haulage tariffs low and encourage competition to assure sufficient participation and interest from retailers to encourage load growth to customers located within the Mildura region (Origin Energy 2002, p. 2).

Envestra also advises that no third party has requested access to the network. Due to the location and relatively small size of the market, the number of access requests is likely to be limited. AGA believes that such requests are unlikely in the future given that most gas users are unlikely to have sufficient incentives to negotiate separately with alternative gas suppliers (AGA 2002, p. 5).

In conclusion, given the size and nature of the market as explained above, Envestra claims that they do not possess:

- the ability to charge monopoly prices for transport services;
- the ability to engage in explicit or implicit price collusion;
- other incentives or opportunities to distort competition in adjacent markets.

The Council notes the comments of Origin Energy who state that Origin's retail tariffs are subject to maximum uniform price control for certain customers types. Origin considers that this exposes them to a degree of volume risk that would be borne by Envestra if the retail sales market was free from price-capping regulation. If the retailer is constrained to charge a prescribed tariff to small customers, it is not able to pass through (and signal to customers) changes to distribution haulage costs (Origin Energy 2002, p. 2). Notwithstanding this, Origin considers that this situation does not present a sufficient incentive for Envestra to user their market power to adversely effect competition in the downstream market, especially when it is in Envestra's interests to increase competition in the retail gas sales market, particularly when actual consumption has consistently fallen short of forecast demand (Origin Energy 2002, p. 2)

Conclusion on criterion (a)

The Council agrees with the application, relying on the statement of the Tribunal in the *Eastern Gas Pipelines decision* concerning regional markets, that Envestra does not have the ability or incentive to exercise market power to hinder competition in the downstream market because of the very small size of the market and because it is in its interest to promote increased throughput into the gas sales market.

The Council considers that continued coverage of the Mildura distribution system is unlikely to promote competition in the downstream market for natural gas sales in the City of Mildura and surrounding towns.

The Council is therefore not satisfied that criterion (a) is met.

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

This criterion reflects the criteria in:

- section 44G(2)(d) of the TPA, relating to declaration of a service for access under Part IIIA of the Act; and
- clause 6(3)(a)(iii) of the CPA relating to assessments of the effectiveness of a State or Territory access regime.

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 application and the submission do not address this criterion. It therefore open to be implied that they agree that it that access (or increased access) to the services provided by means of the Mildura distribution system can be provided without undue risk to human health or safety.

Conclusion on criterion (c)

There is no evidence before the Council to suggest that regulated access cannot be provided to the Mildura distribution system without undue risk to human health or safety. Consequently, the Council is satisfied that this criterion is met.

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

The Tribunal in the *Eastern Gas Pipeline decision* considered that:

> *… criterion (d) does not impose an additional positive requirement which can be used to call into question the results obtained by the application of pars (a), (b) and (c). Criterion (d) accepts the results derived from the application of the other criteria, but enquires whether there are any other matters which lead to the conclusion that coverage would be contrary to the public interest (para 145).*

One matter of public interest is whether any benefits of coverage, such as cheaper prices and more efficient use of resources, are outweighed by regulatory or compliance costs. Other matters of public interest include environment considerations, regional development, and equity.

While no attempt to list public interest considerations can be exhaustive, matters which might be considered include the open-ended list of items in clause 1(3) of the CPA:

- ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
- economic and regional development, including employment and investment growth;
- the interests of consumers generally or of a class of consumers;
- the competitiveness of Australian businesses; and
- the efficient allocation of resources.

Other relevant matters may include impending access regimes or arrangements, national developments and the desirability for consistency across access regimes, relevant historical matters and privacy.

The AGA submits that the Council “appears to regard [this criterion] as only a residual provision of the coverage criterion” and that they do “not consider that there is any support for reading the public interest criterion in this way.

The public interest criterion should be applied as a substantive and independent step in assessments of coverage or revocations” (AGA 2002, pp. 3-4).

The Council does not consider that criterion (d) is a “residual provision” of the criteria. As has been stated, the Council must be affirmatively satisfied that the pipeline meets all of the criteria before it can recommend against revocation. However, the Tribunal has stated, as quoted above, that criterion (d) does not impose an additional positive requirement which can be used to call into question the results obtained by the application of criteria (a), (b) and (c). Criterion (d) is not concerned with addressing the concerns to which criteria (a) to (c) are directed but enquires whether there are any other matters which lead to the conclusion that coverage of the pipeline would not be in the public interest.

The criterion’s use of the double negative – requiring satisfaction that access “would not be contrary to the public interest” – indicates that it does not constitute an additional positive requirement for satisfaction that access would be in the public interest. Rather, the Council must be satisfied that the overall costs of coverage do not outweigh the benefits of coverage. The extent of these benefits depends on the likely effect of coverage on competition in related markets considered under criterion (a) and the resultant positive effects on economic efficiency identified under criterion (d).

The application

The applicant claims that the current revisions to the access arrangements involve an 18-month process, and significant resources from distributors and the Essential Services Commission are devoted to this process. The regulatory costs that would be devoted to reviewing the Mildura Access Arrangement would be recoverable from a small customer base.

Envestra also claim that considerable network marketing has been utilised to maximise penetration into domestic households, and due to the fact that connection rates have not met initial expectations, they are keen to ensure that every opportunity for system growth is maximised. Envestra recognises that the bundled cost of natural gas must be minimised if it is to compete with other fuels, notably electricity and LPG (Envestra 2002, p. 6)

Envestra also claims that since the tariffs for the initial Access Arrangement period were based on tender outcomes, they were not derived from a building block approach as is usually the case under the National Gas Code. In contrast, the forthcoming revisions to the Access Arrangement will need to incorporate a building block approach and be accompanied by comprehensive Access Arrangement Information to support the revisions to the tariffs. Envestra estimates that the cost of submitting revisions to the Access Arrangement and following through with the regulatory process will exceed $150,000. This represents a cost of over $180 per customer. (For comparison, the average domestic natural gas bill in Mildura is approximately $400 per year). In addition to this is the cost to be borne by the ESC in assessing the Access Arrangement revision. These costs are then also incurred for subsequent Access Arrangement reviews (Envestra 2002, p. 6). Origin Energy's submission supports this (Origin Energy 2002, p. 2).

In the case of the Mildura distribution system, Envestra submits that coverage results in regulatory costs that impact materially on end-user costs, and that coverage is therefore not in the public interest.

AGA's submission supports Envestra's application in relation to this criterion.

Conclusion on criterion (d)

The Council accepts that there are regulatory and compliance costs associated with coverage under the National Gas Access Code.

It is necessary for the Council to determine whether the benefits of access outweigh the costs. On the evidence currently before the Council, no third party intends to seek access to the Mildura distribution system, and there would appear to be no benefit from regulated access, which the Council could weigh against the costs associated with regulated access. The most significant benefit of continued coverage is the possibility that access to the Mildura distribution system will facilitate competition. In its consideration of criterion (a), the Council has concluded that continued coverage of the Mildura distribution system would not promote competition in the downstream markets.

Accordingly the Council is satisfied that continued coverage of the Mildura distribution system is contrary to the public interest. The Council is therefore satisfied that criterion (d) is not met.

Appendix 1: Submissions to the Council

The following submissions were made to the Council:

No.	Submission	Date
1.	Australian Gas Association	28 October 2002
2.	Origin Energy	31 October 2002

Appendix 2 - Coverage criteria in the National Gas Access Code

Section 1.9 of the National Third Party Access Code for Natural Gas Pipeline systems provides:

> *Subject to sections 1.4(a) and 1.10. the NCC must recommend that the Pipeline be covered (either to the extent described, or to a greater or lesser extent than that described in the application) if the NCC is satisfied of all of the following matters, and cannot recommend that the Pipeline be Covered, to any extent, if the NCC is not satisfied of one or more of the following matters:*
>
> *(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.*

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—— 2002a, *Final Recommendation on application from CMS Gas Transmission Australia to revoke coverage of the Parmelia pipeline under the Gas Pipelines Access (WA) Act 1998*, February

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Review of Freight Handling Services at Sydney Airport (2000) Re ATPR 41,754
Re: AGL Cooper Basin Natural Gas Supply Arrangements (1997) ATPR 41-593 (AGL Decision)
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