

# Dalby Gas Network

Application to Revoke Coverage  
under the  
Queensland Gas Access Regime

## Recommendation

November 2000

National Competition Council

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# 1 Recommendation

On 23 August 2000, the National Competition Council (**Council**) received an application from Dalby Town Council to revoke coverage of the Dalby Distribution System from the provisions of the *Gas Pipelines Access (Queensland) Act 1998* (**Queensland Gas Pipelines Act**).

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**). In effect, the owner of the pipeline is relieved of any obligation under the National Code to grant access to third parties.

The Council hereby releases its recommendation that coverage of the Dalby pipeline network 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 pipeline would promote competition in another market or confer net public interest benefits.<sup>1</sup> The Council's view takes into account arguments raised by the applicant, submissions lodged by interested parties and discussions with a range of stakeholders.

The Application will now be decided by The Hon. Tony McGrady, MLA, Minister for Mines and Energy and Minister assisting the Deputy Premier on Regional Development. Under the National Code, the Minister has 21 days to decide the matter.

## *The Council's process*

Information on process matters is provided at Appendix 1. A list of submissions received by the Council is provided at Appendix 2. All submissions were taken into account by the Council in formulating its Draft Recommendation, released in October 2000. The Council called for further submissions upon release of the draft, but none were received. As no additional issues came to light, the Council's final recommendation mirrors its draft position.

Copies of the Application, the Council's Recommendation and Draft Recommendation are available to interested parties on the Council's web page at [www.ncc.gov.au](http://www.ncc.gov.au)

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<sup>1</sup> These issues are raised under coverage criteria (a) and (d). See Section 3 of this paper.

## 2 Background

### 2.1 The Queensland Gas Access Regime

Queensland has enacted a gas pipeline access regime to provide parties with a method for seeking access to certain gas transmission and distribution pipelines located in Queensland. The regime is contained in the Queensland Gas Pipelines Act, which applies the Gas Pipelines Access Law which includes the National Code<sup>2</sup>.

A copy of the National Code can be found on the Code Registrar's website at [www.coderegistrar.sa.gov.au](http://www.coderegistrar.sa.gov.au).

The regime assists parties wishing to transport gas through gas transmission and distribution pipelines in Queensland to contract on competitive terms for transport with pipeline owner/operators. For example, a retailer of gas may wish to buy gas from a gas producer at a particular production site and transport it through transmission pipelines to a distribution system, then through this distribution system to its customers. Under the Queensland regime, it has the opportunity to negotiate a contract for transport of the gas with the owners/operators of the pipelines covered by the regime in accordance with the rules laid down by the regime. In the absence of the Queensland regime, the owners/operators of pipelines might, by virtue of any monopoly powers over the transport of gas between the particular geographic regions or over distribution systems to which particular customers are connected, refuse to transport gas or demand a monopoly price for the transport of gas.

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

### 2.2 Coverage of Pipelines under the Queensland Regime

The Dalby Distribution System became covered by the Queensland gas access regime when it was listed in Schedule A to the National Code. Pipelines listed in Schedule A were covered from the commencement of the Queensland gas access regime.

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<sup>2</sup> The Gas Pipelines Access Law is contained in Schedule 1 to the *Gas Pipelines Access (South Australia) Act 1997 (SA)* (the **SA Gas Pipelines Act**) and the National Code, which is contained in Schedule 2 to the SA Gas Pipelines Act.

Where pipelines are covered, the owners/operators of the relevant pipelines must comply with certain obligations under the Gas Pipelines Access Law (including the National Code). These obligations include rules covering such matters as:

- the content and operation of Access Arrangements (Access Arrangements specify the terms, conditions, and prices on which owners/operators offer access);
- the information to be provided by owner/operators to parties interested in obtaining access;
- dispute resolution mechanisms; and
- pricing principles (how the prices in the Access Arrangement are derived).

### 2.3 Revocation of Coverage of a Pipeline

The National Code permits any party to seek revocation of coverage of a pipeline. The party must apply to the Council asking the Council to recommend to the relevant Minister that coverage of a pipeline be revoked. On receipt of the Council's recommendation, the relevant Minister must then decide the matter. For the Dalby Distribution System, the relevant Minister is The Hon. Tony McGrady, MLA, Minister for Mines and Energy and Minister assisting the Deputy Premier on Regional Development.

Both the Council and the Minister must consider the criteria for revocation set out in Section 1.9 of the National Code. The Council's detailed assessment of the Application against the criteria in section 1.9 of the National Code is contained in Section 3 of this document.

Where revocation is granted, the owner and operator of the pipeline are released from their obligations under the Queensland Gas Pipelines Act and the Gas Pipelines Access Law including the National Code. In particular, the owner and operator are no longer required by the National Code to submit an access arrangement for the pipeline to the regulator, or to respond to access requests by third parties.

The Queensland Gas Pipelines Act includes a process for administrative (merits based) appeals against a decision to revoke coverage. In Queensland, appeals are heard by the Queensland Gas Appeals Tribunal. The process for appeals is set out in:

- section 38 of the Gas Pipelines Access Law; and
- Part 4 of the Queensland Gas Pipelines Act.

## 2.4 The Application

The application for revocation of coverage relates to a gas pipeline listed in Schedule A of the National Code. The pipeline for which revocation of coverage is sought is detailed in Table 1 below and the application for revocation is made for the whole of the Dalby Distribution System including the Dalby Gas Gate Sales Station which is identified as AGLMP134.3.

**TABLE 1: Pipeline for which Revocation sought**

Pipeline Licence	Location/Route	Operator	Length (km)	Pipe Diameter (mm)	Regulator
-	Dalby System	Dalby Town Council	-	-	Queensland Competition Council

According to the Application, the Dalby Distribution System serves customers in the area of the town of Dalby. The distribution system supplies gas to a total of 2,278 customers through 86 km of reticulated gas pipes, and delivers an annual volume of gas of about 160 Terajoules (TJ), worth approximately \$1.7 million.

According to the Application, the customer profile for 1999/2000 was:

1999/2000	Number of Customers	Annual Consumption
Domestic	2,177	32.9 TJ
Commercial	77	8.6 TJ
Industrial	14	117.9 TJ
Total	2,268	159.4 TJ

The Dalby Distribution System draws gas from the Roma to Brisbane pipeline, which is owned by Australian Pipeline Trust. Gas is supplied to the Dalby Gas Gate Sales Station from 2 separate 2 inch diameter steel pipes – one from a 16 inch diameter looped steel main and the other from a 10 inch diameter steel looped main.

The Dalby Gas Gate Sales Station is located less than 1 km from the township of Dalby. The Dalby Gas Gate Sales Station is also close to the Dalby Compressor Station which is a compressor station owned by Australian Pipeline Trust on the Roma to Brisbane pipeline.

The Applicant has informed the Council that the Dalby Distribution System is not currently capacity constrained. With the current gas regulator and meter which is installed at the Dalby Gas Gate Sales Station, the maximum gas flow which can be sustained is 2,452 cubic meters an hour. The Applicant has informed the Council that over the last 12 months, the maximum flow through the Dalby Gas Gate Station has been 1,436 cubic metres an hour (the minimum flow was 810 cubic metres an hour). Further, the Applicant has stated that it would be possible to upgrade the Dalby Gas Gate Station regulating and metering equipment to increase the maximum flow of gas if this was required.

Dalby Town Council purchases the gas on a delivered basis at the Dalby Gas Gate Sales Station from the Roma producers. Dalby Town Council then on sells this gas to customers through the Dalby Distribution System, which it wholly owns and operates.

## 3 Applying the Revocation Criteria

This section outlines the criteria in the National Code against which the revocation application must be assessed, and the reasons underlying the Council's recommendation.

### 3.1 The Revocation criteria

In reaching its recommendation, the Council is required by section 1.31 of the National Code to consider the criteria for coverage in section 1.9 of the National Code. Where the Council is not affirmatively satisfied that a pipeline meets each of the criteria in section 1.9, the Council must recommend revocation of coverage of that pipeline.

The criteria set out in section 1.9 of the National Code 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 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 considering these criteria, the Council has taken into account the views of the applicant, and of parties that made written submissions as well as other interested parties with whom discussions were held. A list of the parties that made written submissions is at Appendix 2.

### 3.2 Guidance in Interpreting the Coverage Criteria

In interpreting the coverage criteria under section 1.9 of the National Code, the Council has used general principles of statutory interpretation. The Council has had regard to the following specific matters.

First, the Council has had regard to the purpose sought to be achieved in enacting the Queensland gas access regime.<sup>3</sup> Reference has been had to the preamble to the Queensland Gas Pipelines Act to determine this purpose.

Second, pursuant to section 10.5 of the National Code, the Council has had regard to the introduction and overview to section 1 of the National Code:

- where the meaning of the provision in section 1 appeared clear, to confirm the ordinary meaning conveyed by the text of the provision; or
- where the Council considered the provision was ambiguous or obscure, or the ordinary meaning would lead to a manifestly absurd or unreasonable result, to determine the meaning of the provision.

Third, the Council has had regard to decisions of the Tribunal in relation to applications for declaration under Part IIIA of the TPA. This is because in relevant respects the words of the declaration criteria in sections 44G(2) and section 44H(4) of the TPA raise for consideration the same issues as those raised by the criteria set out in section 1.9 of the National Code. The declaration criteria under the TPA have been considered by the Tribunal in the *Australian Union of Students decision* and the *Sydney Airports decision*.<sup>4</sup>

### 3.3 Criterion by criterion assessment

**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 create better conditions or a better environment for competition in at least one market other than the market in which the gas pipeline provides services. For example, providing access may

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<sup>3</sup> Section 14A, *Acts Interpretation Act, 1954* (Queensland).

<sup>4</sup> *Re Application for review of the decision by the Commonwealth Treasurer & published on 14 August 1996 not to declare the "Austudy Payroll Deduction Service" under Part IIIA of the Trade Practices Act 1974; by the Australian Union of Students* [1997] ACompT 1 (28 July 1997); (1997) 19 ATPR 41-573 and *Re Application for Review of the Declaration by the Commonwealth Treasurer Published on 30 June 1997 of Certain Freight Handling Services Provided by the Federal Airports Corporation at Sydney International Airport* (2000) ATPR 41-754.

promote competition in upstream (gas exploration and production) and/or downstream (gas sales) markets.

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

- the service to which access is sought is not in the same market as the market or markets in which competition is promoted; and
- access would actually promote a more competitive environment in that other market.

The Council's approach is to:

- verify that the market or markets in which competition is said to be promoted is separate from the market for the service; and, if so, then
- determine if access (or increased access) would promote competition in the separate market or markets.

It is not necessary to define precisely the boundaries of all the possible markets, only to determine whether there are distinct markets.

#### *Meaning of the Term "Promote Competition"*

The Council has been assisted by the consideration given to this term by a recent decision of the Australian Competition Tribunal.<sup>5</sup>

The notion of promoting competition in criterion (a) involves the idea of creating the conditions or environment for improving the state of competition compared with that which would otherwise exist. Put another way, the Council must examine whether the opportunities and environment for competition with access to the Dalby Distribution System for which revocation is sought are better than they would be without access.

In applying the with and without test endorsed by the Tribunal, the Council compares the market conditions which would prevail if the pipeline were not covered under the National Code with those that would prevail if it were covered under the National Code.

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<sup>5</sup> *Re Application for Review of the Declaration by the Commonwealth Treasurer Published on 30 June 1997 of Certain Freight Handling Services Provided by the Federal Airports Corporation at Sydney International Airport* (2000) ATPR 41-754 at 40,775)

### *Meaning of the Term “Market”*

In considering questions of market definition, the Council is guided by the work of the Federal Court, the Tribunal, and the ACCC in their consideration of market for the purposes of Part IV, as well as the Tribunal's and the Court's 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. Re Queensland Co-operative Milling Association Ltd (1976) 25 FLR 169 at 190*

This view of market definition has been accepted by the High Court in the *Queensland Wire* case and was adopted by the Tribunal in the context of Part IIIA of the TPA in the *Sydney Airports decision*.<sup>6</sup>

### *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. Product markets can be considered separate if their respective products are not substitutable in demand or supply. Products are substitutable in demand (and 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.
- 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 Airports decision* which is consistent with the approach used by the High Court in *Queensland Wire* and

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<sup>6</sup> *Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Ltd and Another* (1989) 167 CLR 177 and *Re Application for Review of the Declaration by the Commonwealth Treasurer Published on 30 June 1997 of Certain Freight Handling Services Provided by the Federal Airports Corporation at Sydney International Airport* (2000) ATPR 41-754 at 40,772.

developed by Professor Maureen Brunt<sup>7</sup> and Professor Henry Ergas.<sup>8</sup> 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.

Markets may be functionally separate even though there is a *one for one* relationship, that is to say, perfect supply and demand side complementarity. A good example of this is rail track and train operations. 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.<sup>9</sup>

- 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. This refers to whether the size and scope of the market is likely to change over time. The temporal dimension is particularly relevant where production technologies are continually changing. In order to determine the temporal parameters of markets, the Council generally has regard to long-run rather than short-run substitution possibilities.

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<sup>7</sup> Brunt, Maureen (1990), *Market Definition Issues in Australian and New Zealand Trade Practices Law*, 18 *Australian Business Law Review*, 86.

<sup>8</sup> Ergas, Henry (1997), *Submission to the NCC in support of an Application by Carpentaria Transport Pty Ltd*, pp. 1-3.

<sup>9</sup> *Re Application for Review of the Declaration by the Commonwealth Treasurer Published on 30 June 1997 of Certain Freight Handling Services Provided by the Federal Airports Corporation at Sydney International Airport* (2000) ATPR 41-754 at 40,772-40,773.

## ***Views Put to the Council***

The Applicant submitted that the Dalby Distribution System serves the local Dalby area. This suggests that the Applicant considers the pipeline serves a gas sales market within the local Dalby area. The Applicant stated that most of the gas transported in the Dalby Distribution System is used in this local gas sales market for domestic purposes. The Applicant did not envisage that this gas sales market would expand significantly in the foreseeable future.

The Applicant stated that access to the Dalby Distribution System is not likely to promote competition in the gas sales market because “the loads on the system are too small to negotiate favourable gas supply contracts” and the Applicant “would expect the transaction costs associated with negotiating small volume gas supply contracts would be considerable”. The Applicant’s view appears to be that it would not be worthwhile for individual gas users to negotiate contracts directly with producers to buy gas and then seek access to transmission pipelines and the Dalby Distribution System in order to have the gas delivered to those users.

Although the Council has received submissions in relation to the application, not one of these submissions objected to the application. No third party indicated any intention to seek access to the Dalby Distribution System or put forward any argument that access (or increased access) to the Dalby Distribution System would promote competition in another market.

## ***Analysis***

While submissions to the Council did not identify any markets in which access might promote competition, the most likely market or markets in which access *might* promote competition are the market or markets in which gas sales take place.

Such markets may encompass sales of other energy sources available in Queensland such as electricity or LPG, to the extent that these other sources can meet the requirements of energy users.

### *Electricity as a Substitute for Gas*

In the *AGL Cooper Basin decision*, the Tribunal examined the extent of substitution between electricity and gas in defining the nature of the market within which natural gas existed. The Tribunal considered gas and electricity were not substitutes (though to some extent the demand for gas related to the demand for electricity) and that a separate natural gas market existed with competition from other forms of energy at the margins.

The Tribunal considered that over time gas and electricity markets were likely to converge, resulting in the eventual creation of a broader energy market.<sup>10</sup>

While neither the Applicant nor any other interested party has made submissions to the Council on this point, the Council examined this issue at length in its Final Recommendation in relation to the Moomba to Sydney Pipeline System (**Moomba Final Recommendation**) and its Final Recommendation in relation to the Eastern Gas Pipeline (**EGP Final Recommendation**).

The price of electricity affects the price of gas on a number of levels. First, when users are making decisions about asset purchases, the relative competitiveness of gas and electricity are considerations in determining what appliances or plant should be purchased. Second, because one of the uses of gas is as an input for electricity production, its price continues to be constrained by the price of electricity to some degree even after these investments are made.

The Council considered that the evidence before it in the Moomba Final Recommendation and the EGP Final Recommendation lead it to the view that gas and electricity remain in separate markets. The Council considers that that view is equally applicable in relation to the application for revocation which it is currently considering. While the Council considers that electricity can be a substitute for gas in some circumstances and it can also provide some constraints on the price of gas, the Council does not consider that the field of rivalry is so close as to put them in the same market.

#### *Relevant Functional Levels within the Natural Gas Industry*

The Tribunal in the *AGL Cooper Basin decision* considered that there were a number of functional levels to be considered in defining the natural gas market: exploration, production and processing and distribution. The Council agrees with this analysis. In using the term ‘distribution’ in this context the Tribunal meant gas sales, rather than carriage of gas through distribution pipelines.

In examining the distribution dimensions, there is a question whether there are separate functional markets for wholesale sales of natural gas and for retail sales of natural gas.

For the reasons set out in the Moomba Final Recommendation, the Council considers that it is not possible, at this time, for the Council to be sufficiently certain that there are separate functional markets for wholesaling and retailing of gas. For the purposes of its consideration of the criteria under section 1.9 of the National Code, the Council considers the market to be the supply and sale of natural gas, what the Tribunal referred to as the distribution functional dimension of the natural gas market.

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<sup>10</sup> *Re AGL Cooper Basin Natural Gas Supply Arrangements* (1997) ATPR 41-593 at 44,197-44,199.

### *The Market in Which the Dalby Distribution System Provides its Services*

The Council must consider whether the market or markets in which gas sales take place are separate to the market or markets in which access would be sought.

The Council considers that the primary market served by the Dalby Distribution System is the market for gas transportation services in the Dalby area.

As noted above, the Council considers the market occupied by gas transportation services is separable from the market or markets in which gas sales take place.

The next issue is whether access (or increased access) to the pipelines would promote competition in these other markets.

The Council notes that the Applicant contends that gas sales take place in a market which is geographically restricted to the Dalby area. While the Council acknowledges that, on the demand side, there is no viable alternative for gas users apart from the use of the Dalby Distribution System, the Council considers that substitution possibilities may arise on the supply side, through competition between producers to provide natural gas to users connected to the Dalby Distribution System.

The Dalby Distribution System is in turn connected to the Roma to Brisbane Pipeline. The Roma to Brisbane Pipeline is part of a system of interconnected transmission pipelines which run through Southern and Central Queensland. Other major transmission pipelines in this system include:

- the Ballera to Wallumbilla pipeline;
- the Roma to Gladstone/Rockhampton pipeline (the Duke Queensland Pipeline); and
- the Ballera to Mount Isa pipeline.

The Council understands that it is also proposed to construct a major transmission pipeline which would run from gas fields in Kutubu in Papua New Guinea down the east coast of Queensland and connect to the transmission pipeline system in Southern and Central Queensland (**Chevron Pipeline**).

The Council considers that through supply substitution possibilities, the existing pipeline network may give the gas sales market a geographic dimension that encompasses Southern and Central Queensland. This geographic dimension relies on the assumption that producers and users have

access to the network of pipelines described above, on reasonable terms and conditions. Access has been, or will be, provided either because:

- regulation of third party access to monopoly pipelines is now in place in Queensland; or
- the pipelines would provide appropriate access of their own accord.

The Council considers that it is possible that the proposed construction of the Chevron Pipeline may broaden the geographic dimension of this gas sales market from Southern and Central Queensland to encompass the whole of the State of Queensland. However, the Council notes that construction on the Chevron Pipeline has not yet commenced, and that it is not anticipated that the Chevron Pipeline will be completed and operational in the near future.

However, for the reasons discussed below, the Council does not consider it necessary, for the purposes of making its recommendation, to come to a concluded view on the geographic dimension of the relevant gas sales market.

There are a number of ways in which access *might* promote competition. For example, access might promote competition at the retail level of the relevant gas sales market or markets. Retailers or aggregators of gas could seek access to the Dalby Distribution System in order to compete to supply customers with gas.

At present, the Applicant buys gas from gas producers and distributes it through the Dalby Distribution System to users. This means that users in effect buy a bundled gas sales and gas distribution service under which the Applicant sells them both the gas they use and the distribution service through which the gas is delivered to them.

The effect of regulating access to the Dalby Distribution System under the National Code is that it offers gas users the possibility of buying gas directly from gas producers and using the access provisions of the National Code to obtain the distribution service as a separate service at a regulated tariff. Alternatively, gas aggregators or retailers may arrange to buy large amounts of gas, buy access to the Dalby distribution system, and sell a bundled gas and gas distribution service to users at a cheaper price than the price offered by the Dalby Town Council. If this were to result in the supply of gas to consumers at cheaper prices, or on better conditions, then access to the Dalby Distribution System under the National Code could be said to promote competition.

In response to this, the Applicant stated it was prepared to enter into alternative contracts to provide “the same competitive cost benefits without the need to enter into an access arrangement under the National Gas Code”. The applicant added that “*Dalby Town Council is willing to entertain other proposals for negotiated access on commercial terms, including aggregators or retailers that may be able to combine smaller loads into commercial quantities*”.

The Council understands that the current gas contestability timetable in Queensland states that those consumers who use more than 100 TJ annually (**First Tranche Consumers**) will become contestable on 1 July 2001, and all other customers will become contestable on 1 September 2001. The contestability date for gas consumers is the date from which retailers are free to compete to supply those consumers. Thus on the current contestability timetable all consumers of gas from the Dalby Distribution System would be free to choose their retail supplier of natural gas from 1 September 2001.

However, the Council has not been presented with any evidence or other facts or circumstances which could provide the Council with a sound basis for concluding that access to the Dalby Distribution System would promote competition in a market other than the market in which the Dalby Distribution System provides its services. The Council wrote to major gas retailers advising of receipt of the application from Dalby Town Council. None of these retailers raised with the Council any arguments that access (or increased access) to the Dalby Distribution System would promote competition in the market or markets in which gas sales take place. As noted above, the Council also sought to contact potential users in the Dalby region through the Dalby Chamber of Commerce and Industry, but did not receive any responses objecting to the application for revocation or arguing that access (or increased access) would promote competition.

In the absence of any demand for access to the Dalby Distribution System, it is difficult for the Council to reach a conclusion that access would promote competition in another market. Since the Council is unable to conclude that access would promote competition in another market even if the geographic boundary of that other market was to be restricted to the Dalby area, it is not necessary for the Council to decide whether the relevant market for users of gas connected to the Dalby Distribution System should be a wider market encompassing Central and Southern Queensland, or the whole of the State of Queensland. If competition is unlikely to be promoted using a narrow geographic market definition, the Council considers it unlikely that competition could be promoted in that market if that market was geographically larger.

Therefore the Council has come to the view that, on the evidence available to it, the Dalby Distribution System does not satisfy criterion (a).

The Council also notes that if the coverage of the Dalby Distribution System were to be revoked, it would remain open to a person who desired access to the Dalby Distribution System to apply under the National Code for it to be covered again if evidence was later available that indicated that the Dalby Distribution System met each the criteria set out under section 1.9 of the National Code.

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

### ***Background***

Criterion (b) would appear to be designed to identify potential coverage of pipelines where the development of competing pipelines would be inefficient.<sup>11</sup> The intent is that competitive infrastructure (whether in actual or potential terms) should not be covered under the National Code. In other words, access regulation should be limited to infrastructure where competing facilities are not economically viable.

As such, access regulation should normally be confined to infrastructure exhibiting natural monopoly characteristics – that is, where a single facility can meet market demand at less cost than two or more facilities. Such a facility is normally characterised by large up-front investment costs and low operating costs, resulting in economies of scale or scope across a broad range of output. In other words as output from a natural monopoly facility increases, average costs per unit of output continue to decrease across the range of output sought by the market.

This approach is consistent with that of the Australian Competition Tribunal in the *Sydney Airports decision*. The Tribunal held that ‘another’ facility must be one capable of providing services competitive with those provided by the relevant facility. Services which are merely complementary to those provided by the relevant facility should not be regarded as competing services for the purposes of this criterion.

The Council therefore considers the reference in criterion (b) to ‘services’ should be interpreted as involving a consideration of whether it is uneconomic to develop another pipeline to provide competing services.

Legislative restrictions may also sometimes be pertinent in considering whether it is economic to build another pipeline to provide the services provided by the pipeline in question. For example, the feasibility of developing another pipeline may be questionable in some cases due to environmental or planning regulations.

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.

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<sup>11</sup> *Sydney Airports decision* (2000) ATPR 41-754 at 40,791-40,793.

## ***Views Put to the Council***

The Applicant stated that it would not be economic to develop another pipeline to provide the services provided by the Dalby distribution system.

None of the submissions received by the Council in relation to the Application addressed this issue.

## ***Analysis***

The Dalby Distribution System provides gas transportation services to gas consumers in the Dalby area.

In considering whether it 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 reticulating a unit of gas very low. Moreover, up to the point of fully expanded capacity, average costs of reticulation 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 such as the Dalby Distribution Network 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 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 the gas reticulation 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 a relatively inexpensive upgrade of the network). Having said this, the Council recognises it will always be necessary to consider the facts of particular pipelines.

In considering the Dalby Distribution System, the Council has found no evidence to suggest that these pipelines deviate from the typical characteristics noted above. The Council notes that the Applicant has conceded that it is uneconomic to develop another pipeline and that the Dalby Distribution System is currently operating well below maximum capacity. Further, even if the Dalby Distribution System were to reach its current maximum capacity, it is clear that the efficient way of satisfying additional demand would be for the regulating and metering equipment at the Dalby Gas Gate Sales Station to be upgraded.

Therefore the Council considers that the Dalby Distribution System satisfies criterion (b).

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

### ***Background***

The rationale for this criterion is that the National Code should not be applied to pipelines where access might pose an undue risk to human health or safety.

### ***Views Put to the Council***

The Applicant stated that it is “*not aware of any reasons that access to the [Dalby Distribution System] would pose a risk to human health and safety*”.

None of the submissions received by the Council in relation to the application addressed this issue.

### ***Analysis***

The Council is of the view that, on the evidence available, the Dalby Distribution System satisfies criterion (c).

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

### ***Background***

One matter of public interest is whether any benefits of access, 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.

### ***Views Put to Council***

The Applicant stated that it considered that the benefits of access to the Dalby distribution system via an access arrangement under the National Code would be outweighed by the regulatory and compliance costs associated with access under the National Code.

The Applicant noted that all regulatory and compliance costs would need to be recouped from gas users in the form of higher distribution tariffs. It considered that, in view of the small number of users and the high costs of regulation, the costs of regulation under the National Code are likely to be greater than any benefits delivered by greater competition.

One significant regulatory cost is the cost of preparing an access arrangement setting out the tariffs and the terms and conditions on which access to the services of the Dalby Distribution System would be provided. Such an access arrangement would then be approved by the regulator, the Queensland Competition Authority.

The Applicant estimated it may cost the applicant approximately \$150,000 to prepare an access arrangement under the National Code. If this were to cover access to the services of the Dalby distribution pipeline for five years, then, averaged over current loads, this cost would add an average of 20 to 32 cents per GJ to prices. The Applicant doubted that access would provide benefits sufficient to offset this regulatory cost.

The Applicant was also concerned that the costs and benefits of regulated access would not be shared equally across the Applicant's customer base. The Applicant stated that:

*“While all customers would bear the costs of open access, only those very few customers which are able to arrange alternate gas supply would reap any benefits. Dalby Town Council is of the view that this unequal sharing of costs and benefits is also not in the public interest*

*Further, Dalby Town Council is concerned that any reduction in size of the current gas supply contract would inhibit its ability to negotiate a new gas supply contract on favourable terms. Any gas supply increases as a result of the smaller contract would be borne by those customers not seeking access. Dalby Town Council is of the view that this unequal sharing of costs and benefits is also not in the public interest.”*

The Applicant also considered that if certain users did negotiate direct deals with gas producers, it may undermine the Applicant’s ability to negotiate good gas contracts with producers in the future, since it may be negotiating to purchase smaller amounts of gas.

The Applicant argued that price rises due to the costs of regulation or due to it only being able to negotiate less favourable deals may make gas less attractive compared to electricity.

The Applicant was also concerned its gas contract with producers does not contain provisions for it to reduce the amount of gas it must purchase where demand falls. This means that if users purchased gas directly from producers instead of the Applicant, then it may be left buying more gas than it needed. The Applicant was concerned it may have to pass on costs associated with purchasing this gas to its continuing user-base.

None of the submissions received by the Council in relation to the Application addressed this issue.

## **Analysis**

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

However, the Council is not persuaded that the only benefits which might be conferred by regulated access would be limited to a few gas users who would be able to arrange alternate gas supply. The Council considers that, with regulated access to the Dalby Distribution System, a gas retailer or other aggregator would be in a position to offer an alternate supply of gas to a wide range of different gas consumers, including smaller residential consumers post contestability. The Council considers that this may considerably expand the number and type of consumers who might receive benefits from regulated access.

This criterion calls for the Council to engage in a balancing exercise to determine whether the benefits of open access outweigh the costs. On the evidence currently before the Council, no third party intends to seek access to the Dalby Distribution System, and there would appear to be little, if any, benefit from regulated access which the Council could weigh against the costs associated with regulated access.

Accordingly, the Council has come to the view that the Dalby Distribution System does not meet criterion (d).

## Appendix 1: The Council's Process

In determining its final recommendation, the Council has followed the process set out in the National Code. Under this process the Council:

- acknowledged receipt of the Application and advised the Queensland Department of Mines and Energy;
- advertised receipt of the Application in the *Australian Financial Review* the *Courier-Mail* and the *Dalby Herald* on 1 September 2000;
- prepared and released an Issues Paper in relation to the Application and called for public submissions;
- wrote to a large number of parties whose interests may be affected by the Application and conducted discussions with several interested parties in relation to the Application. The Council also arranged for the Dalby Chamber of Commerce and Industry to fax stream its members seeking submissions in relation to the Application;
- released a Draft Recommendation on the Application and called for further submissions.

The Council's final recommendation will now be forwarded to The Hon. Tony McGrady, MLA, Minister for Mines and Energy and Minister assisting the Deputy Premier on Regional Development. 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 to decide the matter.

The Minister's decision may be appealed to the Queensland Gas Appeals Tribunal.

## Appendix 2: Submissions received by the Council

The Council received submissions from the following organisations:

*Energex Retail Limited*

*Queensland Cotton Corporation Limited*