Dear Dr Vertigan

Examination of the current test for the regulation of gas pipelines

Jemena welcomes the opportunity to provide a submission on the examination of the current test for the regulation of gas pipelines (the Review), and we thank you for your proactive engagement to date.

Jemena owns and operates a diverse portfolio of energy and water transportation assets across eastern and northern Australia. With more than $9 billion worth of major utility infrastructure, we supply millions of households and businesses with these essential services every day. In addition to electricity and water distribution, Jemena's assets include three major gas transmission pipelines (including the Northern Gas Pipeline which is currently under development) and the largest gas distribution network in Australia. Each of these assets is subject to the gas access regime and coverage test under the National Gas Law.

As many stakeholders have noted, the Review comes at a time of significant change for the east coast gas market and it is imperative that regulatory and policy settings continue to promote the long term interests of customers throughout this period. Jemena has been delivering value to our gas transmission and distribution customers for many years and we are committed to continuing to deliver value into the future. In addition to significant investment in new and expanded pipelines—Jemena has committed over $1 billion in the last two years—gas transmission prices have largely remained flat in real terms over the past decade under the current regulatory framework.

Jemena has had considerable time to consider and analyse trends in the east coast gas market and critically examine the ACCC’s findings from its East Coast Gas Inquiry (the inquiry). In summary, it is counterintuitive for Jemena to put upward pressure on gas prices when our gas pipeline and network investments depend on gas continuing to be a fuel of choice for end customers. With the increasing uptake of renewable energy sources, localised generation and moderating grid-electricity prices, Jemena firmly believes that the entire gas industry, including pipeline owners, must continue to demonstrate its value to all energy customers.

The attached submission provides Jemena’s responses to the various questions contained in your consultation paper. Jemena considers a convincing case to change the coverage criteria has not been established. Jemena disagrees with the
Inquiry’s sweeping findings of monopoly pricing, and with the general proposition that the current coverage criteria are not ‘fit-for-purpose’ for non-vertically integrated infrastructure (such as gas pipelines).

A strong rationale and historical underpinning for the gas access regime, including its coverage test, exists in the National Access Regime. Before endorsing a departure from the current approach to regulation, the Review should consider that rationale and the effectiveness of the current regime, including the influence that regulation will have on incentives for efficient investment.

As part of our review of the Inquiry’s findings and recommendations, I have sought feedback from our shareholders, who have expressed significant concerns with the ACCC’s proposed changes to the gas access regime. Our shareholders have stressed the need for investment in Australia’s critical infrastructure to continue to be promoted by stable and predictable policy frameworks—put simply, the ACCC’s proposed changes would undermine the viability of projects such as our Northern Gas Pipeline and the future growth of Australia’s pipeline network.

Jemena has also contributed to the Australian Pipeline and Gas Association’s submission on this issue, and we support the Association’s submission.

We look forward to the Review’s next round of stakeholder consultation. Please contact Ian Israelsohn, General Manager Policy & External Affairs, on (03) 9173 7824 if you have any questions regarding this submission.

Yours sincerely

[Signature]

Paul Adams
Managing Director
Jemena Limited

Examination of the current test for the regulation of gas pipelines

Submission on Consultation Paper

18 October 2016
Contact Person

Ian Israelsohn
General Manager Policy & External Affairs
Ph: (03) 9173 7824
ian.israelsohn@jemena.com.au

Jemena Limited

ABN 95 052 167 405
Level 16, 567 Collins Street
Melbourne VIC 3000

Postal Address

PO Box 16182
Melbourne VIC 3000
Ph: (03) 9713 7000
Fax: (03) 9173 7516
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<td>Queensland Gas Pipeline</td>
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<td>Report</td>
<td>ACCC East Coast Gas Inquiry Report</td>
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<td>The Examination of the Current Test for the Regulation of Gas Pipelines</td>
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EXECUTIVE SUMMARY

No clear case of monopoly pricing by pipeline operators

Jemena does not agree with the ACCC’s finding regarding monopoly pricing by transmission pipeline operators as it is based on:

- assertions that are far from conclusive—detail that is provided in the ACCC’s report largely relates to a small subset of services provided by pipeline operators or a small portion of the total value of investments made by pipeline operators, which does not support its finding that monopoly pricing is ‘widespread’
- incorrect and misrepresentative information and analysis relating to Jemena—including analysis in the ACCC’s report which fails to account for the capitalised value of the entire pipeline in calculating pipeline rates of return (quoted in support of claims that pipeline returns are excessive)
- analysis which adopts an inappropriate framework—which fails to have regard to the forward-looking, market-facing factors that influence how Jemena prices its pipeline services, and ignores some of the risks Jemena bears as a pipeline owner.

Current coverage test can address the issues suggested by the ACCC

Jemena disagrees with the ACCC’s characterised ‘problem’ with the current coverage test, namely that it cannot address certain instances of monopoly pricing by pipeline operators which impact efficiency in a dependent market without impacting competition. It is inevitable that sustained monopoly pricing by a pipeline operator would give rise to economic inefficiencies that impact the level of competition in dependent markets. Upon examination of the examples cited by the ACCC to support this claim, it is apparent that each example involves impacts on competition in dependent markets, and that the current coverage test (in particular, criterion (a) of the test), can be satisfied in such circumstances.

Current regime has enabled the realisation of significant customer benefits

Under the current regulatory framework, including the current coverage test, significant new investment and innovation in pipeline services has been delivered to meet customers’ needs in a timely and efficient manner to date. Jemena alone has committed over $1 billion to new pipeline investment since 2014, in addition to developing new services that allow our customers to fully participate in an increasingly dynamic east coast gas market.

In the face of the unprecedented changes experienced by the east coast gas market over the past decade, transmission pipeline prices have remained steady in real terms over this period. Furthermore, gas transmission charges comprise only seven or 13 per cent of a typical gas bill for NSW households and large industrial customers respectively.

In practice, given the relative level of transmission prices, we question whether even major reductions in these prices would (without taking into account the longer-term costs and risks of regulation set out below) be likely to materially reduce end gas prices for customers. Moreover, it does not follow that under a coverage test which does not explicitly focus on the promotion of competition in upstream or downstream markets that customers are likely to benefit from any (short-term) price reductions, which may be absorbed elsewhere in the supply chain.

ACCC’s proposed test carries significant risks for customers

There are significant costs and risks associated with the ACCC’s proposed coverage test, and we consider it would be unlikely to better facilitate the achievement of the National Gas Objective. Regulation is not a costless
exercise and the direct and indirect costs associated with coverage are significant and ultimately borne by customers.

In addition to considerable direct costs—for example, Jemena’s response to its most recent five-yearly gas distribution access arrangement review cost around $8 million—both the act of significantly changing the coverage test and the substance of the ACCC’s proposed test itself create material regulatory risk for gas infrastructure investors, reducing incentives for investment, increasing the cost of debt and equity funding and ultimately increasing prices for consumers.

Efficient investment in Australia’s gas market relies on a stable and predictable regulatory framework. In 2015, Jemena committed to developing the $800 million Northern Gas Pipeline. However, such is the significance of the additional regulatory risk associated with the ACCC’s proposal, that Jemena would not have been able to commit to this major development under the ACCC’s proposed test.

Regulation also carries the risk of ‘holding-up’ efficient investment due to delays associated with the regulatory price review cycle. In late 2015, Jemena completed a significant expansion to the capacity of the Eastern Gas Pipeline, which was carried out in close consultation with customers to allow additional gas to flow from Gippsland to meet higher demand in Sydney by winter 2016. Jemena was able to progress this project from an approach by a customer with a requirement to a final investment decision in twelve months to meet their required timeframes. Investment hold-up in the transmission sector risks creating constraints in the broader gas market that do not allow gas to flow to consumers when it is needed, resulting in higher wholesale gas prices in delivery markets. In an east coast gas market where the ACCC has noted the concerns of some customers about an inability to obtain gas supply offers, it would clearly be contrary to customers’ long-term interests if changes to the pipeline regulatory regime were to cause situations where pipelines pose a constraint to the delivery of gas to customers in the future.

The regulatory uncertainty faced by investors is compounded by the review of the limited merits review regime currently underway in parallel to this review of the coverage test. Even independently, each of these reviews gives rise to significant uncertainty for investors in gas infrastructure. However, with the reviews being undertaken simultaneously, a scenario could eventuate where an investor faces the coverage of a pipeline under a new, untried coverage test with no rights to apply for merits review of the coverage decision, and then faces an access arrangement determination with no rights to apply for merits review of that determination. Not only would such a situation create substantial regulatory risk for investors, increasing required rates of return and/or discouraging investment, it would also result in a material risk of regulatory outcomes that are not in customers’ long-term interests.

Jemena notes that the Council of Australian Governments Energy Council has recently announced an additional parallel set of reforms to the gas transmission market, consistent with the recommendation of the Australian Energy Market Commission, with its package of pipeline capacity market reforms designed to encourage more liquid trading of pipeline capacity.

**Maintaining consistency with the National Access Regime**

To ensure the efficient operation and use of, and investment in, infrastructure throughout the east coast gas market and the broader economy, the historic consistency between the gas pipeline coverage test under the National Gas Law and the declaration criteria under the National Access Regime should continue. The Government’s proposed changes to the National Access Regime’s declaration criteria have been subject to extensive expert review and consultation. If the declaration criteria are amended in line with the Government’s proposal, Jemena considers that the gas pipeline coverage test should be modified to maintain alignment with the declaration criteria.
Further exploration and assessment of any alternatives

Jemena considers that no case has been established to significantly change the coverage criteria, beyond modification to maintain alignment with the declaration criteria of the NAR. The current coverage test can effectively address instances of monopoly pricing by a vertically-separate pipeline.

There are a number of significant related issues and reforms impacting the east coast gas market which create substantial uncertainty for investors. Further exploration of alternative coverage tests should therefore not be undertaken before:

- restrictions on gas supply, acknowledged by the ACCC as the primary issue affecting the east coast gas market, have been addressed
- the full package of the Australian Energy Market Commission’s pipeline capacity trading reforms have been implemented and given time to be bedded down
- arrangements surrounding the limited merits review regime have been clarified.

At such a time, should a clearer and more convincing definition of any problem associated with the coverage test be established, this foundation should be used to explore a range of potential alternatives. As part of this process, assessments of the costs, risks and benefits of each alternative should be undertaken. Noting the significant costs and benefits of the ACCC’s proposed test, and its basis in addressing a disconnect between efficiency and competition which does not exist, Jemena does not consider this proposal is an appropriate starting point for any such consideration of alternatives.
1. WHAT IS THE PROBLEM AND WHY DOES IT NEED ADDRESSING?

**Question 1**

Do you agree with the ACCC’s finding that the majority of existing transmission pipelines on the east coast have market power and are using this power to engage in monopoly pricing? Why/Why not? Please provide evidence to support your argument.

Jemena refutes any finding that it is using market power to engage in monopoly pricing on its pipelines. Jemena actively engages with and negotiates the terms and prices of our pipeline services with our customers to ensure we can best meet their requirements now and into the future.

The ACCC’s findings in its East Coast Gas Inquiry Report (the Report) appear to be based on a framework and methodology that is not appropriate and, in relation to Jemena’s pipelines, is reliant upon misrepresentative or incorrect information.

The conclusion that the majority of east coast transmission pipelines have market power and are engaging in monopoly pricing is not supported by the ACCC’s own Report. From the material provided in the Report, any alleged monopoly pricing the ACCC purports to identify is still relatively isolated when the broader east coast gas market and the size of the pipelines that serve the market are considered. Where detail is provided in the Report, it seemingly relates to:

- a relatively small number of pipelines—for example, smaller regional pipelines
- a small portion of the total value of investments made by pipeline operators—for example, smaller incremental expansions to the capacity of larger existing assets
- a small subset of the services provided by pipeline operators in the east coast gas market—for example, as-available services which, in Jemena’s case, comprise a fraction of the total revenue we derive from our transmission pipelines.

As a matter of principle, the second and third of these findings are not consistent with a conclusion of monopoly pricing, which would need to involve an assessment of revenues against long run costs for an entire pipeline—rather than in relation to a subset of services that may be provided.

Furthermore, the Report specifically acknowledges shortcomings in the ACCC’s analysis of whether pipelines were exercising market power:

> “it was beyond the scope of this Inquiry to carry out a detailed forensic examination of the prices charged by every pipeline on the east coast to determine whether they involve the exercise of market power.”

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1. ACCC, Inquiry into the east coast gas market, April 2016, p. 118.
2. Ibid, p. 104.
This statement infers that the ACCC’s analysis only had a limited focus and should not be considered as wholly representative of the market’s pricing. It is also unclear whether the analysis that was conducted by the ACCC was in any way detailed or simply high-level. It has not released this analysis.

The ACCC cited three broad examples in support of its finding that monopoly pricing by pipeline operators is prevalent throughout the east coast market. Our concerns with each example (as they relate to Jemena’s pipelines) are outlined below.

**Inappropriate methodology used in analysis**

Jemena views the ACCC’s contention that “the prices charged by some pipeline operators that have already recovered the cost of construction are higher than would be the case under full regulation” is flawed in terms of its concept and application. Further, we do not consider the information presented by the ACCC in the Report actually supports a finding of monopoly pricing. We are concerned by the ACCC’s apparent methodology and implied suggestion that the pricing of pipeline capacity should be determined in accordance with the concepts underpinning the determination of reference tariffs for covered pipelines, namely a backward-looking framework based on historical expenditure. Furthermore, in circumstances where a pipeline is covered and such a framework is used to determine its prices, the risk of changes in demand for pipeline services is substantially borne by customers, rather than the pipeline owner. By contrast, as an owner of uncovered pipelines, we fully bear this risk.

Jemena is committed to maintaining long-term, mutually beneficial relationships with our customers to ensure their continued use of our pipelines. This requires us to consider and proactively manage a range of short, medium and long term factors that influence pipeline usage, customer requirements and ongoing maintenance and capital costs associated with the pipeline.

The backward-looking framework suggested by the ACCC places a significant focus on necessarily difficult estimates of the accumulated value of the capital base of a pipeline owner and without taking into consideration competition and market drivers. This is inconsistent with the frameworks for assessing monopoly pricing that have previously been applied to pipelines, in coverage matters evaluated by the National Competition Council. In any case, the tariffs and non-price related terms of access for our pipelines reflect forward-looking considerations and constraints, including:

- the delivered price of gas to the destination market or markets by means of one or more alternative pipelines
- the extent to which upstream producers can inject gas into these pipelines and the extent to which their buyers have a choice as to which end market the gas is to be shipped
- the extent of spare capacity on both the relevant Jemena pipeline and all competing pipelines
- the prevailing prices under existing, medium and long term take-or-pay commitments by existing shippers on Jemena’s pipelines
- the extent to which existing shippers on either Jemena’s or a competing pipeline hold spare capacity under contract, and so are able to compete to provide that spare capacity to third parties (for example by way of bare transfer, assignment or capacity trade)
- across all of these variables, the extent to which the present, highly dynamic nature of the east coast gas market may cause them to change over the relevant period for which any new transportation contract price is to be struck.

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Overall, Jemena does not consider the framework applied to support the ACCC’s findings accords with the commercial and market circumstances in which we operate our pipelines.

Inaccurate or misrepresented information

Jemena does not agree with the ACCC’s finding that “the high rates of return that pipeline operators expect to earn on incremental investments are consistent with monopoly pricing.” This finding is based on a number of inaccurate and potentially misleading statements in relation to Jemena in the Report, regarding matters including the following:

- the high rates of return the ACCC claims are to be earned on one of Jemena’s pipelines—where the claimed figure was not calculated by the ACCC based on the full capitalised value of the asset, and, for example, was instead simply based on the historical cost of constructing the pipeline only;

- the high rates of return the ACCC claims are to be earned on incremental capacity expansions on Jemena’s pipelines—where the claimed figures do not reflect the overall return expectations for the entire pipeline, given that without an existing asset there would be no return at all for additional capacity created by increased compression or looping.

Jemena would welcome the opportunity to discuss the specifics of the above matters in further detail with Dr Vertigan.

Impending market reforms

In relation to the ACCC’s finding “that some pipeline operators are charging excessive prices for as-available and interruptible transportation services on key routes between Queensland and southern states and for hub services at Wallumbilla,” we are not aware of any information or assertions by the ACCC that relate to Jemena or our assets. In any case, when multiple services are provided by the same asset, a valid finding of monopoly pricing requires an assessment of the totality of revenue from all services, against the long run costs of the entire asset.

However, as outlined in Jemena’s response to question 10 below, the pipeline capacity market reforms recently announced by the Council of Australian Governments (COAG) Energy Council are likely to force pipeline operators to price as-available services at near-zero levels in the future. Given these impending reforms, and the very small proportion of total pipeline revenue such services comprise, we consider this point is not relevant in contributing to a finding of monopoly pricing.

Questions 2 and 3

Is the ACCC’s characterisation of why monopoly pricing is a problem accurate? Why/why not?

Are there any additional effects of monopoly pricing on gas market participants that the ACCC did not identify?

Jemena agrees that the economically efficient operation of, and efficient investment in, the east coast gas market, as well as upstream and downstream markets, are crucial to furthering both the long-term interests of gas users as set out in the National Gas Objective (NGO) and Australia’s broader economic interests.

The consultation paper states that “the ACCC observed that this [monopoly pricing by transmission pipelines] could have adverse effects on the economic efficiency of the east coast gas market and upstream and

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6 Noting also that asset returns should be measured against the market value attributed to them, not their historical cost.
downstream markets” (emphasis added). The ACCC’s Report is heavily theoretical and relies on examples of outcomes that may arise under certain prescribed conditions, rather than observed market failures or market predictors. As explained further in our response to questions 6 to 9 and in Appendix A, Jemena considers that instances of monopoly pricing by a vertically-separate facility, including the examples contained in the Report, are likely to impact competition in upstream or downstream markets. Other than the potential impacts on competition in dependent markets, Jemena is not aware of any potential additional effects of monopoly pricing on gas market participants.

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7 Dr Michael Vertigan AC, Examination of the current test for the regulation of gas pipelines: Consultation paper, October 2016, p. 6.
2. IS THE EXISTING REGULATORY TEST WORKING?

Question 4
What do you believe is the objective of the existing coverage test?

Historically, there has been a strong degree of consistency between the coverage test under the National Gas Law (NGL) and the declaration criteria under Part IIIA of the Competition and Consumer Act 2010 (CCA) (the National Access Regime or NAR). Alignment between the two regimes is in keeping with objective (b) of the NAR, which is to encourage a consistent approach to access regulation in each industry.\(^8\)

In line with its structural consistency, the objective of the NGL’s existing coverage test is consistent with objective (a) of the NAR (being the efficient operation of, use of and investment in infrastructure), and the promotion of competition in dependent markets. The promotion of competition in upstream and downstream markets should facilitate improvements in allocative efficiency, and in light of our comments below in response to questions 6 to 9 regarding the relationship between competition and efficiency in dependent markets, Jemena believes the objective of the NGL coverage criteria is consistent with and contributes to the NGO.

It is also important to highlight that the NGO itself requires trade-offs between the achievement of different types of efficiencies over different time horizons. The National Competition Council’s Gas Guide notes that “the need for a ‘long term’ perspective is included [in the NGO] as a caution against focussing on short term benefits to consumers which may undermine longer term investment and welfare gains.”\(^9\) In the context of the coverage test’s objective, it is important to balance the need to create and maintain an environment which encourages efficient investment that will be in the best long-term interests of consumers against short term outcomes or perceived benefits that may stifle such investment.

Question 5
To what extent does the current interpretation of the existing coverage test fulfil the objective?

Jemena considers the current coverage test has fulfilled its objective well. The test has ensured that coverage is only applied to pipelines that have significant and sustained market power in cases where it materially promotes competition in dependent markets, with the consequence that tangible benefits in customers’ long-term interests are realised. Given the potentially significant costs and risks of regulation discussed further in our response to question 16, we consider this is an appropriate outcome.

Furthermore, Jemena and the pipeline sector more broadly have delivered significant investment and innovations in response to customer requirements, consistent with their long-term interests. These positive outcomes have been realised under the current coverage test and, more broadly, the largely stable and predictable framework provided by the gas access regime.

This includes more than $1 billion that Jemena has committed to invest in new transmission pipeline capacity in the period since 2014, including:

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\(^8\) Competition and Consumer Act 2010, s.44AA.

\(^9\) National Competition Council, Gas Guide, October 2013, p. 27.
• the development (currently underway) of the Northern Gas Pipeline (NGP), a new pipeline connecting the Northern Territory with the east coast gas market. The NGP will provide strong incentives for producers to develop the Northern Territory’s gas resources and provide an additional pathway to deliver gas to east coast customers

• a significant expansion of the Eastern Gas Pipeline’s (EGP) capacity to meet growing customer demand in NSW and the interconnection of the EGP with the Moomba to Sydney Pipeline, providing additional flexibility to EGP users and allowing highly-seasonal gas flows on the EGP to be better optimised

• expansions to the Queensland Gas Pipeline (QGP) to respond to the growing needs of industrial customers.

Jemena has also developed a variety of flexible services that allow customers to better participate in an increasingly dynamic east coast gas market, including through the trading of pipeline capacity and gas.

The developments and commitments outlined above have been driven by Jemena in response to our customers’ needs. Furthermore, these positive outcomes for customers are being realised in an environment where transmission pipeline prices comprise a relatively small portion of the total cost of gas to end customers and have remained stable over the past decade.10

Questions 6 to 9

Is the existing coverage test an effective constraint on pipeline operators’ behaviour? Why/why not?

Do you agree with the ACCC that the existing coverage criteria, and in particular criterion (a), establishes a hurdle for regulation that is unlikely to be met by the majority of transmission pipelines on the east coast? Why/why not?

Can the current coverage criteria address the market failure identified by the ACCC - monopoly pricing that gives rise to economic inefficiencies with little or no effect on the level of competition in dependent markets? Why/why not?

Could the coverage criteria be satisfied in the case of a non-vertically integrated pipeline? Why/why not?

We recognise that regulation is a last resort for consumers and pipeline owners and is intended to step in only when the market is not operating as intended. However, as set out in our response to question 16, regulation carries significant direct costs and risks for the asset owners to which it is applied, as well as for the broader market. As a long-term investor that values investment certainty and relies on the continued efficient operation of the gas market to fully realise the value of our assets, it is strongly in our interest—and our customers’ interests—to avoid coverage.

The current coverage test provides a credible threat of regulation, and does pose an effective constraint on our commercial dealings with customers. We maintain policies and procedures to manage the risk that a party seeks coverage of one of our pipelines, including:

• non-discriminatory access policies
• publishing reference tariffs and standard terms and conditions for our pipeline services
• maintaining records of access requests
• building and maintaining collaborative, mutually beneficial relationships with our customers and potential customers, including undertaking an annual survey of customer sentiment

10 Our response to question 15 provides further detail on the contribution of gas transportation costs to the delivered price of gas.
• proactively engaging with our customers and working with them to develop mutually beneficial, negotiated solutions.

We do not agree with the ACCC’s assertions that the current coverage criteria establish a hurdle that is unlikely to be met by the majority of transmission pipelines on the east coast. The ACCC has argued that the current coverage criteria have not been able to address gas transmission pipelines’ exercise of market power because the criteria are focused on competition rather than efficiency, and that there are significant inefficiencies in the provision of pipeline services that have little or no impact on competition in dependent markets.¹¹

Jemena disagrees with the ACCC’s characterisation of the distinction between promoting an increase in competition and promoting efficiency. Competition and efficiency are fundamentally linked to one another. It is through the process of competition that prices and output advance to efficient levels. In the absence of an increase in competition there is no impetus for organisations to change their price, quantity, quality, innovation, and investment decisions to be more consistent with efficient outcomes.

Appendix A provides a discussion of the four illustrative examples that the ACCC’s report says demonstrate situations in which efficiency can be improved by coverage without any accompanying increase in competition.

In light of this discussion, Jemena considers that the examples of potential market failure identified by the ACCC are, in fact, likely to result in impacts on competition in related markets, and therefore can be addressed by criterion (a) in the current test. It therefore follows that the existing coverage criteria, and in particular criterion (a), does not establish a hurdle for regulation that is unlikely to be met by the majority of transmission pipelines on the east coast, and that the coverage criteria can also be satisfied in the case of a non-vertically integrated pipeline.

¹¹ Page 130 of the ACCC’s Report states “…the problem with using competition as a proxy for efficiency is that competition and efficiency are not synonymous. That is, while competition may promote efficiency, significant efficiency improvement can still be achieved in upstream and downstream markets, without any change in competition in a related market, if a pipeline’s market power is constrained.”
3. WHAT IS THE RELATIONSHIP BETWEEN THIS EXAMINATION AND OTHER REFORMS BEING CONSIDERED/PROGRESSED?

Question 10
What is the relationship between the gas pipeline capacity trading reforms and the gas access regime?

The gas market reform package announced by the COAG Energy Council in August 2016\(^\text{12}\) contains a number of significant initiatives for transmission pipeline capacity markets. These reforms, as proposed by the Australian Energy Market Commission, are designed to strengthen the ability and incentive for shippers to trade secondary pipeline capacity.

The changes will take time to implement and for participants to fully utilise new market mechanisms. However, we consider it likely that the proposed day-ahead auction for contracted but un-nominated capacity will compete directly with as-available services sold by pipeline operators\(^\text{13}\) and result in auctioned capacity selling at or near the short-run marginal cost of capacity (which itself is close to zero) for substantial periods. The ACCC’s Report cited “the prices some pipeline operators are charging for as available, interruptible, back haul and bi-directional services”\(^\text{14}\) as evidence to support its claims of monopoly pricing. However, in addition to our earlier statement that these concerns relate to a small subset of services offered by pipeline operators and which account for a very small portion of total pipeline revenues, we also consider that it would be unreasonable to use such concerns as a justification to change the coverage test given the impending restructure of the market for these services.

Over the longer term, the ability for shippers to more readily trade larger and longer-term tranches of (firm) secondary capacity with other shippers is also likely to emerge as a stronger competitor to the sale of primary (firm) capacity by pipeline operators. We note that shippers are currently able to, and do, freely trade secondary capacity. However as the east coast gas market becomes increasingly dynamic, shippers are likely to see such capacity as an increasingly viable way of managing their supply arrangements.

Question 11
What are the implications of any changes to the LMR regime in the context of this examination?

The limited merits review (LMR) regime is a fundamental part of Australia’s energy regulatory framework, and, as acknowledged in the ACCC’s Report, “is designed to minimise the risk of regulatory error in relation to coverage, form of regulation and access arrangement decisions.”\(^\text{15}\) LMR improves the accountability and quality of regulatory decisions (including pipeline coverage decisions) and promotes confidence amongst both consumers and investors in the regulatory regime.

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\(^{12}\) COAG Energy Council, Meeting Communique, 19 August 2016.

\(^{13}\) Alternatively, page 18 of the Australian Energy Market Commission’s East Coast Gas Review Stage 2 Final Report suggests that as-available rights be phased out to avoid them competing with rights allocated in the auction.

\(^{14}\) ACCC, Inquiry into the east coast gas market, April 2016, p.103.

\(^{15}\) Ibid, p.122.
The COAG Energy Council announced in August 2016 that its Senior Committee of Officials would complete a review of the LMR regime by December 2016. The paper published by the COAG Energy Council as part of its consultation on the LMR regime review raises the option of removing access to LMR (as one of four options under consultation), and some stakeholders have voiced support for this option.

The review of two fundamental parts of the regulatory framework—the NGL’s coverage test and the LMR regime—concurrently and within very short timeframes has created significant uncertainty for investors in gas infrastructure. This increased level of regulatory and sovereign risk can increase the required cost of capital for investors, which over time can flow through to higher prices for consumers and/or reduced investment in pipelines.

As noted by the ACCC in its Report, a party may seek merits review of a Minister’s decision regarding the coverage of a gas pipeline. Regardless of the form and substance of the coverage test, we consider it important that, for the reasons outlined above, the LMR regime continues to apply to coverage decisions under the NGL. This would also ensure continued consistency between the NGL and the NAR, which retains access to merits review by the Australian Competition Tribunal.

Furthermore, access arrangement determinations made by the Australian Energy Regulator (AER) are very significant decisions which involve making material trade-offs in the context of customers’ long-term interests. As set out in our response to question 16, we consider that the ACCC’s proposed coverage test carries a real risk of inefficient over-regulation. Given the nature and importance of the access arrangement determinations that would likely be more prevalent under the ACCC’s proposed test, the risks to the long-term interests of gas customers resulting from sub-optimal regulatory determinations would be compounded if access to LMR for regulatory determinations was removed.

**Question 12**

Absent this examination and any decision by Energy Ministers, once implemented, the amendments to the declaration criteria will see the coverage criteria differ from the CCA. Should the coverage criteria continue to be consistent with the declaration criteria or is an industry-specific test warranted? Why/why not?

Consistency between the declaration criteria and the coverage criteria is in line with object (b) of the NAR, to provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry. We consider that the coverage criteria should continue to be consistent with the declaration criteria, and therefore that the Federal Government’s current proposed amendments to the declaration criteria should be mirrored in the coverage criteria.

Previous reviews and commentary on the NAR, gas access regime and other access regimes have noted the desirability of consistency between the approaches to access regulation across different sectors, particularly with regards to the ‘trigger’ for regulation under those regimes. In the event of a significant divergence between the regulatory triggers under the NAR and gas access regime, a key potential impact would be the potential distortionary effect on efficient investment across different infrastructure sectors. Gas pipelines must compete for capital with other forms of infrastructure covered by other access regimes (such as the NAR), so a higher risk of coverage being applied in the gas pipeline sector would likely increase the returns required by pipeline investors or would undermine investment in the sector.

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Significant differences between the declaration criteria and the coverage criteria also raise the potential for ‘forum shopping’ by access seekers, which in itself can create regulatory uncertainty for investors and other market participants.

We encourage the Review to consider the reasons for the historical consistency between the two regimes, and examine and address them in the context of the current and likely future state of the east coast gas market.

**Question 13**

What impact, if any, is the amendment to section 46 of the CCA likely to have on pipeline operators who operate in a manner consistent with that identified by the ACCC as engaging in monopoly pricing?

Jemena has not responded to this question in this submission, however we refer to the response to this question provided by the Australian Pipeline and Gas Association in its submission.

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17 Forum shopping could occur where access seekers are able to seek regulation through multiple access regimes that involve significantly different triggers for regulation, and thereby the access seeker may favour regulation through whichever regime best suits its own circumstances and objectives.
4. HOW COULD THE REGULATORY TEST BE IMPROVED?

**Question 14**

Is a new regulatory test required under the NGL? Why/why not?

Jemena does not consider a new coverage test under the NGL is required.

The COAG Best Practice Regulation guide\(^\text{18}\) sets out eight principles of best practice regulation, a number of which are relevant to the examination of whether a new coverage test is required.

The Best Practice Regulation guide states that a clear case for action must be established before addressing a problem. As set out in our answers to questions 1 to 3, we do not consider that a clear case for action has been established in this case, given:

- the assertions by the ACCC in its Inquiry's findings regarding monopoly pricing rely on limited analysis, utilise an inappropriate framework and adopt misrepresentative or incorrect information
- the examples of 'economic harm' caused by monopoly pricing adopted by the ACCC in its findings would have an impact on competition in upstream or downstream markets, and therefore would be captured under the current coverage test (criterion (a) in particular).

The Best Practice Regulation guide also promotes that a range of feasible policy options be considered, including self-regulatory, co-regulatory and non-regulatory approaches. The benefits and costs of these approaches then require proper and detailed assessment. As noted in our response to question 10, a number of significant changes to gas transmission capacity markets have been proposed by the COAG Energy Council—although these proposed changes are likely to result in significantly less regulatory intrusion than the ACCC's proposed changes to the coverage test. These market reforms will, by themselves, have the potential to significantly influence the competitive dynamics of pipeline services in the market. In line with this principle, the benefits and costs of any proposed changes to the coverage test should be assessed having due regard to these reforms.

Finally, the guide sets out the principle that government action should be effective and proportional to the issue being addressed. Notwithstanding our concerns about the ACCC's conclusions regarding monopoly pricing, we note our responses to:

- question 15, which highlights the relatively-small proportion of customer bills attributable to gas transmission pipeline charges
- questions 16 and 18, which highlight the significant costs, risks and detriment to the long-term interests of consumers that a change to the coverage test is likely to have.

We therefore consider that a change to the coverage test is unlikely to be the most proportional and appropriate policy response to any issue identified in the gas transmission market.

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Question 15
What percentage of the price of delivered gas do transportation costs (transmission and distribution) represent?

A recent report by the Commonwealth Government’s Department of Industry sets out the contributions of various parts of the gas supply chain to end gas prices in the east coast market.19 In relation to customers in markets served by Jemena, we note the review made the below findings.

For residential gas customers in Sydney (supplied by the Jemena Gas Network, which itself is supplied with gas by the EGP and the Moomba to Sydney Pipeline), gas transmission costs account for approximately seven per cent of a typical household bill. By way of comparison, gas distribution20 accounts for approximately 47 per cent.

Total transportation charges account for a lower proportion of the delivered gas price for large, self-contracting industrial customers22 who are directly connected to the transmission network. In 2015, transmission charges for large industrial customers in Sydney accounted for approximately 13 per cent of the delivered gas price.23 For large industrial customers in Gladstone (which is served by the QGP), transmission charges accounted for approximately 11 per cent of the delivered gas price.24

Furthermore, we note that the Department of Industry’s report found that transmission charges for NSW customers have remained approximately constant in real terms over the past decade, whereas the wholesale gas price increased significantly over this period, as shown from a transmission-connected industrial customer’s perspective in Figure 4–1.

Given the relatively low contribution of gas transmission charges to end prices, the Review should consider whether even a substantial reduction in these costs would, in practice, flow through as reductions in the price of gas for end customers if the coverage test for pipelines was not explicitly focussed on promoting competition in upstream or downstream markets—particularly if there is a low level of competition in these markets.

20 We note that the Jemena Gas Network is subject to full regulation under the NGL.
22 Customers with demand above 1 PJ per annum.
24 Ibid.
Figure 4-1: Trends in components of delivered gas prices for large industrial customers in NSW and ACT, 2002 to 2015

Large Industrial Customer (>1PJ pa) - Average Real ($2015) Gas Price Delivered to Sydney, ACT


Question 16

What impact would a change to the coverage test have on pipeline investment, including capital-raising, debt servicing and innovation?

There are two distinct aspects to such impacts:

1. related to the effect of the change in the substance of the coverage test
2. related to the implications of shifting policy to change the test.

In regards to the first impact, in our view the ACCC’s proposed coverage test would be likely to have a detrimental impact on incentives for pipeline investment and innovation because it appears to reduce the threshold for regulation to be applied, thereby increasing operating costs due to the direct costs of regulation.

While the present criterion (a) provides for coverage only where this would or would be likely to promote a material increase in competition in a related market, the ACCC’s proposed coverage test would trigger regulatory intervention by reference to the apparently lower adjectival threshold of when coverage will, or is likely to, contribute to the achievement of the National Gas Objective.
The ‘material’ threshold in the current criterion (a) helps reduce the risk that a pipeline becomes covered in circumstances where the associated costs of regulation (ultimately borne by customers) would outweigh the benefits to customers.\(^{25}\) Although it is unclear precisely how the ACCC’s test would be interpreted and applied, there is a real risk that the threshold would be lowered to the extent that gas pipelines could be regulated in circumstances where the net benefits are negative. This risk of inefficient over-regulation is amplified by the ACCC’s suggestion that coverage initially be extended throughout the entire pipeline sector, effectively transforming the access regime into an ‘opt out’ rather than ‘opt in’ framework.\(^{26}\)

Regulation is not a costless exercise and the direct and indirect costs associated with coverage are significant and ultimately borne by customers.

As the owner of regulated gas and electricity distribution networks, Jemena has significant experience in regulatory management. Applying Jemena’s costs of running a distribution price review to the (comparatively low) operating and maintenance expenditure of our transmission pipelines, should our pipelines be covered the resulting regulatory management costs could be up to 10 per cent of each of our transmission pipelines’ operating and maintenance expenditure each year. We also offer the following examples from our recent experience in relation to regulated utility networks:

- Jemena’s most recent gas distribution access arrangement review project cost around $8 million\(^{27}\)
- Jemena’s most recent electricity distribution price review project ran for around two and a half years, and involved 109 staff working over 30,000 hours to prepare the initial and revised regulatory proposal in line with rule requirements and to respond to AER requests
- compliance with AER-issued Regulatory Information Notices for our electricity distribution network in 2014 (which included a price review and some back-casting of data) cost over $2 million, with the longest of the five Regulatory Information Notices taking over 600 days of staff time to complete and submit our response.

Ultimately, the risk of inefficiently high levels of regulatory intervention would reduce the incentive for pipeline investment and innovation by reducing available returns or, if the increased costs are passed on to consumers in the form of higher prices, by reducing the demand for pipeline services.

Pipeline investment is likely to be further discouraged as a result of the increase in uncertainty and risk that would be brought about by changing the regulatory regime. For example, Jemena’s investment case for the NGP and our ability to expand this and our other pipelines in the future, would potentially be significantly compromised in the face of higher levels of regulatory uncertainty.

The second impact arises from the fact that interpretation and application of any revised test must be clarified and developed through case law and the set of decisions and rulings that establish the relevant precedents. During this process, the uncertainty, risks and costs associated with the regime would significantly increase. The ACCC’s proposal would also mean that the gas pipeline coverage regime would deviate from the NAR. This would reduce the applicability of NAR jurisprudence (that will continue to develop) to the gas access regime and will ultimately result in higher ongoing managerial, administrative and legal costs.

\(^{25}\) The Government amended the NAR to include the word ‘material’ in 2006 in response to concerns identified by the Productivity Commission that a low threshold could result in regulation being applied where there would be only a marginal or trivial increase in competition. The National Gas Law adopted the ‘material increase’ test in 2008, maintaining a consistent approach of only applying regulation where it would result in a non-trivial increase in competition.

\(^{26}\) Page 140 of the ACCC’s Report states: “From an administrative perspective, there would also be value in considering whether any other unregulated pipelines should be deemed to satisfy the test and be subject to full or light regulation from the date the new test takes effect, as was done when the Gas Code was originally implemented.”

\(^{27}\) This figure excludes the costs of internal labour and the cost of seeking LMR in the Australian Competition Tribunal. Note also that under the National Gas Rules, a service provider’s costs related to LMR cannot be passed through to customers.
The increased costs, risks and uncertainties that would be introduced as a result of changing the coverage test would reduce the incentive for investment in gas pipelines, particularly in the early years of the new criteria.

**Question 17**

What impact would a change to the coverage test have on investment, including equity and debt-raising, in upstream and downstream industries/companies?

The proposed change to the coverage test is likely to have a detrimental effect on investment in related markets for three reasons.

First, as discussed in response to question 16, there is a real risk that the proposed criteria would result in an inefficient lowering of the threshold for regulation. This may have the effect that regulation could be instituted even in situations where the benefits of doing so (which are likely to be near term and more clearly visible) would be outweighed by the costs—for which the compromise to the dynamic efficiency associated with the sufficient and timely investment in pipelines is likely to be longer term and more difficult to quantify. Ultimately, it is end-users who would be required to bear the increased costs of regulation in the form of higher prices. As a result, the ACCC’s proposed test may lead to generally higher prices for gas pipeline services which will in turn reduce the potential for retailers or upstream suppliers to invest in the gas market on reasonable terms.

Second, as discussed in response to question 16, the proposed amendments would reduce the incentives for investment in pipelines, which in turn would have a flow on impact to upstream and downstream users and investment. Any reduction or stagnation in the availability of transportation services to upstream or downstream users could extinguish potentially profitable business opportunities that might otherwise be available to those users. In the context of the east coast market’s current need for additional gas supplies (as identified by the ACCC in its Report), we consider there is a significant risk that the reduced availability of transportation services to upstream market participants might restrict the ability of gas explorers to prove up and develop what would otherwise be economic reserves, thereby foregoing opportunities to bring new supply to market.

Third, the uncertainty and risks associated with changing an established regulatory regime would likely further deter investment in related markets. Until the application and interpretation of the revised criteria become well-established the risks of investing throughout the gas sector would be increased, raising the cost of capital and reducing incentives for investment and innovation.
**Question 18**

In relation to the market power test proposed by the ACCC:

- Is it likely to address the problem identified? Why/why not?
- Is it likely to better facilitate the achievement of the NGO? Why/why not?
- Would the test increase the number of pipelines regulated? Why/why not?
- Would the test likely see the prices charged by pipeline operators move towards the efficient cost of supply? Why/why not?
- Are the outcomes associated with pipeline prices moving towards the efficient cost of supply appropriate? Why/why not?
- Should the proposed test be implemented, what impact, including costs, benefits and risks, would you expect this to have on market participants?
- If implemented, should the proposed test also apply to 15 year no-coverage determinations?
- Are there any unintended consequences of the test?

**Is it likely to address the problem identified? Why/why not?**

Jemen disagrees with the ACCC’s premise that there is an identified problem, as addressed in detail in our responses to questions 1 to 3.

Setting aside the question as to whether or not a problem exists, in our view the ACCC’s proposed market power test does not offer a better basis for determining whether a gas pipeline should be subject to regulation. The ACCC’s proposed test has been put forward on the basis of a perceived disconnect between competition and efficiency, but as discussed in our response to questions 6 to 9, we disagree with the ACCC’s characterisation of this problem.

Consequently, Jemen disagrees with the premise upon which the ACCC bases its recommendation to change the coverage test. We see no advantages to changing the criteria to address a disconnect between efficiency and competition that simply does not exist. Further, our examination of the ACCC’s illustrative examples (as set out in Appendix A) suggests that the pipelines in each of these cases would be likely to satisfy the current criterion (a), assuming that the ‘materiality’ threshold was met.

**Is it likely to better facilitate the achievement of the NGO? Why/why not?**

In Jemen’s opinion, the ACCC’s market power test is unlikely to better facilitate the achievement of the NGO for three reasons.

First, as set out in our response to the previous sub-question, competition and efficiency are inextricably related. The ACCC’s proposed test offers no fundamentally better basis than the existing test for determining whether a gas pipeline should be declared.

Second, the ACCC’s proposal incorporates a lowering of the threshold and so risks over-prescribing the regulation of gas pipelines. As discussed in our response to question 16, the ACCC’s market power test would trigger regulatory intervention when coverage will, or is likely to, contribute to the achievement of the National Gas Objective. Taken at face value, this is a lower threshold than the current criterion (a) of the promotion of a material increase in competition. The ACCC has further recommended that consideration be given to deeming
currently unregulated pipelines to satisfy the test should the criteria be revised. Given the time delays and costs associated with regulatory reviews, such an ‘opt out’ approach is likely to lead to over-regulation in the sector.

Consequently, there is a real risk that the ACCC’s proposal would lead to some pipelines becoming regulated even though the benefits of doing so would be more than outweighed by the associated costs. Ultimately, it is end consumers who must bear the costs of regulation in the form of higher prices and/or reduced access to services as a result of investment and innovation being discouraged in the transportation, production and downstream markets. Such outcomes cannot be consistent with better facilitating the achievement of the NGO.

Finally, all else aside, the act of changing the access regime would introduce regulatory risk and costs both in the short term and in the longer term. The loss of relevant jurisprudence and the divergence from the NAR would significantly increase the legal, administrative and managerial costs associated with applications for coverage or revocation of coverage. The change in the criteria would also increase the uncertainty associated with the regulatory regime, thereby increasing the cost of capital and discouraging investment in the sector. Such deterrence of investment could directly impact the opportunities available in related markets. Again, such outcomes would not be consistent with facilitating the achievement of the NGO.

Would the test increase the number of pipelines regulated? Why/why not?

As set out in our response to question 16 and the above sub-question, there is a real and tangible risk that the ACCC’s proposed test could result in over-regulation of gas pipelines as a result of the reduction in the threshold for coverage and the possibility of deeming provisions. Our responses to question 16 and the other sub-sections of this question outline the impacts on end customers associated with over-regulation.

Would the test likely see the prices charged by pipeline operators move towards the efficient cost of supply? Why/why not?

In Jemena’s opinion, the ACCC’s proposed market power test would not result in the prices for pipeline services moving towards the efficient cost of supply for three reasons.

First, as set out in our responses to questions 1 to 3, we disagree with the ACCC’s finding that monopoly pricing by gas pipeline operators is widespread in the east coast gas market.

Second, as set out in our response to the above sub-questions, the ACCC’s proposal is based on an erroneous view of the ability of coverage to increase efficiency without also increasing competition. Given the relationship between competition and efficiency it is infeasible that efficiency could be promoted without also promoting an increase in competition. It follows that the ACCC’s proposed test does not offer a better basis upon which to make declaration decisions.

Third, as discussed in our response to question 16 and the above sub-questions, the ACCC’s proposed test risks lowering the threshold for regulatory intervention to the extent that gas pipelines become subject to coverage even in circumstances where the costs of regulation outweigh the benefits. Consequently, the costs of supplying gas pipeline services would be increased above efficient levels, which would either result in lower returns to businesses or higher prices to end consumers. Any impact that the cost increase has on returns will discourage investment in gas pipelines, which will ultimately reduce the supply of services and increase prices to consumers. This impact on investment incentives would be heightened by the uncertainty and risk that would be introduced by moving away from the current regulatory regime and its associated body of jurisprudence.

Overall, we therefore consider the ACCC’s proposed market power test would be more likely to see the prices charged by pipeline operators moving away from the efficient cost of supply.
Are the outcomes associated with pipeline prices moving towards the efficient cost of supply appropriate? Why/why not?

Jemena fundamentally disagrees with the premise that pipeline prices are currently inconsistent with the efficient cost of supply, as set out in our responses to questions 1 to 3.

Should the proposed test be implemented, what impact, including costs, benefits and risks, would you expect this to have on market participants?

The implications of implementing the proposed test have been discussed in our responses to previous questions and can be summarised as follows:

- cost increases, including:
  - an increase in the administrative, legal and management costs associated with preparing and reviewing applications for coverage or revocation of coverage as a result of the loss of relevant jurisprudence and need to build relevant case precedents
  - ongoing higher administrative, legal and management costs as a result of divorcing the gas access regime from the NAR
  - increased costs associated with over-regulation of pipelines in circumstances where the benefits of regulation are outweighed by the costs
  - an increase in the cost of capital as a result of increased regulatory risk and uncertainty, which would ultimately increase consumer prices and discourage investment in pipelines

- increased risks associated with the change in the regulatory regime, including:
  - the uncertainty that would result from changing the regulatory regime and disassociating the gas pipeline access regime from the NAR
  - the risk of under-investment in gas pipelines as a result of higher costs and increased uncertainty, which would reduce the supply of gas pipeline services and hence opportunities in related markets.

If implemented, should the proposed test also apply to 15 year no-coverage determinations?

If the ACCC’s proposed test were implemented, Jemena is strongly of the view that it should be applied in a forward-looking manner such that those gas pipelines that currently hold no-coverage determinations are able to retain those determinations. Re-evaluating gas pipelines that have been constructed on the basis of a clear commitment by the regulator not to intervene within the initial 15 year window would significantly reduce business confidence in future no-coverage determinations. This has the potential to strongly discourage greenfield investment in the sector.

Are there any unintended consequences of the test?

As described in our responses above, the ACCC’s proposed test risks inefficiently lowering the threshold for regulatory intervention by amending the adjectival requirement for coverage from ‘would promote a material increase’ to ‘will or is likely to contribute to’. This is likely to increase costs and reduce investment in gas pipelines. Ultimately, this may have flow-on effects to dependent markets and gas consumers in the form of higher prices and reduced supply.
Question 19

Is there a regulatory test that would be more appropriate than that proposed by the ACCC? If so, please provide details of what form this test could take.

Jemena does not consider that the case for any structural change to the form of the coverage test has been established. Rather, changes to the test should be limited to those necessary to maintain alignment between the NGL’s coverage test and the declaration criteria under the NAR.

In the event the Review determines that a new test is required, the Review should not start from the ACCC’s recommended test (given the costs and risks highlighted in our response to question 18), but should start with a clearer and more convincing definition of any problem that is to be addressed. From that foundation, a range of potential alternatives should be considered, and an assessment made of the costs, risks and benefits of each, and taking into account other reforms announced by the COAG Energy Council, including those to capacity trading arrangements.

Furthermore, we note that every access regime in Australia balances the threshold form of coverage (the ‘trigger’) with the form of regulation to be applied to the relevant services provided by the covered asset. Broadly, there is a spectrum of such forms of regulation, ranging from price monitoring to ex ante price control. Whatever approach is ultimately taken to the trigger for coverage, it is fundamentally important that there remains a range of options for the form of regulation. Moreover, it would be appropriate for the Review to consider whether other forms of regulation should be included.

In this regard, we note that a number of stakeholders have recently voiced support for the greater use of a ‘negotiate-arbitrate’ form of regulation, particularly in instances where large and sophisticated counterparties are likely to be involved in access negotiations for pipeline services. For example, we note comments by ACCC Chair Rod Sims at the ACCC/AER Regulatory Conference on 4 August 2016 in support of the use of negotiate-arbitrate to regulate non-vertically integrated monopoly infrastructure in preference to other forms of regulation. This form of regulation provides strong incentives for parties to reach commercial agreement on the terms of access to a facility, thus minimising the potentially-significant costs of direct regulatory involvement (compared to ex ante price regulation).

Indeed, ‘light regulation’ as currently prescribed under the NGL essentially mirrors the negotiate-arbitrate form of regulation provided for under the NAR. We consider that the gas access regime should seek to rely more heavily on a negotiate-arbitrate model for covered pipelines.
A1. THE LINK BETWEEN COMPETITION AND EFFICIENCY

In support of its findings, the ACCC has provided four illustrative examples that it submits demonstrate situations in which efficiency can be improved by coverage without any accompanying increase in competition. In the first two, the ACCC contends that competition is not increased because the number of competitors in the market would not be affected by a reduction in pipeline service prices. In the latter two, the ACCC contends that competition cannot be improved in markets that are already workably competitive. We disagree with the ACCC’s assessment of these examples. In our view, the ACCC reaches its conclusions on the basis of a mischaracterisation of competition combined with unrealistic and simplistic market constructs.

It is not the case that the number of competitors in a market must increase in order for competition to be increased. The competition element of criterion (a) has consistently been defined in the context of access regimes in Australia in terms of the opportunities and environment for competition, and not the number of competitors in an industry. A reduction in pipeline service prices would increase the achievable margins for customers. This would have the effect of encouraging rivalry between incumbent firms to secure additional sales as well as potentially encouraging new firms to enter the market. It is as a result of this increase in competition that the reduced pipeline prices would, ultimately, be passed on to end consumers in the form of lower prices. An immediate increase in the number of competitors in the market is not a necessary condition for an increase in competition to be promoted.

We also disagree with the ACCC’s over-simplified assumption that competition cannot be increased in a market that is already workably competitive. Under some definitions, ‘workably competitive’ is taken to mean that no single firm is able to affect the market price. We agree that it may be less likely that reducing the price of pipeline services will affect competition in such a dependent market. However, this interpretation of ‘workably competitive’ is not consistent with the examples set out by the ACCC, in which prices in the dependent markets are affected. There is simply no reason to presume that competition could not be increased in the markets that are described in the ACCC’s latter two examples.

The ACCC’s illustrative examples are further over-stylised in that they consider unrealistic scenarios in which there is a single dependent market reliant on the pipeline services. The current criterion (a) is met so long as increased competition is promoted in at least one dependent market, irrespective of the size or significance of that market. Given the ACCC’s recent findings in relation to the insufficiency of competition in upstream markets for gas exploration and production, it seems highly likely that these markets would be strong candidates for any robust finding of pipeline market power to be found to have a detrimental effect on competition. Further, in relation to potential downstream markets where competition may be affected by pipeline market power, It is highly improbable that any major pipeline serving Australia’s east coast gas market would have only a single user, served without the involvement of a retail intermediary, both of which would be necessary for there to be perhaps just one candidate market in which competition was affected.

We therefore consider that the pipelines in each of these cases would be likely to satisfy the current criterion (a), assuming that the ‘materiality’ threshold was met.