



NATIONAL COMPETITION COUNCIL

REVIEW OF DRAFT GUIDELINES

FOR

LIGHT REGULATION OF GAS PIPELINES

Comments by Major Energy Users

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Overview

1. The Major Energy Users Inc (MEU) supports the light regulation of gas pipelines where it has been unambiguously established that the pipelines concerned do not have significant market power, where the costs to the pipeline service provider and the regulator will be lower and result in lower overall costs to consumers.
2. The key to successful commercial negotiation between users and the pipeline service provider is the adequacy of information available to the former, as well as the ready accessibility of such information.
3. Considerable care needs to be exercised in not exaggerating the effectiveness of the countervailing power of users, including large end users. Small users have no influence at all on shippers' negotiations with pipelines.
4. The 'with and without' analysis must be quantified, as conceptual analysis is insufficient to prove unequivocally that a move to light regulation will result in lower overall costs to consumers.
5. Pipeline duopolies can exercise significant market power through tacit collusive practices.
6. This submission seeks to provide the National Competition Council with consumer perspectives on the light regulation approach, including consideration that should be given to the forms of regulation factors.

1 Introduction

1. The Major Energy Users Inc (MEU) welcomes the opportunity to provide comments on the exposure draft guidelines for the light regulation of gas pipelines.
2. The MEU agrees with the move, under the National Gas Law, to provide for a lighter form of regulation, but “where significant market power is possessed by the pipeline service provider” (p.12) a direct form of regulation is appropriate. The principle the MEU supports is predicated on the theory that where light handed regulation results in an overall lower cost (including regulatory costs) for the provision of the service, then it is in the interests of all stakeholders. The caveat that is implicit is the need to demonstrate that this will be the case..
3. Gas pipelines provide strategic infrastructure and, because it is often uneconomic to have duplicate pipelines, they are considered to be natural monopolies and the rationale for economic regulation is strong. Further, gas pipelines provide an essential service, as the use of gas has now reached the stage where the use of gas for heating, industrial use and most importantly power generation, is no longer considered to be an option. The need for secure power supplies (considered by all to be an essential service in the modern world) is now paramount and predicated on gas fired generators, and the use of gas has become a key element in the fight to reduce greenhouse gas emissions.
4. However, the task of regulating monopoly infrastructure, such as gas pipelines, is complex and is not without difficulty. Much has been achieved in the regulation of gas pipelines in Australia over the past decade and the Australian economy and consumers have realised substantial gains.
5. The reviews by the Productivity Commission and the Expert Panel in Energy Access Pricing cited in the NCC’s draft guidelines (p.12) are clear attempts to ensure further gains by making adjustments to the regulatory framework in order to minimise the risks for investment and innovation and to ensure that consumers and the community at large can benefit through more efficient (price and low-price) outcomes. In the MEU’s view, this is the context and indeed, the *raison d’être* for the policy adjustment in making available a ‘light handed’ regulatory regime.
6. This lighter form of regulation emphasises “commercial negotiation and information transparency, with regulatory intervention through the right to the arbitration of disputes being retained as a default” (p.12) is to ensure that “the administrative costs to the pipeline services provider and the regulator will be lower”.(p.12). Whilst the concept of negotiation does provide some comfort to policy makers and regulators alike, in that negotiation implies some degree of matching joint needs, care should be taken in regard to who will negotiate on behalf of whom.

7. The reason to move to light regulation is based on the basic assumption that this will minimise the costs for the service provider and the regulator, resulting in an overall lower cost for providing the service. Under light regulation, instead of one intrusive assessment by the regulator, once every five years or so, there will be many smaller individual assessments (negotiations) between the service provider and many users and potential users. Unfortunately, under light regulation the parties ultimately liable for the costs for the service (the many small users) have no standing in any negotiations with the service providers, as all such negotiations lie with the users (shippers). If there are no drivers on the shippers to negotiate lower overall costs then small consumers (as well as larger users) are disenfranchised under light regulation. Transportation costs will be simply seen as 'pass-through' costs.
8. Negotiation between large gas end uses and service providers is an obvious example where negotiation might occur, but in the case of small gas users this assumption starts to lose credibility. In fact, there will be no party tasked with negotiating with the monopoly pipeline owner on behalf of small gas users. Any assumption that retailers will take on this task on behalf of small consumers is a fallacy. Why should they? Retailers will accept the pipeliner pricing and "pass through" the costs to small users. That this is the case is clear from the observed lack of representation or participation by retailers in full regulatory reviews of gas pipelines. Consumer interests are only represented by consumers in such reviews. So the NCC needs to assess by what mechanism small consumers can have their views put in a "negotiation" with the pipeline owner, when the role of the regulator will be primarily one of "seeing fair play".
9. Of course, light handed regulatory measures must be 'workable' and efficient if they are to be implemented. This might include the speed and ease with which the regime works. For example, with the caveat that direct comparisons between the new Australian light-handed regime and the British regime, is not being made here, it is worth noting the following assessment by Carpenter and Lapuerta¹ (1999, p.1 and 2):

“Although attractive in theory the implementation of light-handed regulation in the United Kingdom has faced several problems. First, light-handed regulation has not worked as anticipated to avoid the need for lengthy regulatory proceedings. Second, light-handed regulation has unintentionally created inefficient incentives for regulated companies. Third, light-handed regulation has not successfully constrained the monopoly power of incumbents”.

¹ “A Critique of Light-Handed Regulation” by Paul Carpenter Carlos Lapuerta, *Northwestern Journal of International Law & Business*, February 1999

Carpenter and Lapuerta (1999, p.22) further noted that:

“Regulators have had to confront issues related to the measurement of assets, depreciation, rates of return and cost projections.... Furthermore, light handed regulation has exacerbated the information disadvantage of regulators, which has been exploited successfully by regulated companies”.

10. The NCC’s exposure draft points to the appropriateness of lighter regulation (pp.12 and 13):

“...where the market power exercised by the provider is less than substantial and there is the potential for the contestability for the services to emerge. It may also be appropriate where the number of access seekers is relatively small and these parties can themselves exercise some countervailing market power in the course of commercial negotiations. Further, light regulation may be an appropriate option for regulation where particular assets are in transition towards effective competition”

11. The MEU observation to the first point from the above statement (“the potential for the contestability for the services to emerge”) is that it inherently accepts that the pipeline owner is allowed to enjoy transitory rents for a period, on the assumption that they may or may not be swept away when and if contestability for the services emerges. The issue that lies unaddressed is how much rent is tolerable, for how long, and will contestability necessarily bring forth new entrants?

12. The MEU observation regarding the second point above (“countervailing market power”) is that it ignores the reality that even large consumers do not necessarily have countervailing power – their investments are often many multiples of those of pipeline owners and have limited negotiating coin when “negotiating” with a monopoly. In fact experiences MEU members have had when “negotiating” with a monopoly energy service provider proves the adage that the term “negotiating” with a monopoly is an oxymoron. Where there is a competing pipeline, the situation may be a little different, but there is no guarantee that a duopoly may not simply engage in market sharing in order to push up prices and maximise revenues.

13. The response to the third point (“assets are in transition towards effective competition”) is that this is tantamount to suggesting that a temporary rather than a permanent enjoyment of monopoly rents may be sufficient to elicit the right entrepreneurial behaviour and hence investment and innovation. In other words, the “temporary” monopolist is not necessarily profit seeking and may be quite altruistic in its behaviour.

14. But none of the NCC observations address the fundamental concern detailed in MEU para 7 above. Whilst the NCC highlights the advantages of light regulation, it does not address the mechanics as to how end users of gas (especially small and medium users) can influence the

monopoly provider, and who will undertake the negotiations on behalf of the many smaller users.

15. The NCC makes reference to the ability to revert to the Courts in the case where there is contention. The concern in this regard is that appeals to the Courts are expensive. It is in the interests of a service provider to revert to the Courts and accept the costs of doing so, From the view point of a consumer of gas (especially a small user) it is less clear whether the costs inherent in the Court process are warranted. As has been seen in previous appeals, even large consumers of gas have eventually withdrawn from appeals, for a variety of reasons, costs being but one. But for small consumers such a process is totally biased in favour of the service provider, as the rewards are much greater.
16. In the MEU's view, many of the assumptions pertaining to the reasons for light-handed regulation are fraught with complexities and difficulties, and require skilful and careful consideration by regulators. The NCC needs to be cognisant of these complexities, issues, and assumptions and the guidelines carefully crafted and implemented, and avoid proscribing the ability of the AER from exercising independent reviews (under arbitration) under the National Gas Law.

2. Light Regulation Determinations – Overview

2.1 Use of extrinsic material in interpretation

17. The MEU agrees with paras 32 to 38 of the exposure draft. Para 36 is particularly important in regard to the importance of the Second Reading Speech for the National Gas Law to provide guidance to the courts, especially the NGL objective and the form of regulation factors in s16 of the NGL.
18. The MEU also agrees especially with para 38 where the exposure draft refers to “some care needs to be taken in relying too heavily on any one particular statement” in the light of the fact that “the policy surrounding the light regulation regime, while consistent at a high level, did develop significantly from the Productivity commission’s review, the Ministerial response, Expert panel and the final consultation...”
19. There was much debate over the balance of the Productivity Commission’s Review report and with aspects of its analytical work, and with the practicalities of its recommendations on light-handed regulation. It was as a result of that controversy that the Expert Panel was established to provide independent analysis and to arrive at fresh recommendations, which Ministers subsequently made decisions on. For example, a key Productivity Commission recommendation concerning the regulator being required to have a presumption in favour of the network service provider with respect to its WACC application was overturned by the Expert Panel and this was accepted by Ministers. Reliance on the Productivity Commission’s analysis underpinning that recommendation would, therefore, be quite unsafe.
20. Against that general background, the MEU agrees that “some care needs to be taken in relying too heavily on any one particular statement” (para 38) primarily because of the overlay of additional analytical and policy review processes (the Expert Panel and the Ministerial response) over the initial Productivity Commission’s review and the initial Ministerial response to that review.

3. Decisions on light regulation when pipeline is a covered pipeline

3.1. Calculating time

21. Rule 11 allows a decision-maker, when calculating elapsed time (such as the 4 months provided for in s114), to disregard several periods as listed in para 51 (a) to (e). There is a clear risk that the cumulative periods listed in 51(a) to (e) could be very substantial. Also, the informational requirements could be just as substantial.

22. The MEU would suggest that there is a need for the NCC to specify some overall maximum timeframe to cover the periods under para 51 (a) to (e) (although it is recognised that some periods, such as those involving court proceedings may not be able to be predicted nor a line in the sand being drawn). A key objective of a light regulation regime is that it is a truncated regime, and that transactions costs are kept as low as possible. Not to apply a truncated process at the NCC level could negate the perceived benefits of having a light regulatory regime.

3.2. Extending time limits

23. The MEU agrees with para 53 whereby the NCC has the power to extend time limits if the proposal is complex, difficult or because of circumstances beyond the NCC's control.

24. The concerns about the timeliness of the NCC process expressed under section 3.1 above apply here as well. The NCC must be able to extend time limits on each occasion by 2 months, with possibly a maximum number of extensions proscribed.

4 Section 122 – Principles governing light regulation determinations

4.1 Section 122

25. The MEU notes para 67 and the NCC's view of the factors that require consideration, and the NCC's reference to the NGL's second Reading Speech concerning the manner in which light regulation determinations are to be made.

26. In that regard, the NCC refers (p.29) to the Second Reading Speech which states, inter alia, that:

“Light regulation may be particularly relevant for point to point transmission pipelines, with a small number of users who have countervailing market power”.

27. It is worthwhile to note that many large users are sceptical about their ability to exercise countervailing power, notwithstanding the confidence held by some that such power exists. In particular, it is worth noting, from the Productivity Commission's Report *Review of the Gas Access Regime* (June 2004), which states that:

“Although such alternatives might provide some users with a degree of bargaining power relative to a pipeline owner, other users might not be in such a position. A user that has no real fuel or energy substitute and is located in a market that is serviced by a single transmission pipeline (for which there is excess demand) is unlikely to have significant bargaining power. Western Power argued this, noting:

...[as] contracts expire, and WPC's [Western Power Corporation's] needs for gas transmission capacity increase, WPC is finding that It has little or no bargaining power. There are a number of large users in the south west of Western Australia, all with a critical need for gas and all competing for the limited amount of the DBNGP [Dampier-Bunbury pipeline] transmission capacity that is available. ... In circumstances where WPC has a large sunk investment in gas-fired generators and there are no alternative gas or gas transportation options, WPC cannot make a credible threat to not deal with the owner of the DBNGP. (sub. DR115, p.16).

Worsley Alumina also argued its bargaining power was constrained by some of these factors:

In the present environment, the user will incur the highest cost if it is unable to secure gas transmission capacity. In Western Australia, users lack any real ability to credibly make a threat to

the owners of the DBNGP [Dampier-Bunbury pipeline] that users will cease contracting to access gas transmission services as users' bargaining power is severely constrained by a number of factors...

- (a) lack of alternative transmission pipelines;
- (b) the extensive sunk costs in infrastructure that can only be fuelled by natural gas for example gas turbines;
- (c) a very limited ability to substitute alternative fuels for natural gas, especially in industrial applications where product quality considerations may require the use of natural gas, for example in calcination in alumina refineries; and
- (d) environmental agreements. (sub. DR110, p.4)

Similarly, WMC Resources argued (with particular reference to the Western Australian goldfields region) that users lacked bargaining power because they lacked credible alternatives:

...there appears to be little significance attributed to the lack of bargaining power of pipeline users, which are completely dependent upon the services of a particular pipeline. That's particularly the case, I think, in Western Australia, particularly in the goldfields region and a lot of the mining and industrial clients there. (trans., p.923)

28. It is worth noting that the Report also draws attention to a submission from a large user, Orica, to the effect that it could cease manufacturing and switch its ammonia requirements over to imports once its gas contracts expired, and imputes that Orica could have negotiating coin with the pipeline owner. The Productivity Commission did not make the point that should Orica switch to imports of ammonia, it would have had to write off several hundreds of millions of dollars in ammonia manufacturing plant and equipment!
29. The purpose of the above is to make the point that large users do not necessarily have market power, depending on circumstances, and they are the best source of information on the issue. Generalisations and suppositions about what is possible should not be a substitute for factual assessment.
30. But even more telling is that small consumers have virtually none. Some large consumers (gas fired power stations and large industrial users) are also shippers ("Users" of the gas pipeline services) but generally the bulk of the gas transported is done by retailers which have aggregated the demand of many small consumers. The assumption is that retailers would act on behalf of these small consumers, but as retailers can "pass

through” the cost of gas transport they have no incentive to negotiate with the pipeliner to reduce these charges (see MEU para 7 above). Every retailer will incur the same cost for gas transmission transport and therefore there is no incentive to negotiate on behalf of small gas consumers.

31. The NCC must therefore be certain that the interests of all gas consumers will be represented in any “negotiations” with the pipeliner before it can assume that light handed regulation is a feasible alternative to full regulation.

4.2 Factors the NCC ‘must have regard to’ under s122 (2) – the national Gas objective

32. The MEU had strongly supported Section 23 of the NGL which sets out the national gas objective as follows:

“The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.”

33. In addition, this objective is explicitly referred to in the Second Reading Speech, as a consideration for all of the key decisions in the regime. Again, the MEU had provided strong support for this during the development of the NGL and NGR.
34. It is worth noting though that gas pipeline owners and their representatives had strongly opposed such an objective being incorporated in the gas pipeline regulatory regime and when that was not accepted, sought unsuccessfully to incorporate the objective in the NGR, rather than in the NGL, the implication being that it would be far easier to seek to amend the Rules rather than Legislation.
35. The NCC refers to qualification of the objective in the second reading speech, in that the objective is an economic concept. The issue that the NCC must address in its assessment of light regulation is, that in economic terms, is there a fair and equitable ability for all consumers to “negotiate” a reasonable access price on the monopoly pipeline. If there is not, in reality, the equal ability for the provider and the consumer (which must ultimately incur the costs for providing the service) to negotiate an equitable outcome for the provision of the service, then either the NCC must:
- a. Decide that light regulation is not allowed, or
 - b. Determine how this equality can be provided as part of the light regulatory approach to be used.

4.3 Any other matters it considers relevant

36. The MEU strongly supports para 79 of the exposure draft which states:

“This section gives the NCC the ability to consider other related and relevant issues. Given the economic focus of the legislation and the large number of factors already being considered, the NCC does not see this ability as a mechanism for a large number of arguments and perspectives to be put outside of those already under consideration. To do so would be to take the reference out of context. The NCC notes the reason for its inclusion links back to the Expert Panel which observed that:

The Panel believes that it would be prudent to allow the AEMC to consider any other factors that might be relevant to the assessment of the extent of market power to ensure that any extenuating circumstances can be included in the assessment. For example, there may be circumstances where a service provider’s past behaviour in not misusing the market power it possesses becomes relevant to a consideration of whether a less intrusive form of regulation could be applied to it.”

37. The MEU considers that the Expert Panel’s ‘insightful’ observation of the likely altruistic behaviour of a service provider needs to be carefully assessed to ensure reality and that the actual behaviour has not been historically unsafe and would therefore detract from the economic focus of the regime.

4.4 Factors the NCC must consider under s122(1)

38. The MEU is struck by the second part of para 83 of the exposure draft, viz:

“The NCC also considers that the questions of judgement involved in assessing the likely future scenarios (i.e. the with or without analysis) and the explicit role given to the national gas objective and form of regulation factors indicates a need to focus on qualitative rather than a pure quantitative economic analysis which would be highly dependent upon the assumptions included in the model”.

39. The MEU recalls that during the Productivity Commission’s Review of the Gas Access Regime, major stakeholders had criticised the review for its absence of quantitative analysis, especially on the issue of the cost-benefits of the regime. Stakeholders had provided the Commission with estimated costs of regulation, including the benefits stemming from the regulatory regime. The resulting Review was the poorer for its lack of quantitative analysis. The Commission’s conceptual analysis and philosophical preferences led it to delivering an unbalanced report.

40. The MEU believes that the NCC should not preclude quantitative analysis from its consideration of applications. Indeed, as the Objective of the Gas Law is to be assessed on an economic basis, it is impossible for a purely qualitative analysis to provide clear economic support for any decision made in the absence of any qualitative analysis. Whilst the Productivity Commission's Review was in respect of the regime, the NCC will be assessing particular cases and quantitative analysis should be less difficult and, in fact, much more meaningful with such an underpinning.
41. A qualitative analysis provides a view as to what might be expected, and what controls and actions might lead towards a targeted outcome. A quantitative analysis provides greater certainty as the extent that such controls and actions actually will provide. In this regard, reference is again made to the concern as to who will provide the balancing power for end users against the monopoly power of the pipeline owner?
42. Moreover, the concept of market power and the degree of market power considerations that the NCC would need to give, would be considerably enhanced by quantitative analysis. For example, s122 (1) (b) (i) requires the NCC to consider these issues.
43. The MEU also believes that the applicant be required to provide as much quantification as is available to enable the NCC to undertake the 'with or without' analysis.

4.5 The operation of s122 (1)(a)

44. The MEU agrees with the issues that may be raised in the analysis of the effectiveness of each form of regulation (i.e. 'with or without' analysis) as listed in para 86 (a) to (g). For example, issue (c) clearly makes the point that there be no discrimination, and the MEU fully supports this view. However, the resultant corollary is that this will provide no incentive for Users (usually retailers) to be active in tariff setting, as the actions of one will benefit all. This lack of involvement is the outcome seen in full regulation reviews. If retailers do not act for end users (especially small end users) who will? Under full regulation there is the view that the regulator will set a tariff that is balanced between the needs of the service provider and the end user.
45. The MEU agrees that the listing of issues (a to g) provides significant detail as the issues that need to be addressed in an application for light regulation. As well as the need to ensure that the change to light regulation does not result in an increase in the price for the service or reduction in the ability to gain access, it is pointed out that the Objective of the Gas Law must be seen in context of how such a change would impact on the end user in its total impact, rather than looking at the

pipeline in isolation. In this regard, the analysis must also include whether there are (and to what extent) effective countervailing forces to prevent a service provider from using its market power to reduce inter-basin competition.

4.6 The operation of s122 (1)(b)

46. It goes without saying that, as the NCC is required to consider the likely costs that may be incurred by an efficient service provider under each form of regulation, that the NCC will face the problem of information asymmetry.
47. Whilst the service provider is required to submit an estimate of its costs for providing the service, the NCC is required to take an independent view. In this regard, major stakeholders, such as large users, retailers and gas producers, would have information that would assist the NCC in its quantification analysis. Against this background, the NCC would be very wise to ensure the active participation of these stakeholders. This would be achieved by the NCC establishing good communications, and review processes to maximise stakeholder participation (especially as the timelines for initial submissions are very tight). At the same time the NCC must identify methods for ensuring the interests of small consumers are also addressed.
48. With regard to the NCC's statement in para 90, that:
- “...an efficient service provider could be expected to minimise its own transaction costs in dealing with both the regulator and users wherever feasible.....It must be recognised that costs on service providers imposed by regulation are passed on to users and end users through the regulatory regime”.
49. The MEU does not believe that there is any incentive on the part of monopoly network service providers to minimise transaction costs, as these are automatically passed on to shippers (users) and then onto end users (consumers). Effective economic regulation will result in costs minimisation, usually through providing powerful incentives, whilst ineffective economic regulation results in cost padding. Light regulation, largely driven by information asymmetry, will incentivise cost padding. The real issue is - under what form of regulation will the service provider have the most powerful driver to minimise costs? The NCC should be cognisant of these considerations and address them as part of its analysis. The assumption made above is unsafe.
50. There is an assumption that the service provider will be efficient, and because of this it will reduce transaction costs. This is a bald assumption, as there is little driving a service provider towards efficiency under light regulation, compared to the efficiency drivers included in full regulation. This raises the question – Does light regulation have the

same implicit drivers for reaching efficient costs even if the pipeline does not have significant market power? Yet the NCC seems to assume that it will.

51. The NCC should also be aware that under full regulation, reference tariffs are usually the maximum tariffs faced by users and there is little negotiation for discounted tariffs. A light regulation regime may encourage more negotiation and innovation with the former driving up transaction costs and the latter, tending to reduce transaction costs. These need to be examined.
52. The likely costs where light regulation applies that may be examined should also include the costs incurred in the application to the NCC for light regulation.
53. With regard to para 92 (on (ii) the likely costs that may be incurred by efficient users and efficient prospective users), the MEU agrees that the key issue for consideration is the transaction costs involved for users in negotiating new or altering existing access arrangements. The expectation is that transaction costs will be significantly reduced. Yet, there is no efficiency driver on the service provider to structure its costs to be the most efficient. In practice, the efficient costs for users and prospective users will be the trade off between the costs of driving the service provider to an efficient cost and the cost of accepting a higher (and therefore inefficient) cost from the service provider. In this regard, full regulation provides an ability for users and prospective users to accept the regulator set pricing and conditions. Under light regulation such small consumers are left to incur the costs (hopefully) negotiated by shippers who will just pass through the outcome of the negotiations they have. If there is no incentive on the shippers to negotiate the best arrangement and the arrangement negotiated is available to all, where is the benefit to these consumers?
54. The MEU also observes the NCC view that (NCC para 92)

“...where the number of users are small, existing capacity is fully contracted and long term contracts are in place, there may be little cost for users of moving to light regulation and no material lessening of the effectiveness of the regulation in preventing the exercise of market power”.

To a degree this observation has validity, yet overlooks the fact that by the setting of a reference tariff under full regulation, this provides prospective users with a point around where negotiations can commence in the event that some capacity becomes available. It also provides a reference point for consumers to develop a bundled price so they can compare offers for a bundled service. This especially has relevance where all the capacity is held by one shipper.

5. Forms of regulation factors –relevant considerations

5.1 The NCC can determine the weight to be given to each factor

55. The MEU agrees with paras 102 and 103 in terms of the NCC being able to determine the weight to be given to each factor and that the significance of each factor may vary depending upon a range of considerations and from application to application.
56. The MEU also agrees with para 104 with respect to the degree of market power associated with the supply of the service being the principal criterion in deciding the form of regulation to be applied. In this regard, the MEU considers that the assessment of the degree of market power should be based on existing conditions and considerations and not based on presumptions about the likely altruistic behaviour of service providers. There should not be any presumption in favour of the network service provider.
57. The NCC should be transparent as to how it sets weighting factors and how it reached its conclusions regarding the value it attributes for each weighting.

5.2 Forms of Regulation Factors

(a) The presence and extend of any barriers to entry in a market for pipeline services

58. The MEU agrees with the discussion in paras 107 to 112.

However, it is important to note that two pipelines do not necessarily lead to an absence of market power. For example,

- a. Two pipelines may decide to operate a duopoly market arrangement and ratchet up prices,
- b. One pipeline may be fully contracted and thereby offer limited competition to a second pipeline
- c. One pipeline might be contracted on a pressure control basis (and therefore able to provide “swing” gas) but the other might be a flow controlled pipeline and have less ability to provide balancing services.

(b) The presence and extent of any network externalities (that is interdependencies) between a natural gas service provided by a service provider and any other natural gas service provided by the service provider)

59. The MEU agrees in principle with paras 113 - 121, but with some caveats.

60. Where it has been determined that a pipeline is permitted to be uncovered as a result of analysis indicating there is competition, then such a pipeline should be permitted light regulation. Equally, where it has been determined that a pipeline should not be uncovered, and that there is an argument that it holds sufficient market power to be a covered pipeline, then it would be difficult to argue that light regulation is an option if there have been no change in circumstances.

61. That notional access can be granted to an access seeker (for example where gas swaps have been implemented) does not necessarily support the view that market power does not exist, and that light regulation is a viable option.

62. Great care is necessary in the assumption that alternative forms of energy are viable options and therefore apply competitive constraints, especially within distribution networks. Cost is not the only criterion for whether gas or an alternative source of energy is viable. Environmental issues must also be addressed, such as local government impositions on smoke, and carbon emission constraints, which place non-financial constraints on alternatives. To allow free rein to a service provider when alternatives are not permitted for non-financial reasons is economically inefficient and allows a service provider to factor in monopoly rents.

(c) The presence and extent of any network externalities (that is, interdependencies) between a natural gas service provided by a service provider and any other service provided by the service provider in any other market.

63. The MEU fully agrees with the views of the NCC in para 122

(d) The extent to which any market power possessed by a service provider is, or is likely to be mitigated by any countervailing market power possessed by a user or prospective user

64. The MEU had earlier pointed to circumstances where major users have limited countervailing market power. Moreover, certain users have limited avenue for substitution, e.g. in the case of firms that use gas as a feedstock as well as an energy source. Countervailing market power is also limited where another pipeline supplying the same market is fully contracted.

65. There is a bold assumption that the size of a consumer and its financial status provides it with a unique ability to leverage a commercial outcome with a monopoly provider. In fact, direct experience has shown that comparatively small (in financial terms) monopoly providers have successfully used their monopoly position to prevent a much larger consumer from using its financial position to achieve any advantage.

66. The MEU strongly considers that the ability of major users to exercise countervailing market power must not be exaggerated. There are very few circumstances where a consumer has a sufficiently large demand for gas, has the geographic ability to commercially consider bypass and has the financial resources to provide a credible threat to a service provider. The reasons for this is that if there had have been such an opportunity, then the consumer would have funded its own service provision initially. In fact, there are very few examples where a large consumer has exercised its own ability to be its own gas service provider in gas (or electricity), attesting to the fact that this consideration is credible.

(e) The present and extent of any substitute, and the elasticity of demand, in a market for a pipeline service in which a service provider provides that service

67. As mentioned above, substitution is limited with respect to companies that use gas as a feedstock. Substitution is also difficult where prevailing market conditions preclude any switch (e.g. such as in electricity during drought-induced supply shortages; seasonal factors that prohibit commercially negotiated contracts (during summer peaks); and lack of long term contracts). The MEU also points to emerging issues such as the Carbon Pollution Reduction Scheme and the Renewable Energy Target, whereby relative prices of energy sources would significantly change, and reduce the substitutability of alternative energy sources to gas. In this scenario, the demand for gas (and gas transportation) will be relatively inelastic, and there will be limited potential for users to shift consumption away from gas towards alternatives, such as electricity and diesel. The view of the Expert Panel, noted in para 138, is unsafe, in the light of emerging issues.

68. There is reference to elasticity in demand. In fact, elasticity in demand for essential services such as gas and electricity is very low. The main reason for demand variation in both gas and electricity is weather related (heat increases demand for electricity and gas for power generation, and cold increases demand for gas and power generation) and therefore effectively outside the control of consumers. In the absence of the weather related demand variations, gas (and electricity) demand shows a high resilience in relation to demand stability.

69. History shows that a duplicate pipeline from the same source to the same demand point is most unlikely to be built by a competitor. There is an overall lower cost for an exiting pipeline to loop its exiting asset or to increase the amount of compression than building a duplicate. The current approach to the looping of DBNGP is a case in point, where looping is being carried out by the existing owner.

70. Thus, credible competition at a demand point will only come from a new pipeline from a new gas source, such as SEAGas pipeline to Adelaide. This then raises the question, as to whether the shippers on the new

pipeline will take their monopoly rents (if any) in the pipeline service or at the gas source.

(f) The presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be)

71. As noted above, the use of gas exhibits a lower elasticity of demand than is generally realised. This is more driven by external issues such as carbon emissions constraints and local government ordinances covering other emissions such as gaseous emissions and particulate emissions. Whilst there may be technically based alternatives such as coal for gas, in practice these are not alternatives in reality.

72. Once a facility has converted to gas its ability to use alternative forms of energy for the same purpose is very limited due to the investment made by the consumer. Thus investment decisions made by consumers (perhaps based on when gas was a lower cost) then become a barrier to utilise alternatives, and should not become the basis for service providers seeking monopoly rents.

73. The main driver of variable demand (and therefore implied elasticity) is not the use of alternatives but weather considerations.

(g) The extent to which there is information available to a prospective user or user, and whether that information is adequate, to enable the prospective user or user to negotiate on an informed basis with a service provider for the provision of a pipeline service to them by the service provider

74. The information asymmetry problems are severe in the case of natural monopoly gas pipelines and the NGL and NGR contain extensive mechanisms intended to facilitate the provision of information in various circumstances. It was with this in mind that end users successfully achieved such strong information disclosure provisions in the NGL and NGR. The potential to lose this provision of information by moving to light regulation is a great concern.

75. From the users' point of view adequacy and timeliness of information provision are the key issues. Also, the adequacy of information by the AER on access negotiations is particularly important. The NCC should consider how adequate information may be accessible to consumers to enable some negotiating coin. The pipeline would normally point to the availability of many different sources of information as adequate to assist negotiations. However, ready availability of information, as is the robustness of the information are critical.

6. National Gas Rules – requirements for making light regulation determinations

76. The MEU has no comment on this section, which reflects the provisions of the NGR.

7. Revocation of light regulation determinations

77. The MEU has no comment on this section, which reflects the provisions of the NGR.

8. Merits Review

78. The MEU has no comment on this section, which reflects the provisions of the NGL and NGR.