



Australian Energy Markets Commission

**Review into the scope of economic regulation
applied to covered pipelines**

GPR0004

ISSUES PAPER

Submission by

The Major Energy Users Inc

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The views expressed in this document do not necessarily reflect the views of Energy Consumers Australia. The content and conclusions reached in this submission are entirely the work of the MEU and its consultants.

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1. Introduction

The Major Energy Users Inc (MEU) welcomes the opportunity to provide its views on the AEMC review into the scope of economic regulation applied to covered pipelines.

The MEU notes that the massively rising prices for gas in the domestic market has drawn attention to the many occurrences of where the gas market has allowed the providers of services (gas and its transportation) to levy monopoly rents.

The gas market, especially the east coast gas supply arrangements, has in the past contributed to fostering our internationally competitive energy-intensive industries such as mining, minerals, agricultural, manufacturing and processed foods industries. These linkages are particularly important, as are the linkages to the economic and social benefits arising from the location of these industries in regional, rural and remote areas and the development of a more broadly based economy.

However, the promising outcomes from the well thought out energy reforms, begun in the 1990s to enhance Australia's economic development, have been sadly overturned by the loss of our international competitiveness in electricity and, more recently, gas pricing.

A number of factors have contributed to this loss of competitiveness in electricity and gas supply costs. They include the failure of national regulation to restrain increases in gas and electricity network costs and, just as importantly, they also include a lack of political and regulatory will to respond to emerging challenges in the energy market in an effective and timely fashion.

The MEU, which represents large industry that employs many ordinary Australians, particularly in regional areas, notes that the decision to review and potentially amend the rules applying to coverage and regulation of gas pipelines needs to recognise that the gas transportation industry is very concentrated (especially in transmission) and has allowed owners of regulated (and unregulated) gas pipelines to enjoy considerably more profit than would be expected from past regulatory decisions.

1.1 About the MEU

The Major Energy Users Inc (MEU) represents the interests of large energy consumers operating in the east coast gas market and in other jurisdictions. The MEU comprises some 30 major energy using companies operating in NSW, Victoria, SA, WA, NT, Tasmania and Queensland. MEU member companies – from the steel, cement, paper and pulp, automobile, tourism,

mining and the mining explosives industries – are major manufacturers across all states and territories, are significant employers of labour and contractors, and are located in many regional centres, including Gladstone, Newcastle, Port Kembla, Albury, Western Port, Geelong, Mount Gambier, Port Pirie, Kwinana and Darwin.

Analysis of the energy usage by the members of MEU shows that in aggregate they consume a significant proportion of the gas used domestically and electricity generated in Australia. As such, they are highly dependent on the extent of the competition that applies to the provision of gas and electricity, the retail functions needed to enable the competition to apply and to the transport networks to deliver efficiently the energy so essential to their operations.

Many of the members, being regionally based, are heavily dependent on local suppliers of hardware and services, and have an obligation to represent the views of these local suppliers. With this in mind, the members of the MEU require their views to not only represent the views of large energy users, but also those of smaller power and gas using facilities, and even at the residences used by their workforces that live in the regions.

The companies represented by the MEU (and their suppliers) have identified that they have an interest in the **cost** of the energy as well as the associated transport services as this comprises a large cost element in their electricity and gas bills.

A failure in the supply of electricity or gas effectively causes every business affected to cease production, and MEU members' experiences are no different. Thus the **reliable supply** of electricity and gas is an essential element of each member's business operations.

With the introduction of highly sensitive equipment required to maintain operations at the highest level of productivity, the **quality** of energy supplies has become increasingly important with the focus on the performance of the energy transmission and distribution networks, because the transport systems control the quality of electricity and gas delivered. Variation of electricity voltage (especially voltage sags, momentary interruptions, and transients) and gas pressure, by even small amounts, now has the ability to shut down critical elements of many production processes. Thus member companies have become increasingly more dependent on the quality of electricity and gas services supplied.

Each of the businesses represented by MEU has invested considerable capital in establishing their operations and in order that they can recover the capital costs invested, long-term **sustainability** of energy supplies is required. If sustainable supplies of energy are not available into the future, these investments members have made will have little value.

Accordingly, MEU members are keen to address the issues that impact on the **cost, reliability, quality** and the long term **sustainability** of their gas and electricity supplies.

The members of MEU have identified that in addition to the need for strong competition in the competitive parts of the energy supply chains, energy transport plays a pivotal role in the energy markets. This role encompasses the ability of consumers to identify the optimum location for investment in their operations, and provides the facility for generators and gas producers to also locate where they can provide the lowest cost for energy supplies. Equally, consumers recognise that the cost of providing the transport systems are not an insignificant element of the total cost of delivered energy, and due consideration must be given to ensure there is a balance between the competing elements of price versus reliability, quality and long term security;

The MEU recognises there is tension between the four elements of cost, reliability, quality and long term security and therefore makes its comments in this submission in full knowledge of the need for managing this tension.

1.2 The elephants in the room

As an overarching concern in relation to this issues paper, the MEU is very much aware that the supply of gas is tightly held by a very few producers. Of all the concerns that the MEU and its members have, it is the lack of competition at the production end of the gas supply chain that is causing the most pain to consumers.

The MEU notes that all gas transmission pipelines are effective monopolies as they each provide a unique service. Even where there are multiple gas pipelines serving a specific centre of demand, each of these pipelines still provides a unique and therefore a monopoly service.

For example, there are two pipelines delivering gas to Adelaide – Moomba Adelaide pipeline (MAPS) and SEAGas pipeline. It is important to note that the service offered by each is unique in that MAPS is the only pipeline that delivers gas to Adelaide from the Moomba gas fields and beyond and SEAGas only delivers gas from Victoria. As gas prices are different at these different locations, to consider that the pipelines are in competition is a fallacy.

The MEU considers that this feature needs to be better understood because if this does not occur, then the changes that might be made to the rules applying to regulated pipelines might not deliver the results intended.

The MEU concurs with the ACCC observation that a review of the profitability of the various gas pipelines is greater than might be expected than if the pipelines were in direct competition. The MEU is aware that steps have been taken to rebalance this with regard to unregulated pipelines, but the MEU has observed over the years that the owners of regulated pipelines have also significantly over recovered the revenue expected from a regulatory decision.

This implies that regulation is not acting as a surrogate for competition and that either the rules for regulation are insufficient for the purpose or the application of the rules is inadequate. Of course it could also be that both apply.

In summary, the MEU considers that all gas pipelines are monopolies and regulation of covered pipelines is not achieving the goals expected by consumers.

1.3 The framework for regulating pipelines

Pipelines will be regulated if they are either declared to be monopoly service providers by governments (as was the case when the Third Party Gas Access codes was developed) or if they pass the coverage test included in the National Gas Law (NGL). As the ACCC pointed out in its review of the east coast gas market, the coverage test included in the NGL is not appropriate and, as a result, unregulated pipelines now have more controls applied to them which limit the pipeline owner's ability to impose monopoly rents.

However, covered pipelines can be "uncovered" if they can demonstrate that the cost of coverage exceeds the benefit of regulation. Once uncovered, these pipelines are almost never going to become regulated again. What this means is that, at one point in time, a pipeline can demonstrate that the cost of regulation exceeds the benefit of regulation (and this is a relatively easy hurdle to overcome) and becomes uncovered, but when conditions change, reregulation is very difficult to reimpose.

For example, one MEU member advises that a pipeline serving its facility was regulated but subject to a contract with a single shipper for a 10 year period. Because of this 10 year contract, the pipeline advised that the cost of regulation exceeded the benefit to consumers of its coverage and on application to the NCC was "uncovered". On completion of the 10 year period, when the long term contract expired, the pipeline tripled its tariffs. On seeking recoverage, the rules for gaining coverage were found to be much more arduous than those for revoking coverage, and it was impossible to prove coverage should be reapplied. So a pipeline that had once been covered because it was a monopoly is now able to impose monopoly rents with impunity because the rules for recoverage effectively prevented it being reregulated.

The MEU considers that there needs to be a different approach where a pipeline that is subject to a contract(s) for shipping set under a competitive tender and therefore renders the need for regulation to be superfluous for the term of the contracts could be made not subject to regulation for the period those contracts are in force but to be subject to regulation again when those contracts expire.

1.4 Regulatory process

The MEU notes that there are subtle differences between the regulatory process for electricity assets and gas assets. However, these differences can have a significant impact on the ability of consumers to engage in the revenue reset process. This difference arises because the development of the regulatory approaches for gas and electricity were developed in different forums.

For example, under electricity, the regulator can determine on the regulatory operation (ie price cap or revenue cap) but this does not apply for gas. At the other end of the scale, under electricity regulation the regulator is required to release an issues paper¹ with the submission from the regulated entity but this does not apply for gas.

With this in mind, there should be consistency in the regulatory processes for both electricity and gas assets.

1.5 Greenfields pipelines

The MEU accepts that if a new pipeline is built based on a competitive tender process, there is an argument that the pipeline should not need to be regulated for the term of the foundation contracts, providing these do not exceed 15 years. However recent changes to the operation of the gas markets (especially on the east coast) shows that the basic assumption that pipelines will predominantly provide firm forward haulage is being challenged as a result of the very high price of gas and the demand from the export facilities, causing bi-directional flows and a greater use of interruptible capacity.

MEU members have experienced cases where pipelines have recognised that by pricing for services that were once not contemplated but now needed as a result of the changed environment, this presents an opportunity to increase revenues above the revenue a regulator would set based on the pipeline fundamentals (ie WACC*RAB + opex, etc).

¹ Consumers advise that the provision of an issues paper with a regulatory proposal provides focus for consumer involvement in the process

With this in mind, the MEU considers that there needs to be an ability of the regulator and/or NCC to determine that when the operation of the greenfield pipeline changes, regulation may be necessary to ensure that the pipeline is not using its monopoly position to increase revenues above those that would result if the pipeline was fully regulated.

1.6 Price cap regulation

Inherent in the concept of generating reference tariffs, is the concept of price cap regulation that applies to gas pipelines as a price cap approach is inherent in the development of reference tariffs for the most commonly used services of a regulated pipeline.

Price cap regulation, in theory, provides an incentive to the pipeline owner to increase demand for usage of the pipeline and by doing so, reduce the costs for all users; it also provides an incentive to “game” the regulator and thereby deliver revenues higher than were expected by the regulator when setting the allowed revenue.

The ability of the pipeline owner to “game” the regulator and enhance the forecast revenue lies primarily with the forecasts of gas usage within each customer class and the structures for the tariffs developed for each customer class. The AER has moved away from price caps for electricity networks because, amongst other issues, of the ability of price cap regulation to disadvantage consumers. The AER comments²

“We consider that a WAPC³ does not provide a high or even reasonable likelihood of efficient cost recovery. We consider the WAPC provides an opportunity for distributors to recover revenue systematically above forecast. That is, under a WAPC distributors have the opportunity to recover revenue substantially above forecast revenue when actual quantities exceed forecast quantities, and to recover revenue close to forecast when actual quantities are below forecast quantities.”

As a result of its analysis, the AER has determined in its most recent decisions on electricity transport, to apply a revenue cap approach to all regulated electricity networks.

In the case of transmission pipelines, the regulator can be gamed in a different way through maximising the prices for various pipeline services for which there is no reference price.

² AER “Preliminary positions on replacement framework and approach for CitiPower, Jemena, Powercor, SP AusNet, United Energy for the Regulatory control period commencing 1 January 2016” page 48

³ Weighted average price cap

An example is where the predominant pipeline service is for forward haul and the reference price is based on the regulatory assessed revenue divided by the expected forward haul volume – that is, the allowed revenue is fully recovered from forward haul contracts.

If a shipper seeks back haul on the same pipeline, the pipeline gets increased revenue from the additional service and so acquires more revenue than the regulator has considered reasonable for the pipeline. The backhaul service is likely to reduce the operating costs on the pipeline⁴. As the back haul service can only be offered by that specific pipeline, effectively the additional service is priced as a monopoly service and the shipper would have to seek arbitration if it considered the price to be excessive. So, while the cost of the backhaul service might be small (or even negative), the pipeline owner can charge a monopoly based price with little risk of being challenged. The overall result is that the pipeline acquires more revenue than is expected by the regulator.

There is a clear indication that a change to the regulatory approach implicit in the rules is warranted. The MEU considers that the AEMC should examine the benefits and detriments of the current implicit price cap approach to see whether a change from the current price cap arrangement would provide a better outcome for consumers.

1.7 The limitations of Contract Carriage model

Generally distribution gas pipeline networks operate on a market carriage approach where the prices for transport tend to be common for most end users of the same classification, regardless of location within each network⁵. Small users pay for their transport based on the amounts of gas used at each point of consumption whereas larger users pay for their transport reflecting the amount of capacity of the pipeline that has to be reserved for each large customer. Either way, it is recognised that there may be multiple paths to deliver gas to a specific location.

In contrast to the market carriage approach that applies in gas distribution networks, transmission pipelines operate on a contract carriage model⁶. The contract carriage approach allows the pipeline to acquire more revenue than the regulator considers is appropriate through selling other services such as an “interruptible” or a back haul service. Under contract carriage, the pipeline can

⁴ Back haul effectively reduces the forward flows on a pipeline and thereby reduces the costs of compression needed for forward haul.

⁵ Very large end users operate on a demand based tariff which can reflect some locational pricing, but usually these geographic based locations are quite broad

⁶ Except for the Victorian gas transmission system, which has features more akin to a distribution network

sell its capacity on a firm basis up to the rated capacity of the pipeline. The reference service is based on the amount of capacity sold (ie to the forecast amount of maximum daily quantity – MDQ – sold to each shipper). As each shipper might actually transport less than its MDQ, there is frequently unused capacity available to be sold on an interruptible basis.

So while the reference service price is based on firm capacity forecast to be sold, the pipeline can increase its revenue through the sale of interruptible capacity, the revenue from which is additional to the revenue considered by the regulator to be appropriate for the pipeline⁷.

If transmission pipelines were operated on a market carriage basis, then all available capacity would be available to all shippers up to the capacity of the pipeline without the need to buy additional firm service. This approach is the same as is used for electricity transmission transport and the Victorian gas transmission network.

The MEU considers that the AEMC should review whether consumers would be better served by converting gas transmission transport to market carriage.

1.8 Augmentation

It is asserted by a number of stakeholders during the AEMC review of the east coast gas markets that regulation and market carriage both provide a barrier to efficient augmentation of gas pipelines.

The MEU points out that both market carriage and regulation have not prevented the electricity transport system to be augmented as and when necessary. Indeed, there are many⁸ who have pointed out that regulation has permitted the electricity networks to be over augmented (gold plated) to the detriment of consumers. This hardly supports a view that regulation and market carriage are deterrents to efficient augmentation!

Implicit in the AEMC review of the east coast gas market is that it also considers efficient augmentation of the gas transport system is enhanced by the use of the contract carriage model of operation. Frequently cited as an example of the detriments of regulation in relation to augmentation, is the decision by the AER not to require Victorian consumers to fund the augmentation of the Culcairn interconnect to allow increased volumes of gas to leave the Victorian gas market. That eventually such an augmentation occurred without Victorian consumers being liable for the cost supports the view that the AER made the correct decision.

⁷ The same issue applies for backhaul services and short term storage (park and loan).

⁸ See, for example, Grattan Institute reports on electricity networks

But the MEU points out that augmentation of gas transmission pipelines operated under contract carriage only occurs when there is a party prepared to underwrite the augmentation and commit to paying for the increased capacity for an extended period.

The reality that augmentations only occur when fully underwritten by a shipper is a major barrier to efficient augmentation. Under market carriage, efficient augmentation occurs more regularly because it is effectively underwritten by all consumers. While it is asserted that requiring all consumers to underwrite an augmentation is not efficient, the MEU points out that it is more likely that efficient augmentation will occur under this arrangement than under contract carriage.

Augmentation of transmission pipelines particularly is made in discrete (usually large) steps and MEU members report that where an augmentation is needed for a new shipper, the pipeline owner requires that new shipper to be liable for the entire cost of that augmentation, including the spare capacity that might result from the augmentation. This imposes a considerable financial liability on the new shipper, perhaps to the extent that the new shipper will not underwrite the augmentation due to cost, and will find some other solution. This means that otherwise an efficient augmentation does not proceed. When examined from a purely pipeline perspective, this outcome might be efficient, but when considered on a national basis this outcome might not be the most efficient outcome for the wider community.

In this regard, it is pointed out that many of gas transmission pipelines across the country were built initially by governments or underwritten by governments. Through this mechanism, there was built into the transmission networks sufficient spare capacity that has benefitted Australia for many years since construction.

The MEU points out that while the gas rules allow for a pipeline owner to speculatively augment its pipeline and by doing so potentially earn some future benefit, there has been few (if any) such speculative augmentations undertaken. This clearly shows that pipeline owners will only augment if there is another party to fully undertake the risk of the augmentation.

It would appear that perhaps private ownership coupled to contract carriage is not as efficient in initiating augmentations as is assumed and asserted.

1.9 Arbitration

There is an explicit arbitration process where an aggrieved shipper can seek more appropriate outcomes but this approach has three major drawbacks.

-) The shipper needs to know that what it is seeking is not unreasonable, but the only party that can provide an early indication of this is the pipeline owner, which has a vested interest in not providing the best outcome for the shipper.
-) The process is not costless for the shipper and therefore there has to be sufficient and almost certain reward for the shipper to embark on the process
-) The pipeline owner has all the information and the amount of information readily accessible by a shipper is limited⁹ and therefore the shipper has little information on which to base its arguments with the pipeline or even when an appeal for arbitration is made.

Underlying these three issues, is that most consumers use a retailer to arrange their shipping of gas. As the cost of transport is effectively a “pass through” cost for retailers, the retailers, acting as shippers for their customer, have little incentive to seek lower costs for transport. But it is the retailer that contracts with the pipeline for transport but the consumer that pays. This break in accountability provides a clear barrier to a consumer seeking lower transport prices.

One MEU member points out that it has sought lower transport costs from a pipeline and comments that it received little support from its retailer in its “negotiations” as the retailer did not see any value to itself for providing significant support.

The process for providing information on non-scheme pipelines introduced by the GMRG would be appropriate for regulated pipelines to publish and make available on request by a shipper and/or a consumer and should be considered by the AEMC. Such information could also be published on the AER website, similar to that provided for electricity transport in regulatory information notices (RINs).

The cost of an arbitration is a further barrier to resolving issues between pipeline and consumers, and the smaller the amount of gas shipped on behalf of a consumer, the less likely there will be the commercial driver for a shipper or its customer to seek a better outcome.

The MEU considers that whilst arbitration is needed as the “ultimate incentive”, perhaps there could be a less intrusive and less expensive option where the AER oversees negotiations between pipeline and shipper (ensuring there is sufficient information made available to the shipper); such negotiations could be followed by some form of conciliation process provided by the AER if

⁹ For example, for electricity transport, there is a wealth of information available on the AER website included in the regulatory information notices (RINs). Even access arrangement information provided by pipelines at each regulatory reset is less than is available in the RINs

negotiations are unsuccessful. Such a staged approach would be a less expensive than arbitration.

1.10 Summary

The MEU is pleased the AEMC is reviewing the rules for regulating covered gas pipelines as the MEU has seen that regulation so far has not delivered the outcomes that were expected of the rules by consumers, and allowed regulated pipelines to accrue more revenue than was considered appropriate by the regulator. Further, it is clear the ACCC in its recent review of the east coast gas market has come to a similar conclusion.

The MEU considers that a significant cause of the issues identified by its members lie with the gas market rules for regulated (and unregulated) gas pipelines not being sufficient for the needs of consumers. In fact, the recent GMRG analysis and proposed changes for unregulated pipelines has identified that more information and controls are needed than is currently required by the current gas rules for regulated pipelines.

In this response to the issues paper, the MEU has proposed a number of enhancements to the gas rules the AEMC should incorporate into its rule revisions.

2. Response to AEMC questions

The MEU provides the following responses to the AEMC questions posed in its issues paper. The MEU notes that these responses should be seen in context with the observations provided in the earlier part of this response

#		Description	MEU observations
1	a	<p>What do you think are the objectives of the current regulatory framework? Are the objectives of the framework clear? Has the framework achieved them?</p>	<p>Recognising that each pipeline provides a monopoly service, it should only receive revenue consistent with its costs and a fair return for the investments made. The framework does not state that this is a core aspect. Implicitly, the regulatory framework has demonstrably allowed pipelines to gain more revenue than is warranted and expected by the regulator.</p> <p>Where the pipeline does take a risk greater than included in the regulatory bargain, then it is entitled to a reward for taking that additional risk. It is clear from the actions of the pipelines that they do not take such additional risks and therefore should not be able to garner more revenue than implied by the regulatory bargain.</p> <p>The rules need to be changed to ensure that this occurs.</p>
	b	<p>Are the objectives of the current regulatory framework still relevant, or should they focus on different issues such as monopoly pricing?</p>	<p>Regulation is intended to be a surrogate for competition. If a pipeline gains more revenue than would occur under competition, then the regulatory rules need to be changed to ensure that this does not occur. Currently the rules permit more revenue than the regulator considers necessary and appropriate; therefore the rules are insufficient to deliver the most efficient outcome for consumers.</p> <p>Fundamentally the rules are to prevent monopoly pricing yet this is occurring. This is not in the long term interests of consumers so the rules need to prevent the exercise of monopoly power whether this is in relation to price of other non-tariff issues.</p>

	c	Has the current incentive-based framework appropriately incentivised the efficient operation, use and investment in pipelines? Should a different approach to incentives be considered?	The current incentive based approach has delivered excessive revenues for no increased risk taking by the pipeline. On this basis alone, the framework has not achieved its purpose as there are monopoly rents being taken. This means that the incentives are too great and need to be modified.
	d	Are there other third party access regimes (for example, for rail, ports or telecommunications) that would better achieve the purpose of the gas regulatory framework?	
2	a	Do you consider that the benefits delivered by the access arrangement review process for a full regulation pipeline outweigh the costs?	The NGO requires the regime to benefit the interests of consumers over the long term. From a consumer point of view, the benefits of full regulation outweigh the costs, especially noting that the pipelines that are not regulated have exhibited significant monopoly rent taking. This clearly demonstrates that regulation does deliver better outcomes for consumers. Further, considering that even fully regulated pipelines have provided greater benefits to the pipeline than was anticipated by the regulator at the time of resetting the allowed revenue, it is clear that even the regulation we do have, still allows pipelines enhanced outcomes. Because pipeline owners continue to invest in regulated pipelines, it is clear that they consider the returns generated by regulated pipelines are acceptable and sufficient. This implies that the regulatory regime does not impose a cost that makes continued regulation non-viable for pipeline owners or cost consumers more than they otherwise would.
	b	Is there a regulatory framework that may better achieve the desired objectives compared to the current negotiate-arbitrate framework supported by access	See comments in section 1 above.

		arrangements developed under incentive-based economic regulation?	
	c	Do you think that the access arrangement process should be amended to be similar to the revenue determination process for electricity service providers? Should there be greater recognition of consumer consultation, particularly for distribution pipelines?	Yes. See comments in section 1 above
	d	Have the NGR been effective and adaptable to the evolution of the gas industry?	No. See comments in section 1 above. The current NGR have been developed on the basis of forward haul and a number of pipelines are exhibiting dual directional flows and under the current approach, this provides an opportunity for monopoly rent taking. The MEU considers that there needs to be an assessment as to whether the setting of a reference tariff is sufficient for ensuring that pipelines only receive sufficient revenue to cover their costs (ie an economically efficient revenue).
3	a	Do the form of regulation factors consider relevant structure, conduct and performance issues to enable the NCC to make an informed decision on the application of full or light regulation?	No. Just as the approach by the NCC under the revocation of coverage addresses factors that are in reality unrelated to the relevance as to the ability of pipelines to exercise market power, so too does the approach to light regulation. At its most fundamental, all gas pipelines provide a monopoly service and are not subject to true competition. Removing regulation (whether to light regulation or revocation) provides an opportunity for extracting monopoly rents and this is not in the long term interests of consumers.
	b	Do you consider that the light regulation regime has been fully utilised and	No. Consumers have seen monopoly rents taken on unregulated pipelines and even on regulated pipelines ¹⁰ . To assume that the benefits acquired by lightly

¹⁰ By accruing revenues greater than was expected by the regulator

		appropriately enforced to produce benefits to pipeline users and achieve its objectives? If not, why not?	regulated pipelines have been passed to consumers, and there are no monopoly rents being taken, is patently false. The fact that the GMRG has identified that uncovered pipelines need to have increased controls applied identifies that the controls applied to lightly regulated pipelines are obviously insufficient. This clearly supports the view that light regulation is inappropriate ¹¹ for use with gas pipelines.
	c	Are there other regulatory requirements that should be applied to light regulation pipelines? Are there current requirements that should not be applied?	The MEU considers that light regulation of gas pipelines should be revoked and full regulation reapplied. As a minimum, owners of pipelines under light regulation should have the same conditions applied that the GMRG has decided should be applied to unregulated pipelines. Either of these options would maintain some consistency in the rules applying to all gas pipelines.
	d	Having regard to the new proposed non-scheme pipeline regulatory arrangements on information disclosure and arbitration, is the light regulation regime still relevant? Should it be retained, removed or amended?	No. See response to Q3(c)
4		Do you consider that the three levels of regulatory discretion in approving the elements within an access arrangement are useful and assigned appropriately?	There is a need for discretion by the regulator as it has been demonstrated in past determinations that the lack of discretion has resulted in harm to consumers. It is recognised that for the development of the most efficient outcome for consumers there needs to be an ability to reflect changing circumstances and the development of better understanding and knowledge. If the rules do not allow

¹¹ The MEU also considers that generally light regulation in other spheres has been demonstrated to be insufficient to protect consumers and has permitted the extraction of monopoly rents. The monitoring function identifies where these rents are being taken but the ACCC has no powers to prevent their continuation. The MEU points to the ability of airports to extract monopoly rents through the charges made for car parking at airports.

			<p>discretion, the resultant rigidity has the potential to harm consumer long term interests.</p> <p>On this basis the MEU considers that the regulator needs to have sufficient discretion for it to ensure that the final determination meets the long term interests of consumers. As a general view, the MEU does not support limiting the ability of the regulator to achieve this outcome.</p> <p>It is the ability to appeal the use of the discretion allowed that has caused the most problems over the years. It has been the limited merits appeal mechanism where the application of discretion has caused concern as to the use of discretion, ultimately benefitting asset owners and cost increases for consumers. The decision of the CoAG Energy Council to make the AER rate of return guideline binding is an outcome of this. Now the AER has the discretion to balance the competing aspects of what is allowed in the rules but with the AER decision being binding.</p> <p>The MEU considers that the CoAG Energy Council decision to cease the operation of the limited merits review process will impose on the regulator a stronger requirement to ensure that its use of discretion is used appropriately – this is evident in the process proposed by the AER in its approach to developing the rate of return guideline.</p>
5	a	<p>Do you consider it beneficial that both forecast and actual capital expenditure are assessed by the regulator?</p>	<p>Yes. At all times, the capex, both forecast and actual, needs to be prudent. The MEU has seen examples of where pipelines have sought to include capex which subsequently was not used and at other times needed additional capex which had not been allowed. The regulator needs to be able to evaluate both forecast and actual capital. If forecast capital is allowed but not used, consumers suffer. If capex that was not included is subsequently needed, the regulator needs to be able to assess whether it should be rolled into the regulatory asset base at the next AA review.</p>

	b	Does an appropriate level of regulatory scrutiny on investment occur if the regulator’s discretion is limited?	Discretion allows the regulator to assess the prudence of the proposed capex. Limiting this ability can result in suboptimal outcomes (see response to Q5a). The MEU does not consider that granting the regulator discretion will result in any detriment if the capex is prudent, but limiting the discretion provides an opportunity for the pipeline to impose unnecessary costs on and risks to consumers.
	c	Can the same capital expenditure criteria apply to both market carriage and contract carriage pipelines? And to both transmission and distribution pipelines?	The MEU can see no reason why the same approach cannot be applied to all forms of carriage and type of pipeline. Transmission and distribution pipelines have the ability to provide speculative capex but have elected not to do so. This implies that the investment criteria are seen to be universal in application.
6	a	Should there be discretion regarding which extensions and expansions are to be included as part of a covered pipeline? On which basis do you consider that such discretion should be exercised?	If the costs for the extensions/expansions are to be paid for by consumers, then the regulator should have full discretion as to what is to be included in the allowed revenue. If the pipeline wants to invest more, then it can do so and pay for it itself – this is the concept of the speculative investment. Once the regulator is convinced that the additional investment is prudent, the value of the investment can be added into the RAB when the regulator considers consumers should be paying for the additional work.
	b	If a pipeline is partially covered, does this impact on the application of the cost allocation and tariff setting rules? Does it impact on other aspects of an access arrangement?	With the advent of the rules to be applied to non-scheme pipelines, the issue of partial coverage becomes important as, implicitly, the element of the pipeline that is not covered would/should become subject to the requirements for non-scheme pipelines. As the rules for non-scheme pipelines are now more stringent, this lessens the risks to consumers but does not eliminate them.. Having part of a pipeline not regulated creates an opportunity for the pipeline to

			<p>increase revenue and there is a need for the regulator to ensure that consumers are not paying a premium if the combined revenues exceed what would apply if the entire pipeline was regulated.</p> <p>The MEU considers that partially covered pipelines should become wholly covered and spare capacity that might exist in the unregulated portion to be considered “speculative”.</p>
	c	Should the same extension and expansion requirements apply to both market carriage and contract carriage pipelines? And to both transmission and distribution pipelines?	Yes. See response to Q5c
7	a	In your opinion, why has the speculative capital expenditure account rarely been used?	<p>As commercial entities (especially listed firms) are judged on their short term profitability, decisions are made not to provide expenditure on assets which do not have a demonstrable return in the short to medium term. This drives decisions to be made so that investments are judged by short term certainty of income. A classic example of this “short termism” is the decision by Jemena to decrease the size of the Northern Gas Pipeline than originally proposed as it did not have certainty of revenue based on the volumes of gas transport contracted.</p> <p>In counterpoint, most of the pipelines built by government in the past were deliberately oversized compared to short term volumes expected to allow for future but undetermined growth – examples of this are the Dampier Perth, Moomba Adelaide and Moomba Sydney pipelines. This probably occurred because governments have a history for recognising that long lived infrastructure (pipelines, electricity networks, roads, railways, etc) needs to be sized to reflect expected significant growth over the longer term and because governments (appropriately) have a need for lower rate of return on investment.</p>

	<p>b Should the regulatory framework support more or less investment of a speculative nature? If more, how could it do so most efficiently and effectively? With which party(s) should the risk of speculative investments reside?</p>	<p>In addressing this question, it is important to note that doubling the capacity of a pipeline does not double the cost¹². This means that the cost of providing the surplus capacity is relatively low compared to the cost of the contracted capacity and cost reflective tariffs that would be charged would also be lower for the surplus capacity once used. Retro-fitting additional capacity is much more expensive than incorporating additional capacity when the pipeline is built.</p> <p>Speculative investment is primarily related to an initial build or a major augmentation of a transmission pipeline. Initial build pipelines are not regulated due to the 15 year no coverage approach, so speculative investment for regulated pipelines predominantly applies to augmentations.</p> <p>Additional but unused capacity has to be paid for by either the pipeline owner or shippers (ultimately consumers). Imposing the cost on the owner, reduces their profitability and increases their risk (will the surplus capacity be ever used?) so they would require the surplus capacity to be rolled into the regulatory asset base (ie become a cost to consumers). Imposing higher costs on current consumers makes them less likely to use the service provided and becomes a wealth transfer from current consumers to future consumers.</p> <p>The current regulatory approach assesses the depreciated cost of the pipeline and divides this by the capacity forecast to be used, so essentially, the current regulatory framework passes the cost of surplus capacity to shippers and then to consumers. While this is implicitly a transfer of cost and risk to consumers, the regulator has a responsibility to ensure that capex is prudent, so implicit in the framework, deliberate inclusion of surplus capacity is excluded.</p> <p>In a practical sense, the issue of speculative investment only applies to</p>
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¹² For example, increasing a pipeline from 8 inch diameter to 10 inch diameter increases capacity by 50% yet the cost increase is likely to be less than 20% as the cost of gaining easement access is the same, the cost of trenching is much the same, although there is ~25% more steel and pipeline equipment costs will be marginally greater

			transmission pipelines and not distribution as augmentation of mains in a distribution network to accommodate increased demand is shared amongst all consumers and being not as “lumpy” as transmission expansions, more easily incorporated into tariffs with less shock ¹³ .
	c	If the regulatory framework permits speculative investment, should it also allow for the management of redundant assets?	Yes. Redundant assets should be taken out of the regulated asset base. The pipeline receives a rate of return that reflects the risk of unused assets so there is no reason for consumers to pay for both a return on assets which includes risk and for assets that are no longer used
8	a	Does the current regulatory framework offer appropriate incentives for a service provider to offer spare capacity of a covered pipeline where it is efficient to do so?	<p>No. The current approach provides excessive incentives.</p> <p>Under the price cap regulation, there is an active incentive for getting new customers to use the pipeline, even if adding these additional customers is inefficient.</p> <p>As the framework allocates allowed revenue against the reference service, the pipeline is incentivised to offer services which are not recovered under the reference service.</p> <p>Adding new customers and offering unregulated services allows the pipeline to over-recover its allowed revenue.</p> <p>If there is a regulatory framework change to a revenue cap, then the pipeline is indifferent to getting new customers as its revenue is secured.</p> <p>In reality, pipelines (both regulated and unregulated) do not need to “chase” new customers as customers have to come to the pipeline as it provides a monopoly service. Under a revenue cap, the pipeline can provide multiple services other than the reference service and effectively can provide a range of services without trying the “game” the framework.</p>

¹³ This also applies to the Victorian gas transmission system as that is effectively more akin to a distribution network operating with market carriage than a point to point transmission system

	b	Do you think that scheme pipeline service providers maintain useful spare capacity registers? Does this rule need to be amended in light of expected market reforms?	As identified in the GMRG review of non-scheme pipelines, there is insufficient information provided about pipelines for prospective users to access. The MEU considers that as a minimum, scheme pipelines should be required to provide as much information as non-scheme pipelines are now required to do, and this should be provided on a continuous basis rather than just at each regulatory reset. Spare capacity should be just one of a suite of information that should be made available.
	c	Are the rules on defining a service provider interacting with ownership and operational structures in a way that impacts on disclosure of potentially available pipeline capacity?	Greater clarity is required. See response to Q8a
9	a	Does the ability of service providers to exclude extensions from an access arrangement raise concerns for pipeline users?	The MEU considers that there is little capacity for pipeline extensions to be made “competitive”, as the pipeline controls the connection to the extension and the pipeline easement. MEU members have experienced the ability of the pipeline to impose excessive costs for connections to extensions and while, in theory, an extension might be built on a competitive basis, in reality, this becomes quite challenging. The GMRG recognises this in its assessment of the rules for non-scheme pipelines and the MEU considers that, as a minimum, a monopoly service provider must be subject to some form of control through provision of necessary information and then either arbitration or the ability to refer the issue to the regulator for resolution.

	b	Would service providers and users benefit from the NGR including a negotiation framework for the connection of separately owned assets to covered pipelines?	See response to Q9a The MEU does not consider that a negotiation framework ¹⁴ alone is sufficient to ensure that the pipeline does not use its monopoly position to the disadvantage of the consumer. A form of arbitration or reference to the regulator is needed to ensure that any negotiation will be possible. This is a conclusion inherent in the GRMG process.
10	a	Do the requirements to provide key performance indicators as part of an access arrangement result in useful information to users and prospective users of a pipeline?	The MEU considers that KPIs and information similar to that provided by electricity service providers in their annual benchmarking performance RIN data is needed. Similarly, cost information in the cost analysis RINs should be provided to the AER on an annual basis to allow the AER and consumers to identify appropriate costs for various activities.
	b	Should the rules allow for the regulator to be more specific on which key performance indicators for distribution and transmission pipelines should be reported? Would this provide for better comparisons across pipelines and over time? If not, how could greater consistency be achieved?	Yes. See response to Q10a The provision of KPIs (and the degree of achieving these) and economic benchmarking RIN data is essential for consumers to be assured about the regulatory bargain made on their behalf by the regulator.
11	a	Is the purpose of a reference service as an aid to negotiation for pipeline services a relevant purpose for both transmission and distribution pipelines? Has this been a successful approach? Should access arrangements cover a broader range of	The change in the gas market environment has significantly changed the concepts that were the basis of the Third Party Gas Access Code. This has resulted in a major shift away from the assumptions embedded in the Gas Code (and now the Gas Rules). For example, in recent times, pipelines that were considered to be unidirectional are now bidirectional. Swaps of gas imply financial reverses in flows as well. The concept of a reference service was predicated on the assumption

¹⁴ It is an oxymoron to refer to negotiation in relation to a monopoly service provider

		services?	<p>there would be one dominant service provided (ie firm forward haul) and the rules assume that the allowed revenue would be recovered from this service.</p> <p>In recent times, firm forward and back haul are more common, as are interruptible forward and back haul and park and loan services. Unless the concept of a reference service is changed to reflect the new reality, there is considerable concern that pipelines will use the advent of these new more often required services as a tool to increase revenues and effectively impose monopoly rents.</p> <p>The MEU considers there is a strong argument to move to revenue cap regulation and for tariffs being developed for each service reflecting the cost basis for providing each as applies in electricity regulation.</p>
	b	Should reference services continue to be defined in relation to market demand? Is there a more appropriate approach to defining reference services?	<p>See response to Q11a.</p> <p>The MEU considers that the concept of reference services should be changed to a model where a range of services and their tariffs are developed based on the cost of providing the service, with the allowed revenue recovered under a revenue cap approach</p>
	c	Does the access arrangement process limit the ability of the regulator and the service provider to make changes to the reference services for an access arrangement? If so, how could this be resolved? Is there merit in adopting the framework and approach process for access arrangements?	<p>Yes.</p> <p>See responses to Q11a and Q11b</p>
12	a	Does the light regulation regime achieve its objectives of providing relevant information to users and prospective users on access to a pipeline?	<p>No. To maintain light regulation adds a layer of complexity which has the potential to impose unnecessary costs onto consumers and allow the pipeline to garner monopoly rents.</p> <p>In fact the concept of light regulation imposes less requirements than now applies</p>

			<p>to non-scheme pipelines.</p> <p>The ACCC east coast gas review identifies that unregulated gas pipelines were gaining monopoly rents and implies that light regulation was not achieving the aims of this form of regulation. It is also clear that fully regulated pipelines are accruing monopoly rents as they consistently recover more revenue than was allowed by the regulator.</p> <p>Those pipelines subject to light regulation are so because the NCC considered this was appropriate but the difference now between the requirements of regulated and non-scheme pipelines is now considerably narrowed, making the need for light regulation effectively redundant.</p> <p>There are two options available to address the issue of lightly regulated pipelines – either make light regulated pipelines fully regulated (preferred by the MEU as regulation of such pipelines was still seen to be necessary by the NCC) or make then non-scheme pipelines subject to the GRMG requirements.</p>
	b	Should the information reporting requirements and the limited access arrangement provisions specified for light regulation pipelines be amended to better achieve the regime’s purpose?	<p>Yes. As a minimum to that required for non-scheme pipelines but preferably to the level proposed in the response to Q10a and Q10b above for regulated pipelines.</p>
13	a	Do access arrangements and access arrangement information documents contain relevant and accessible information for users and prospective users seeking access to a covered pipeline? Is consistency in the provision of information important to aid in its understanding?	<p>Some of the information needed by stakeholders for a regulatory reset is provided in the AAI, but this quickly goes out of date between resets. As noted in responses to Q10a and Q10b more information is required to ensure that trends can be identified and accurate cost data for commonly carried out tasks is needed to assure consumers that the costs claimed by the pipelines is accurate and relevant. The MEU considers that economic benchmarking and category analysis data as provided for electricity networks is needed to be provided and updated annually.</p>

	b	Do the Part 11 information requirements result in the provision of information that is relevant to users and prospective users seeking access to a covered pipeline? Is there other relevant information that could be provided? How do these requirements compare to the reforms for non-scheme pipelines?	Part 11 needs to be upgraded to provide, as a minimum, the data required by the GRMG for non-scheme pipelines should apply to regulated and light regulated pipelines. Further, to enable prospective shippers to assess whether access costs are reasonable, current information is needed, so annual updating is needed
	c	Could the Bulletin Board, or the scheme register, play a greater role in making available information regarding covered pipelines?	Yes, to some extent. The regulator holds most of the information as this is provided with the AAI at a reset. It also understands how the revenue was calculated and the tariffs developed, so use of the GBB and a register might have limited application. As noted in responses to Q10a and Q10b better information should be held by the regulator and made available to consumers.
14	a	If there is uncertainty about how the current arbitration framework operates, how could this be resolved? Should Chapter 6 of the NGL and/or Part 12 of the NGR be amended with regard to the information and/or the processes?	Yes. There needs to be a clear and unequivocal approach outlined in the rules for addressing issues and disputes. The six dot points outlined in section 6.4.4 are all valid concerns and must be addressed. The process for non-scheme pipelines addresses some of the concerns so the rules for regulated pipelines need to be upgraded to reflect the GMRG approach. For regulated pipelines, the regulator should be able to address disputes without the need for the expensive commercial arbitration implicit in the GMRG approach. Moving to a revenue cap approach with the number of services actually used all having tariffs set will assist in reducing disputes.
	b	Are there aspects of the arbitration framework for non-scheme pipelines under development by GMRG that could also apply to scheme pipelines?	Yes, especially in relation to the costs of connection and the allocation of allowed costs into tariffs for non-standard services. Rather than have these addressed by a commercial arbitrator, this work should be done by the regulator based on the information provided by the prospective shipper and the information held by the

			<p>regulator from the most recent reset and annually upgraded RIN data provided. The reset work and data held by the regulator makes it the most appropriate body to assess a dispute.</p> <p>The move proposed by the MEU to a revenue cap and tariff setting will remove many of the disputes to be addressed by commercial arbitrator under non-scheme pipelines</p>
	c	Which pipeline services should be subject to arbitration? Are there any pipeline services that should be excluded?	All services should be subject to arbitration
15	a	Do you consider that the reference tariffs for transmission and/or distribution pipelines reflect the efficient costs of providing those reference services? If not, which provisions of the NGL or the NGR are contributing to that outcome?	<p>No. There are other services that are provided as well as reference services and there is no certainty that these other services will be priced reflecting the costs involved to provide them or the appropriate allocation of overhead costs.</p> <p>The MEU considers that a move to a revenue cap is more likely to result in each of the services (including reference services) being more cost reflective as the pipeline has no incentive to bias the costs each service carries. While a price cap arrangement applies, there is an active incentive for the pipeline to allocate costs in a way which maximises expected revenue.</p>
	b	Should the NGR recognise partially covered pipelines and provide specific guidance on cost allocation in this context?	<p>Having part of a pipeline unregulated provides an opportunity for the pipeline to recover more revenue than might apply if the entire pipeline was regulated as the sum of the revenues from the unregulated portion and the regulated portion might exceed the cost if the entire pipeline was regulated</p> <p>The MEU considers that partially regulated pipelines increase the potential for misallocation of costs as there is an incentive for the pipeline to do so. While the GMRG approach to setting tariffs for the unregulated portion of a pipeline might result in better allocation of costs, this outcome is not certain.</p> <p>As all pipelines are monopolies there is no justification for having part of a pipeline</p>

			<p>unregulated (with this part of the costs of the pipeline subject to the GMRG approach) and the other part regulated by the AER, as this provides an opportunity for the pipeline to “play” one entity off against the other, to the detriment of consumers.</p> <p>The NGR needs to reflect this potential and provide clear guidance as to how information, costs and pricing generated by the AER will be available to the commercial arbitrator (and vice versa) so that there is no ability to “double dip” by the pipeline.</p>
	c	<p>Do the tariff setting requirements in the NGR provide the appropriate balance between discretion and guidance to achieve cost reflective tariffs? Should the discretion of the regulator be limited?</p>	<p>With the emerging need for more services to be provided than the basic firm forward haul tariff, there is a need to ensure that all likely services that might be needed are priced to ensure that over-recovery of revenue is not possible. The approach preferred by the MEU is that a revenue cap approach should be applied but alternatively, there should be reference tariffs provided for all likely services to be provided by the pipeline.</p> <p>With this in mind, the pipeline should report to the regulator what services had been sought in the previous period and the regulator should verify through consumer feedback what services are needed. Then the regulator should determine what tariffs are to included in the access arrangement and require the pipeline to develop prices for each of the services identified</p>
	d	<p>Why do you think that distribution pipeline service providers tend to charge the reference tariffs as the prices for the services that they provide?</p>	<p>Because, by doing so, there is unlikely to be any disputes with consumers, and consumers accept them on the basis they have been set by the AER.</p>
	e	<p>Is the balance between prescription and discretion for the reference tariff variation mechanism appropriate? Would more guidance in the NGR or from the</p>	<p>No. See earlier comments</p> <p>Consumers (and the AER) need to be assured that the revenue generated from all services should not exceed the allowed revenue. This can only be achieved by the</p>

		<p>regulator better support the development of these mechanisms?</p>	<p>AER having all of the needed discretion to assess both the tariffs and the forecast volumes for each service to assure them that the revenue all the services provided matches the allowed revenue</p> <p>If, subsequently the AER identifies that the allowed revenue has been exceeded, the AER should have the ability (discretion) to ensure that this over-recovery does not continue.</p> <p>Under a revenue cap approach, this issue does not apply as over/under recovery of revenue is adjusted in the next year.</p>
16	a	<p>Do the non-tariff requirements for access arrangements result in relevant information being provided to users and prospective users of covered pipelines? Are there other non-tariff requirements that would be relevant?</p>	<p>Generally yes but this does not mean that the non-tariff terms are equitable or sufficient (see response to Q16b).</p> <p>However, the MEU notes that in the case of queuing an auction can be held for available capacity but there is no clarity on how the proceeds from this auction will be allocated back to consumers so that the pipeline does not accrue revenue exceeding the revenue allowed by the regulator</p>
	b	<p>Should the NGR or the regulator provide more guidance on which non-tariff requirements should be included in an access arrangement? Is there a need to provide greater guidance regarding the regulator's assessment of non-tariff requirements?</p>	<p>Consumers need greater certainty than the current rules require (eg at each regulatory reset). The MEU considers that there should be greater prescription as what are considered to be "model" non-tariff terms (the MEU suggests that these model non-tariff terms should be developed by the regulator) and deviations from these should require approval of the regulator.</p>

