

10 June 2014

Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

COMPETITION POLICY REVIEW ISSUES PAPER

Dear Panel Members

Please find attached the Australia Pipeline Industry Association's (APIA) submission to the Panel in response to its Issues Paper. APIA welcomes this comprehensive review of Australia's competition policy. APIA would like to highlight:

- The ongoing competition issues in wholesale gas markets, which are exacerbating the challenges facing Australia's gas markets caused by the major structural shift towards an export focus.
- The findings of a number of reviews, including the 2002 CoAG Energy Market Review (the Parer Review) and the 2014 Eastern Australian Domestic Gas Market Study, which show competition shortcomings have been recognised for many years, but are yet to be adequately addressed.
- The recommendations of the Productivity Commission's Review of the National Access Regime, the Commission's deliberations on the production process exemption and the uncertainty that exists around its application to infrastructure that is part of a production process.

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APIA makes three recommendations to the Review Panel:

1. The Competition Policy Review should recognise the ongoing competition issues in wholesale gas markets and recommend policy action to address them.
2. The Productivity Commission's recommendations regarding the coverage criteria for the National Access Regime should be adopted and the production process exemption should be clarified in light of the amendments.
3. The Competition Review should recognise the value of certifying industry-specific access regimes and the importance of undertaking to certify the electricity and gas access regimes in the Australian Energy Market Agreement 2006.

APIA looks forward to discussing these issues further with the Panel. Please contact APIA's Policy Manager, Steve Davies, on (02) 6273 0577 or at sdavies@apia.asn.au for further information.

Yours sincerely



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AUSTRALIAN PIPELINE INDUSTRY ASSOCIATION

RESPONSE TO THE COMPETITION POLICY REVIEW

ISSUES PAPER

10 JUNE, 2014

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INTRODUCTION

The Australian Pipeline Industry Association (APIA) welcomes the opportunity to provide comment to the Competition Policy Review Panel's Issues Paper. APIA is the peak body representing Australia's gas transmission industry. APIA's members build, own and operate the gas transmission infrastructure connecting the disparate gas supply basins and demand centres of Australia, offering a wide range of services to gas producers, retailers and users.

Since 2000, APIA's members have invested in and built more than \$2.2 billion¹ of infrastructure providing 4000km of coverage across 10 major new gas transmission pipelines in eastern and northern Australia². These pipelines have been built to meet the demand of Eastern Australia's gas markets. In Western Australia, a similar level of investment expanding the State's major pipelines has occurred over the same period.

It is this investment that has led to the evolution of pipeline networks across Australia's gas markets, promoting basin-on-basin competition and underpinning the emergence of trading hubs in the demand centres. It is these networks that will facilitate the next evolution in trading and increased flexibility across these markets. Importantly, this investment has occurred across a mix of regulated and unregulated assets and has been facilitated through bilateral negotiation and contracts, as envisaged under the access regime established in the *National Gas Law 2008*.

Australian domestic gas markets are undergoing a once-in-a-lifetime structural change. The development of an LNG export industry in Queensland is driving a surge in production activity and will increase gas demand fourfold on the East Coast, creating an environment of gas supply tightness. In Western Australia, new export projects and the expiry of long-term domestic gas supply arrangements are leading to domestic supply uncertainty. Both circumstances are placing substantial upward pressure on domestic gas prices, with a doubling of prices in both Eastern and Western markets, in some cases tripling, in comparison to the historical price. Without an increase in supply and suppliers, there is little prospect of these prices reducing.

In this environment, it is appropriate to encourage renewed focus on competition in Australia's gas supply arrangements and any issues that may be arising from the current policy settings.

¹ This investment does not include infrastructure built for LNG projects or expansion of existing pipelines.

² AER State of the Energy Market 2013 p108-109



COMPETITION IN WHOLESALE GAS MARKETS

There are three long-standing issues affecting competition in the upstream gas sector, the first two of which are of direct relevance to this review:

- Access to upstream gas infrastructure;
- The continuing practice of joint marketing in the wholesale gas market; and
- Barriers to competition arising from petroleum tenement management.

These issues are not new to Australia’s gas markets. As the National Competition Council (NCC) noted in 2000³, the Council of Australian Governments (CoAG) Upstream Industry Working Group delivered a report on gas reform issues in 1998 that focussed on three key issues:

- *barriers to competition arising from acreage management systems;*
- *third-party access to upstream facilities; and*
- *contractual and marketing arrangements.*

The NCC’s summary of the Report is included at Attachment A. Despite this report being finalised over 15 years ago, the issues are largely unchanged.

In 2002 the final report of the CoAG Energy Market Review, commonly called the Parer Review, included at Exhibit 7 its assessment of gas industry issues:

Key findings	Proposed solutions
There is insufficient upstream gas competition on the East Coast to promote a healthy market.	The separate marketing of gas should be actively facilitated as current contracts expire. Governments should give more consideration to promoting competition in gas markets when awarding exploration leases.
Too much regulatory uncertainty exists around new pipeline development.	Allow project developers to seek an upfront binding ruling on coverage, and the choice of either an up-front and longer term binding ruling on the regulatory conditions that will apply or, for a new transmission pipeline, a 15-year economic regulation holiday.
There is a lack of tradeable capacity on some pipelines, and other market supporting mechanisms.	Introduce tradeable capacity and other mechanisms on new and unregulated pipelines.
Both industry and users have concerns with the Gas Code.	Review the Gas Code to judge its effectiveness from both a gas industry and user perspective.

³ Multi-User Infrastructure Access: Implications of Third Party Access for Infrastructure Access, Ed Willett, NCC, July 2000



Access by independent producers to upstream facilities will become more important.	Review the industry's principles for access to upstream facilities.
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The second, third and fourth points have been addressed since the Parer Review. Points two and four were addressed during the development of the current access regime for gas pipelines, the *National Gas Law 2008*. The third point has been the subject of recent review and is being progressed through:

- the industry-led development of a new service facilitating capacity trading, the operational capacity transfer; and
- information enhancements for the National Gas Bulletin Board to facilitate further capacity trading are currently under development.

Further information on capacity trading is available at Attachment B.

The first and last points have not been substantially addressed.

Joint Marketing

Joint marketing continues to be an issue of concern to domestic gas markets. Most recently, in November 2013, the Victorian Gas Market Taskforce (VGMT) recommended:

*The Victorian Government, with the objective of moving away from joint marketing arrangements, request the Australian Competition and Consumer Commission (ACCC) review the existing joint marketing arrangements for gas producers, assessing their relevance in light of the rapidly evolving eastern gas market.*⁴

Third party access to upstream infrastructure

In regard to third-party access to upstream infrastructure, the Commonwealth Department of Industry's January 2014 Eastern Australian Domestic Gas Market Study (EADMG) stated:

The implication of current arrangements is that, in practice, the sharing of processing facilities is largely a matter of whether the technical and commercial objectives of asset owners can be satisfied. These may include strategic objectives, for example to exclude competitors from access. To the extent to which this is a barrier to entry over time may be limited by competitors building smaller or alternative plant (the economies of scale for building new processing may not be as large as with transmission pipelines). However, it is also the case that more ready access to processing in the proximity of reserves could accelerate supply response. It is therefore not surprising that a number of

⁴ Victorian Gas Market Taskforce Final Report, Recommendation 11



parties have raised concerns over the difficulties with negotiating access to processing infrastructure in the current environment.⁵

Despite this statement, the EADGMS did not identify access to this infrastructure as an option for future reform. This may be due to an apparent misinterpretation of the Productivity Commission's findings in its Review of the National Access Regime. This issue will be discussed in more detail below.

Title administration

The EADGMS also identified title administration and management as a potential area of further reform, noting the role that effective administration plays in limiting stockpiling and strategic management of reserves:

In addition to efficient and effective administration of petroleum titles, an important objective of acreage management regimes is to provide explorers and producers with the discipline and incentive to commercialise resources at the time where the value to society is highest. To that end, a key task of title management regimes is to ensure 'land banking' does not occur and that the commercialisation of gas resources is not unnecessarily delayed — bearing in mind risk, technical, market and regulatory factors.⁶

Ongoing competition concerns

Overall, it is clear competition remains a concern in Australia's gas markets. The EADGMS stated:

A common and consistent complaint made by major users is that the current eastern gas market lacks sufficient competition. This is essentially a reflection of the level of confidence in the price discovery process — where once several offers of supply might have been expected, it appears some users are receiving only one or two 'serious' offers. While those claims are subjective and anecdotal, there appears to be a need to improve confidence in the price discovery process.⁷

and

Competition in the wholesale market has complex and interdependent drivers. Outcomes are the result of regulatory and commercial decisions ranging from acreage allocation through to mergers and acquisition activity and supply decisions. Upstream supply — that is, gas exploration and production — is a necessary but not sufficient driver of competition in the wholesale market. In particular, competition may also be influenced by infrastructure, as the efficiency of commercially

⁵ EADGMS, p54

⁶ EADGMS, p97

⁷ EADGMS, p87



*determined or regulated access to pipelines, processing and storage, influence pricing and investment decisions in upstream and downstream markets.*⁸

Both the EADGMS and the VGMT identify the need for further review. From the EADGMS, the policy option identified was to:

*Consider commissioning a review of gas market competition to focus on matters driving wholesale market outcomes.*⁹

From the VGMT, the recommendation was:

Eastern market governments request that:

- a. The Productivity Commission (PC) conduct a comprehensive review and cost benefit analysis of potential reform options relating to the eastern gas market, taking into account the rapid change in market dynamics and with the aim of increasing efficiency, transparency and **competitiveness**¹⁰ of the eastern gas market; and*
- b. Eastern market State Premiers jointly write to the Commonwealth Treasurer, incorporating the proposed terms of reference, to seek approval for the PC review.*¹¹

Matters of infrastructure access under the National Access Regime and joint marketing are already being considered in the Competition Review Panel. APiA considers the current arrangements are not producing ideal, competitive outcomes in the wholesale gas market and the issues manifesting in that market may be indicative of the issues that can arise in other markets, particularly those undergoing structural change.

RECOMMENDATION 1

The Competition Policy Review should recognise the ongoing competition issues in wholesale gas markets and recommend policy action to address them.

⁸ EADGMS, p88

⁹ EADGMS, p90

¹⁰ Emphasis added by APiA

¹¹ Victorian Gas Market Taskforce Final Report, Recommendation 15



INFRASTRUCTURE ACCESS – THE NATIONAL ACCESS REGIME

The Issues Paper provides a good summary of the purpose of the National Access Regime at section 5.15 and recognises the Competition Policy Review is considering the recommendations of the Productivity Commission's (PC) Review of the National Access Regime.

A matter specifically covered in the Commission's review was the production process exemption. The Commission considered the implications of the High Court's Pilbara Rail Decision and submissions on the subject and stated in its Final Report¹²:

The production process exception as interpreted by the High Court is suitable for Part IIIA, as Part IIIA is a generic access regime. Amending the production process exception to suit a particular industry, for example the iron ore export industry, would be likely to result in a provision that is ill-suited to other industries. The Commission considers that in many cases it will be appropriate to assess the potential coordination costs of access on a case-by-case basis. This can be achieved through an assessment against the declaration criteria — the Commission has recommended that greater consideration be given to coordination costs to assist in preventing declaration from inefficiently breaking up highly integrated supply chains.

It appears from the High Court's ruling on the Pilbara Rail matter and the Commission's statement that the production process exemption should be considered as an additional reasonableness test for infrastructure that is part of a production process, to ensure the benefits of competition outweigh the costs of coordination, rather than an absolute exclusion of such infrastructure from declaration.

The Issues Paper has highlighted the recommendations of the Commission to improve the NAR:

amending the 'competition test', the 'uneconomical to develop another facility test' and the 'public interest test' under the regime, to ensure declaration occurs where the benefits arising from increased competition in a dependent market are likely to outweigh the costs of regulated access

But it has not recognised the link the Commission made between these recommendations and the production process exemption. This link is of high consequence; it is clear from the submissions to the Commission that there is some uncertainty about the application of the exemption following the High Court's ruling in the Pilbara Rail case.

The treatment of the production process exemption is of high consequence to the issue of third-party access to upstream gas infrastructure, particularly processing facilities. The applicability of the exemption to gas processing facilities has not been tested. It is generally considered to apply, as evidenced from the statement in the EADGMS:

¹² Productivity Commission, Review of the National Access Regime, p150



*The Competition and Consumer Act 2010 excludes declaration of a service which amounts to the use of a production process. This is likely to exclude upstream production facilities from third-party access requests under the Act.*¹³

This stands in contrast to the position of the Australian Petroleum Producers and Explorers Association (APPEA), which seems to be that the provisions of the CCA 2010 can provide access to upstream infrastructure:

*APPEA considers that commercial negotiation is the least cost and more effective method for achieving third party access to upstream facilities. Commercial negotiation has led to a number of access arrangements being achieved without threat of government intervention. There is no reason to expect that commercial negotiation will not continue to deliver these outcomes. In the event of some failure of negotiation, the provisions of the Competition and Consumer Law 2010 are available, should a party seek to invoke them*¹⁴.

APIA fully supports APPEA's position that commercial negotiation is the most effective method for achieving third-party access to infrastructure. However, in the case where an infrastructure asset owner wields significant market power or may wish to act strategically, it is necessary to have a regulatory mechanism to ensure competitive outcomes can be achieved. Such a mechanism is provided through the NGL for transmission and distribution pipelines. The NGL allows for pipelines to be uncovered, with coverage being considered on application from market participants when commercial negotiations have not succeeded in providing satisfactory outcomes.

It is not clear that the National Access Regime provides such a regulatory mechanism for upstream gas infrastructure, or any infrastructure that may be considered part of a production process. It is likely that any future application of the production process exemption will need to be tested in the courts, a process in which well-resourced, incumbent infrastructure owners can more readily participate than the parties seeking access to infrastructure, which are often much smaller, emerging companies.

Adding to the confusion in the specific case of upstream gas infrastructure, the EADGMS stated:

The Productivity Commission released a draft report on 28 May 2013 on third party access arrangements in Part IIIA of the Competition and Consumer Act. While the Productivity Commission did not consider the National Gas Law, the two regimes are similar and the Commission concluded that processing facilities should not be included as facilities covered in the National Access Regime.

¹³ EADGMS, p54

¹⁴ APPEA submission to the EADGMS, p20



The Commission made no such statement in either the draft or final report. As noted above, the Commission's view is that the production process exemption should be considered an additional test, to be reflected in changes to the declaration criteria. Neither report made any mention of gas processing facilities.

RECOMMENDATION 2

The Productivity Commission's recommendations regarding the coverage criteria for the National Access Regime should be adopted and the production process exemption should be clarified in light of the amendments.



CERTIFICATION OF THE ENERGY ACCESS REGIMES

There is one recommendation in the Productivity Commission's final report on the Review of the NAR that APIA does not support. The Commission considers that certification of the electricity and gas access regimes is unnecessary:

On balance, the costs of certifying the electricity and gas regimes may outweigh the benefits. Therefore, the Commission considers that COAG should release the state and territory governments from the existing requirement to submit their electricity and gas regimes for certification (although the state and territory governments would be free to seek certification of their regimes if they considered that there would be net benefits from doing so).¹⁵

The primary reason for this position appears to be a concern about the cost of certification. There is little regard given the commitment made by State and Federal Governments in the *Australian Energy Market Agreement 2006* to certify the, then under development, National Electricity Law and National Gas Law. Without subsequent advice or statements on the matter, it is reasonable to conclude that investments in energy network infrastructure since 2006 have occurred under the assumption the regimes have been certified.

APIA considers certification of the electricity and gas regimes is essential for two reasons:

- It removes any possibility that infrastructure under the electricity or gas regimes can be declared under the NAR. The Commission states that the removal of this possibility is:

To improve investment and regulatory certainty, and reduce administrative costs.¹⁶

- It would deliver greater consistency as it ensures the overarching framework of the National Access Regime protects against drift to objectives, principles and practices that are not directed to the efficiency of the national economy. Jurisdictional changes to State and Territory access regimes, including cooperative schemes such as the Gas Access Regime are open to adjustment to respond to policy and/or political objectives that diverge from the overarching objective of national economic efficiency. These adjustments can create distortions in investment decisions that are not contribute to the efficiency of the national economy.

RECOMMENDATION 3

The Competition Review Panel recognise the value of certifying industry-specific access regimes and the importance of undertaking to certify the electricity and gas access regimes in the Australian Energy Market Agreement 2006.

¹⁵ Productivity Commission Review of the National Access Regime, 2013, p23

¹⁶ Productivity Commission Review of the National Access Regime, 2013, p31



STATE AND TERRITORY REGULATORS

The National Gas Law is one of the access regimes administered by multiple regulators:

- the Economic Regulatory Authority (ERA) in Western Australia;
- the Utilities Commission of the Northern Territory in the NT; and
- the Australian Energy Regulator (AER) in all other states and territories.

During 2011-12, the Australian Energy Market Commission oversaw an extensive rule change process for the economic regulation of network service providers, resulting in the requirement for regulators to produce Guidelines outlining preferred processes to determine the rate of return. The AER and the ERA have published Guidelines that differ on many inputs:

- The AER favours ten, rather than five years for risk free rates, which translates at present to around 70 basis points in the Weighted Average Cost of Capital.
- The AER favours a principled approach to imputation credits whilst the ERA favours an empirical valuation approach; the practical upshot is a difference of 20 basis points in gamma.
- The AER favours a trailing average approach for debt which effectively updates the cost of one-tenth of the debt every year, whilst the ERA proposes to update the debt risk premium every year. The practical upshot is that the ERA approach introduces new risk not present in the AER's approach.
- The ERA has maintained its bond-yield approach which essentially involves it creating its own debt cost index, whilst the AER has opted for a Bloomberg or RBA index to estimate the cost of debt.

The outcomes of application of these Guidelines to the regulatory process remain to be seen. If there are materially different outcomes, the potential for these differences to create distortions in investment incentives across Australia must be considered. Moreover, the degree to which any such distortions might impact the efficiency of the economy, and therefore the national interest, must also be considered by policymakers.

In APIA's view, whilst it can be argued that competition in ideas between regulators might result in better regulation over the longer term, this needs to be balanced against the impacts on economic efficiency and investment incentives created when different regulators interpret the same law in different ways.



ATTACHMENT A – Excerpt from the NCC

An excerpt from Multi-User Infrastructure Access: Implications of Third Party Access for Infrastructure Access, a presentation by Ed Willett, Executive Director of the NCC, July 2000.

<http://ncc.gov.au/images/uploads/CISp00-008.pdf>

Reforming regulatory barriers to free and fair trade in gas

The COAG 1994 agreement called on governments to remove all remaining regulatory and legislative barriers to free and fair trade in gas. While the access reforms have focussed on the downstream area, a major focus of the legislation review program has been to review upstream issues. The access reforms alone are unlikely to benefit consumers unless there is competition between gas producers.

Australian gas markets were traditionally – and to a large extent, still are – characterised by highly integrated supply chains in each State supported by long-term exclusive contracts between producers, pipeliners and retailers. It is difficult to assess the extent to which this structure has impacted on gas prices due to the lack of price transparency in the Australian market. It is frequently argued that well-head prices in Australia are very competitive by international standards. But the same used to be said about electricity prices prior to reform, while gas prices reportedly fell by two thirds in Canada after upstream gas monopolies in that country were disaggregated.

The Upstream Issues Working Group (UIWG), an intergovernmental group on which the Council was an observer, examined upstream gas reform issues in 1998. The Groups' final report focussed on three key upstream issues:

- barriers to competition arising from acreage management systems;
- third party access to upstream facilities; and
- contractual and marketing arrangements.

Acreage management issues

One of the best ways to promote upstream reform is through new discoveries of gas. The broad issue for the Council here is whether the legislative framework – under the various State, Territory and Commonwealth Petroleum Acts – creates conditions for the issue of exploration permits that are conducive to competition. The kind of issues here include the size and duration of permits, relinquishment and retention arrangements, the allocation criteria used when issuing permits, and publication of exploration data.

The Council accepts that there are issues of balance here. For example, if the size of permits is too small, especially for highly speculative sites, explorers may be reluctant to commit resources to exploration. But the danger of issuing large permits is that dominance may be conferred upon the successful permit holder in the event of a discovery.

The UIWG report highlights a number of critical issues in this area, including the need for greater transparency in acreage bidding processes. The Group identified one necessary condition as being to ensure that the details of winning acreage bids are published or made readily available to interested parties. Jurisdictions appear, on the whole, to have accepted this recommendation and are making the necessary changes to legislation.



Third party access to upstream facilities

Another potential barrier to competition is the monopoly ownership and control of upstream production facilities like gas processing plants and gathering lines. Bottlenecks can arise in the gas supply chain where these facilities are uneconomic to duplicate – that is where there are significant economies of scale and/or scope.

The UIWG identified a need for progress on access to upstream facilities, but was unable to reach agreement on an industry code. However it remains open to individual jurisdictions to introduce legislation providing a basic right for third party access and binding dispute resolution. There are indications that some jurisdictions are considering this option.

Marketing issues

The UIWG report found that the present immaturity of Australia’s gas markets would make mandatory separate marketing by partners in joint ventures premature at this stage. However, the UIWG also found that separate marketing would enhance intrabasin competition, and targeted this as the longer-term goal. In the meantime, it argued that the ACCC should continue to assess the actions of gas joint ventures on the basis of the public interest test, and that the ACCC should be mindful in its ongoing reviews of authorisations of the desirability of requiring separate marketing as soon as this becomes feasible.



ATTACHMENT B – Improvements in transmission capacity trading

The gas capacity trading reforms formed a major piece of the Standing Council on Energy and Resource's (now the CoAG Energy Council) 2013 gas market reform agenda and it has led to a number of commitments that will have an impact on the environment for capacity trading.

In response to the SCER consideration of transmission capacity trading, gas transmission companies, working with customers, developed a consistent framework for the provision of operational capacity transfers. Operational capacity transfers are superior to the traditional bare capacity transfers for a number of reasons. They:

- are an incentive to offer capacity, as it reduces the administrative burden for shippers;
- provide a more appropriate allocation of risk as the obligations of the seller are transferred to buyer;
- increase operational efficiency as it preserves the relationship between pipeline operator and shippers, both new and existing;
- allow a buyer of traded capacity to easily aggregate capacity from multiple sellers;
- improve transparency through publication of bids and offers, information on trades, available and contracted capacity; and
- support new entrants as it allows new shippers to access short-term capacity.

Engagement with market participants has shown a clear preference for operational transfers and it is expected that this service will be utilised where there is a market need.

This initiative, initially advocated by APA Group, has been endorsed by the gas transmission industry and can be readily applied to any pipeline in response to market need. Operational capacity transfers will be available on Wallumbilla hub pipelines operated by APA Group and Jemena at the commencement of that market. Both companies, and other pipeline service providers, are investigating its utility in other markets and on other pipelines. APIA has developed and published a guideline for operational capacity transfer services to ensure a consistent approach is used across all pipelines as this service expands.

In December 2013 SCER produced a capacity trading Decision Regulatory Impact Statement recommending the development of further information initiatives and standardised trading contracts to support capacity trading. This development of this mechanisms will continue throughout 2014.

A further advantage of the industry-led response is its speed, the new service was conceived, developed and approved in the space of four months. This stands in contrast to SCER's information process, the RIS consultation ran over a period of nine months and the information proposal is still to be further developed following its recommendation in December 2013.