

RIVERLAND GAS TRANSMISSION PIPELINE

**APPLICATION TO REVOKE COVERAGE OF A
NATURAL GAS TRANSMISSION PIPELINE
UNDER THE SOUTH AUSTRALIAN
GAS ACCESS REGIME**

**Final Recommendation
August 2001**

National Competition Council

Introduction

In May 2001, the National Competition Council (the **Council**) received an application from Envestra Limited for revocation of coverage of a natural gas transmission pipeline located in South Australia under the provisions of the *Gas Pipelines Access (South Australia) Act 1997* (the **Gas Access Act**). The pipeline in question is SA:PL6 (the **Riverland Pipeline**).

The Council has also received an application from Envestra Limited for revocation of coverage of a natural gas transmission pipeline located in South Australia and Victoria (Vic:PL11, the **Mildura Pipeline**) under the provisions of the Gas Access Act and the *Gas Pipelines Access (Victoria) Act 1998*. The Mildura Pipeline is considered in a separate recommendation; this recommendation relates only to the Riverland Pipeline.

The effect of revocation is to remove a pipeline from regulation under the National Third Party Access Code for Natural Gas Pipeline Systems (**National Code**), implemented in South Australia by the Gas Access Act. In effect, the owner of the pipeline is relieved of any obligation under the National Code to grant access to third parties.

Under section 1.31 of the National Code, the Council must recommend that coverage of a pipeline be revoked if it is not satisfied that the pipeline meets each of the criteria set out in section 1.9 of the National Code.

After consideration of the application and submissions lodged by interested parties, as well as discussions with various interested parties, the Council has reached the view that the Riverland Pipeline does not meet criteria (a) and (d) under section 1.9 of the National Code and that coverage of this pipeline should be revoked.

This document comes in two parts. Part A explains:

- the legislative background to the South Australian gas pipeline access regime;
- the concepts of coverage and revocation under the regime; and
- details of the application, including specifications of the Riverland Pipeline, and the Council's processes.

Part B contains the Council's detailed consideration of the criteria on which the Council's final recommendation is made.

Part A – Coverage and Revocation under the Gas Access Regime

South Australia has enacted a gas pipeline access regime to provide parties with a method for seeking access to certain gas transmission and distribution pipelines located in South Australia. The regime is contained in the Gas Access Act, which applies the Gas Pipelines Access Law which includes the National Code.¹

A copy of the National Code can be found on the Code Registrar's website at www.coderegistrar.sa.gov.au.

The regime assists parties wishing to transport gas through gas transmission and distribution pipelines in South Australia to contract on competitive terms for transport with pipeline owners/operators. For example, a mining company may wish to buy gas from a gas producer at a particular production site and transport it to a gas-fired power station at its mining site. Under the regime, it has the opportunity to negotiate a contract for transport of the gas with the owners/operators of pipelines covered by the regime in accordance with the rules laid down by the regime. In the absence of the regime, the owners/operators of pipelines might, by virtue of any monopoly powers over the transport of gas between the particular geographic regions, refuse to transport gas or demand a monopoly price for the transport of gas.

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

Coverage of Pipelines

The Riverland Pipeline, for which revocation of coverage is sought, became covered by the gas access regime when it was listed in Schedule A to the National Code. Pipelines listed in Schedule A were covered from the commencement of the access regime.

Where pipelines are covered, the owners/operators of the relevant pipelines must comply with certain obligations under the Gas Pipelines Access Law

¹ The Gas Pipelines Access Law is contained in Schedule 1 to the Gas Access Act and the National Code, which is contained in Schedule 2 to the Gas Access Act.

(including the National Code). These obligations include rules covering such matters as:

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

Revocation of Coverage of a Pipeline

The National Code permits any party to seek revocation of coverage of a pipeline. The party must apply to the Council asking the Council to recommend to the relevant Minister that coverage of a pipeline be revoked. On receipt of the Council's recommendation, the relevant Minister must then decide the matter. For the Riverland Pipeline, the relevant Minister is The Hon Wayne Matthew, MP, South Australian Minister for Minerals and Energy.

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

The criteria set out in section 1.9 of the National Code are:

- (a) that access (or increased access) to services provided by means of the pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the pipeline;
- (b) that it would be uneconomic for anyone to develop another pipeline to provide services provided by means of the pipeline;
- (c) that access (or increased access) to the services provided by means of the pipeline can be provided without undue risk to human health or safety; and
- (d) that access (or increased access) to the services provided by means of the pipeline would not be contrary to the public interest.

The Council's detailed assessment of the application against the criteria in section 1.9 of the National Code is contained in Part B of this document.

Where revocation is granted, the owner/operator of the pipeline is released from its obligations under the Gas Pipelines Access Law (including the National Code). The owner and operator are no longer required by the National Code to submit an Access Arrangement for the pipeline to the regulator, or to respond to access requests by third parties.

The Gas Access Act includes a process for administrative (merits based) appeals against a decision to revoke coverage. The process is set out in section 38 of the Gas Pipeline Access Law. In respect of the Riverland Pipeline, administrative appeals from revocation decisions are heard by the SA Gas Review Board.

The Application

The revocation application for the Riverland Pipeline relates to a gas pipeline listed in Schedule A of the National Code, as detailed in Table 1 below.

Table 1: Pipeline for which Revocation is Sought

<i>Pipeline Licence</i>	<i>Location/ Route</i>	<i>Owner</i>	<i>Operator</i>	<i>Length (km)</i>	<i>Diameter (mm)</i>	<i>Regulator</i>
SA:PL6	Riverland Pipeline System	Envestra Limited	Epic Energy Pty Limited			ACCC
	Angaston to Berri main line			166	114	
	Sedan to Murray Bridge			65	114	

Riverland Pipeline

The Riverland Pipeline was constructed to carry gas from the Angaston gate and compressor station to the Berri gate station for distribution in the Berri area. The Riverland Pipeline has several farm taps, and a lateral pipeline also connects the Riverland Pipeline at Sedan to the township of Murray Bridge for distribution. The distribution networks in Berri and Murray Bridge are covered under the National Code and are owned and operated by the applicant. The total length of the Riverland Pipeline is 237 km, including 166 km from Angaston to Berri and 65 km from Sedan to Murray Bridge.

Major gas users connected to the Berri distribution network include BRL Hardy, Tarac, Berrivale Orchards, Visy Board and Berrivale Cannery. Major gas users connected to the Murray Bridge distribution network include National Dairies and Metro Meats.

The Riverland Pipeline is operated for the applicant by Epic Energy. Epic Energy is an independent owner and operator of natural gas pipeline systems, and owns among other pipelines the Moomba to Adelaide Pipeline system that supplies the Riverland Pipeline with natural gas from the Moomba processing plant. Epic Energy is not related to the applicant, but has contracted with the applicant to provide the technical operation of the Riverland Pipeline until 2003.

The only direct customer of the applicant currently purchasing transportation capacity on the Riverland Pipeline is Origin Energy Limited (**Origin Energy**), a major energy retailer. Origin Energy has a 19.97 per cent interest in the applicant, and has the right to appoint two non-executive directors to the applicant's board. Origin Energy and its subsidiaries are involved in the day-to-day management of parts of the applicant's business. However, Origin Energy's energy sales functions are structurally separate and ring-fenced from its asset management functions as required by the National Code, and would continue to be so if coverage of the Riverland Pipeline were revoked.

Origin Energy sells a package of delivered gas (comprising transportation and natural gas) to a range of domestic, commercial and industrial customers using the Riverland Pipeline. Most of this gas is sold to large industrial customers, as set out below:

Table 2: Origin Energy Riverland customers (consumption)

<i>Category</i>	<i>Annual Consumption (TJ)</i>
Domestic	0.7 (0.1%)
Commercial	11 (1.6%)
Industrial	668 (98.3%)
Total	680 (100%)

The Riverland Pipeline is constructed from polyethylene-coated steel with 114 mm outside diameter. It has a maximum operating pressure of 10,000 kPa and is currently operating at around 4,000 kPa. The maximum delivery capability of the Riverland Pipeline is 1,825 TJ per year or 5 TJ per day. It currently delivers around 680 TJ per year or 1.86 TJ per day, around 37 per cent of its capacity.

The Riverland Pipeline also delivers natural gas to the Mildura Pipeline for transportation to the Mildura distribution system. Although the Mildura Pipeline is subject to a separate recommendation, since it is supplied with gas from the Riverland Pipeline it is described briefly below.

Mildura Pipeline

The Mildura Pipeline was constructed to deliver natural gas to Mildura and surrounding areas, following a competitive tender submitted to the Mildura City Council by the applicant and Origin Energy in 1997. The Mildura Pipeline was commissioned in November 1999. It delivers gas 148 km from the Berri gate station in South Australia (where it is supplied by the Riverland Pipeline) to the Mildura gate station in Victoria, for distribution through the Mildura system. The Mildura distribution network is covered by the National Code and is owned and operated by the applicant.

The Mildura Pipeline is operated for the applicant by Origin Energy Asset Management Limited (**OEAM**), a subsidiary of Origin Energy, described above. OEAM operates most of the applicant's pipeline infrastructure throughout Australia. The applicant notes that the role of OEAM includes the sale and marketing of transportation services and in some instances the negotiation of transportation contracts (subject to the applicant's approval). However, OEAM is structurally separate and ring-fenced from Origin Energy's retail operations as required by the National Code, and would continue to be so if coverage of the Mildura Pipeline were revoked.

Origin Energy is the only direct customer currently acquiring transportation capacity on the Mildura Pipeline from the applicant. Origin Energy takes delivery of all gas at the Mildura gate station for distribution in Mildura. Origin Energy sells a package of delivered gas (comprising transportation and natural gas) to a range of domestic, commercial and industrial customers in Mildura. Most of this gas is sold to large industrial customers, as set out below:

Table 3: Origin energy Mildura customers (number and consumption)

<i>Category</i>	<i>Customers</i>	<i>Annual Consumption (TJ)</i>
Domestic	415 (86%)	4 (2%)
Commercial	64 (13%)	45 (20%)
Industrial	6 (1%)	172 (78%)
Total	485	221

The Mildura Pipeline is constructed from polyethylene-coated steel with 114 mm outside diameter. It has a maximum operating pressure of 9,900 kPa and is currently operating at around 4,000 kPa. The maximum delivery capability of the Mildura Pipeline is 880 TJ per year or 2.4 TJ per day. It currently delivers around 220 TJ per year or 0.60 TJ per day, around 25 per cent of its capacity. Its original forecast was for 325 TJ in 2000/01, and the applicant advises that it is not expected to reach its full capacity "for many years".

Process for Considering the Application

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

- acknowledged receipt of the application and advised the owner and operator of the pipeline;
- advertised receipt of the application in the *Australian Financial Review* on 18 June 2000;
- prepared and released an Issues Paper in relation to the application;
- wrote to a large number of parties whose interests may be affected by the application and also conducted discussions with several interested parties in relation to the application; and
- released a draft recommendation and called for further submissions, notifying a large number of parties.

Following the forwarding of this final recommendation to the Minister:

- the Council will provide copies of the final recommendation to relevant parties, including the owner/operator and any party who made a submission;
- the Minister must make a final decision to grant or not to grant revocation of coverage within 21 days of receiving the final recommendation;
- the Minister must provide copies of his decision and reasons to relevant parties, including the owner/operator and any party who made a submission;
- the Minister's decision (if it is to grant revocation of coverage) can take effect no earlier than 14 days after the date on which it is made; and
- any person adversely affected by the Minister's decision may apply for review under the Gas Access Acts to the SA Gas Review Board.

Part B – Consideration of the Criteria under Section 1.9 of the National Code

Under the National Code, the Council must consider whether the relevant pipeline continues to meet the criteria for coverage in section 1.9. The Council must recommend revocation in respect of a pipeline unless it meets all of the criteria.

In considering these criteria, the Council has taken into account the views of the applicant, and of parties that made written submissions as well as other interested parties with whom discussions were held. A list of the parties that made written submissions is at Appendix 1.

Guidance in Interpreting the Coverage Criteria

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

First, the Council has had regard to the purpose sought to be achieved in enacting the gas access regime.² Reference has been had to the preamble to the Gas Access Act to determine this purpose.

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

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

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

2 Section 22, Acts Interpretation Act 1915 (South Australia).

considered by the Tribunal in the *Australian Union of Students decision* and the *Sydney Airports decision*.³

Finally, the Council has had regard to the decision of the Tribunal in the *Eastern Gas Pipeline decision*,⁴ where the Tribunal specifically considered the interpretation of the coverage criteria under section 1.9 of the National Code.

The Relevant Pipeline and the Services Provided by that Pipeline

Each of the criteria in section 1.9 of the National Code requires consideration of whether either the pipeline under consideration or the services provided by it satisfy certain tests. The Council therefore considers it useful to begin by identifying the Riverland Pipeline and the services provided by it before considering the individual criteria in detail.

“Service” is defined broadly in the National Code to mean a service provided by means of a pipeline including (without limitation) haulage services (such as firm haulage, interruptible haulage, spot haulage and backhaul), the right to interconnect with the pipeline and ancillary services.⁵

The Council considers that for the purposes of considering the application for revocation of coverage, it is not necessary to define every possible type of gas transportation service.

The definition of “service” in the National Code says nothing about the geographic scope of the service provided by a pipeline, in other words whether the transportation service is one which is a point to point service, or a more broadly defined service of transporting gas to a particular destination or region.

In the *Eastern Gas Pipeline* decision, the Tribunal decided that the “service” provided by means of the relevant pipeline was a haulage service for the transport of gas between one point on the pipeline and another. The Council considers that this approach to service definition is consistent with the language of the Code and the approach to service definition more generally under Part IIIA of the TPA. It also reflects the fact that service definition is concerned with the particular facility at issue.

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

4 Re Duke Eastern Gas Pipeline Pty Ltd [2001] ACompT 2

5 Section 10.8, National Code

The Council concludes that, consistent with this approach, the services of the pipeline for which revocation has been sought may be described as gas transport services from the Angaston gate station to the Berri gate station as well as to points in between including the farm taps and the lateral from Sedan to the Murray Bridge gate station.

The Market in which the Pipeline Provides Services

Having identified the relevant services or products as being the point to point gas transportation services identified above, ordinary market analysis must be used to determine what market each separate product is in. In other words, for each separate transportation service, it must be determined whether there are any other transportation services competitive with that service.

Meaning of the Term “Market”

In considering the questions of market definition, the Council is guided by the work of the Federal Court, the Tribunal, and the Australian Competition and Consumer Commission (ACCC) in their consideration of market for the purposes of Part IV, as well as the Tribunal’s and the Court’s consideration of Part IIIA.

The Tribunal has defined “market” in the following way:

A market is the area of close competition between firms, or putting it a little differently, the field of rivalry between them (if there is no close competition there is of course a monopolistic market). Within the bounds of a market there is substitution – substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive.⁶

This view of market definition has been accepted by the High Court in the *Queensland Wire* case⁷ and was adopted by the Tribunal in the context of Part IIIA of the TPA in the *Sydney Airports decision*, and in the context of the National Code in the *Eastern Gas Pipeline decision*.

6 Re Queensland Co-operative Milling Association Ltd (1976) 25 FLR 169 at 190

7 Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Ltd and Another (1989) 167 CLR 177

Dimensions of Markets

The relevant dimensions of markets include the following.

- The product market, that is, the types of goods and services in a market. Product markets can be considered separate if their respective products are not substitutable in demand or supply. Products are substitutable in demand (and therefore in the same product market) if consumers will substitute one product for the other following a small but significant change in their relative prices. Substitution in supply occurs when a producer can readily switch its assets from producing one product to another.
- The functional market. Functional market definition focuses on the different steps in a production process. In defining functional markets, the Council has had regard to the Tribunal's approach to functional market delineation in the *Sydney Airports decision* which is consistent with the approach used by the High Court in *Queensland Wire* and developed by Professor Maureen Brunt⁸ and Professor Henry Ergas.⁹ The Council considers that the two following conditions must be satisfied before markets can be regarded as functionally separate:
 - The layers at issue must be separable from an economic point of view (economically separable). This involves an assessment as to whether the transaction costs in the separate provision of the good or service at the two layers are so large as to prevent such separate provision from being feasible. In effect, to be in different markets, vertical integration must not be inevitable.
 - Each layer must use assets sufficiently specific and distinct to that layer such that the assets cannot readily produce the output of the other layer (economically distinct). In effect, supply side substitution must not be so readily achievable as to unify the field of rivalry between the two layers.

Markets may be functionally separate even though there is a *one for one* relationship, that is to say, perfect supply and demand side complementarity. A good example of this is rail track and train operations. However, where complementarity is associated with economies of joint production or consumption such that separate provision or consumption was not economically feasible, the services will not be in functionally separate markets.

8 Brunt, Maureen (1990), Market Definition Issues in Australian and New Zealand Trade Practices Law, 18 Australian Business Law Review, 86.

9 Ergas, Henry (1997), Submission to the NCC in support of an Application by Carpentaria Transport Pty Ltd, pp. 1-3.

- The geographic dimension of the market. This refers to the area covered by the market such as national, intrastate or regional markets. The reference to “other markets” in criterion (a) includes markets outside Australia.
- The temporal dimension of the market. This refers to whether the size and scope of the market is likely to change over time. The temporal dimension is particularly relevant where production technologies are continually changing. In order to determine the temporal parameters of markets, the Council generally has regard to long-run rather than short-run substitution possibilities.

Criterion (a) that access (or increased access) to services provided by means of the pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the pipeline.

Background

The rationale for this criterion is that access regulation is only warranted where access is likely to create better conditions or a better environment for competition in at least one market other than the market for the services of the gas pipeline. For example, providing access may promote competition in upstream (gas exploration and production) and/or downstream (gas sales) markets.

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

- the service to which access is sought is not in the same market as the market or markets in which competition is promoted; and
- the creation of the right of access for which the National Code provides would actually promote competition in that other market.¹⁰

The Council’s approach is to:

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

10 See the Eastern Gas Pipeline decision.

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

In order to determine whether the services provided by the pipeline for which revocation is sought are in the same or different markets from the market or markets in which competition is likely to be promoted, the Council applies the test outlined earlier under the discussion of market definition.

First, the Council must consider the market or markets in which the pipeline provides its services.

As noted above, the Council has decided that the services provided by this pipeline are point to point services. The Council considers that the primary market served by the Riverland Pipeline is the market for gas transport services from the Angaston gate station to the Berri gate station as well as to points in between including the farm taps and the lateral from Sedan to the Murray Bridge gate station.

The Council must next consider the market or markets in which competition may be promoted. There are a number of potential markets that may be affected by a decision to revoke coverage of the Riverland Pipeline, in particular, the markets encompassing the activities of gas exploration, production, processing, reticulation, wholesaling and retailing.

The most likely market in which access (or increased access) to the services of the Riverland Pipeline may promote competition is the market within which gas sales take place. Access may also increase competition in markets that supply other products using gas as an input, including the market in which electricity is produced using gas-fired generation or cogeneration.

In defining the relevant market in which sales of natural gas take place, the Council examined:

- whether the relevant market was a natural gas sales market or an energy sales market;
- whether there are a number of functional levels within which sales of natural gas occur (e.g., wholesale, retail); and
- the geographic extent of this market.

Electricity or LPG as a Substitute for Gas

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

The Tribunal considered that over time gas and electricity markets were likely to converge, resulting in the eventual creation of a broader energy market.¹¹

The applicant notes that sales of gas and electricity are generally treated as separate markets, and states in relation to the Riverland Pipeline that during the six years that natural gas has been available in the Berri and Murray Bridge areas, there has been no discernible decrease in LPG or electricity prices. While neither the applicant nor any other interested party has made detailed submissions to the Council on this issue, the Council examined this issue at length in its final recommendations on the application for revocation of coverage of parts of the Moomba to Sydney Pipeline and the application for coverage of the Eastern Gas Pipeline.

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

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

The Council considers that the position of LPG may be similar to that of electricity. The Council considers that natural gas and LPG may be viable substitutes for some users, however the Council does not currently have sufficient information to conclude that the field of rivalry is so close as to put them in the same market.

In the *Eastern Gas Pipeline decision* the parties agreed and the Tribunal accepted that “the product of concern is mainly gas as there is little competition between energy sources at this time.” The Tribunal considered that other forms of energy may warrant consideration in two circumstances:

- in the long term, when gas is used to generate electricity; and
- in regional areas, where gas is introduced to compete with established forms of energy.

11 Re AGL Cooper Basin Natural Gas Supply Arrangements (1997) ATPR 41-593 at 44,197-44,199.

Although the Council considers that the gas and electricity markets may provide some competitive constraint on or otherwise influence each other, it considers that in the present case these markets remain separate at this time.

Relevant Functional Levels within the Natural Gas Industry

The Tribunal in the *AGL Cooper Basin decision* considered that there were a number of functional levels to be considered in defining the natural gas market: exploration, production and processing and distribution. In using the term “distribution” in this context the Tribunal meant gas sales, rather than carriage of gas through distribution pipelines. Equally, the Tribunal in the *Eastern Gas Pipeline decision* considered that the gas transmission market was functionally separate from other parts of the gas market including exploration, production/processing, sales and distribution/reticulation. The Council agrees with this analysis.

Geographic Dimension of Gas Sales Market

Currently, all natural gas in South Australia is provided from the SA Unit in the Cooper/Eromanga Basin and almost all of it is transported through the Moomba to Adelaide Pipeline and the several smaller pipelines, including the Riverland Pipeline and Mildura Pipeline, that connect to it.

Natural gas is also supplied from the SA Unit to New South Wales through the Moomba to Sydney Pipeline and to Victoria through the Interconnect. This suggests a degree of supply-side substitutability, to the extent that a gas producer in the SA Unit (or a gas supplier acquiring from such a producer) may supply that gas at least to South Australia, to New South Wales or to Victoria.

Natural gas is also supplied from Bass Strait to Victoria and to New South Wales through the Interconnect and the Eastern Gas Pipeline. In addition, the nearby South-West Queensland Unit in the Cooper/Eromanga Basin supplies gas from Ballera throughout Queensland. The Council understands that the South Australian government is encouraging proposals for a new source of gas into South Australia, and that some proposals already put forward contemplate the direct interconnection of South Australia with Victoria or the Northern Territory.

The Council considers that the implementation of such proposals and the increasing volumes of gas transported between pipeline systems will result in a natural gas sales market whose geographic area encompasses South Australia, New South Wales, Victoria and south-east Queensland. The Council notes that in the *Eastern Gas Pipeline decision* the Tribunal accepted a market for the sale of gas to users in South-East Australia.

This geographic dimension relies on the assumption that producers and users have access to the network of pipelines described above, on reasonable terms and conditions. This access has been, or will be, provided either:

- by the regulation of third party access to monopoly pipelines; or
- because the pipelines would provide appropriate access of their own accord.

The Council does not consider that, for the purposes of making its final recommendation for the application for revocation, it is necessary to come to a final view on the exact geographic extent of the gas sales market. The Council will refer to the market in which gas transported by the Riverland Pipeline is sold as the South-East Australian Gas Sales Market.

Temporal Dimension of Gas Sales Market

The Council considers that there are no particular issues going to the temporal dimension of the South-East Australian Gas Sales Market on which consideration of this criterion is likely to turn. However, as noted above, the Council recognises that relevant considerations include the possible future convergence of energy markets and the possible construction of other pipelines that will have an impact on this market.

The Council considers the market in which the services provided by the Riverland Pipeline exist is separate from the South-East Australian Gas Sales Market.

Meaning of the Term “Promote Competition”

The Council has been assisted by the consideration given to this term by a recent decision of the Tribunal in the *Sydney Airports decision*,¹² subsequently endorsed by the Tribunal in the *Eastern Gas Pipeline decision*.

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

In applying the with and without test endorsed by the Tribunal, the Council compares the market conditions which would prevail if the pipeline were not

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

covered under the National Code with those that would prevail if it were covered under the National Code.

In the *Eastern Gas Pipeline decision*, the Tribunal found that a critical question in determining whether regulated access would promote competition was whether or not the operator of the pipeline had market power in the market in which the transport service was provided. The Council considers that the presence of market power is a significant factor in deciding whether regulated access will promote competition in another market.

Views Put to the Council

The applicant notes that Origin Energy is currently the only retailer of gas delivered using the Riverland Pipeline, and argues that:

even as full retail contestability unfolds, the relatively small downstream markets in Berri, Murray Bridge and Mildura make it difficult for a multi-retailer environment to flourish.

The applicant also notes that:

No third parties have sought access, or indicated a desire to seek access, to the Pipeline.

The applicant therefore submits that access to the Riverland Pipeline would not promote competition in other markets.

The applicant stated that it has a natural incentive to negotiate and expedite access to the Riverland Pipeline due to the existence of significant unused capacity in that pipeline.

The Council understands that the population of the Murray Bridge area is in the order of 16,000, the population of Berri in the order of 6,000, and the population of Mildura in the order of 45,000. The Council notes that large customers taking more than 5 TJ per year in Victoria and 10 TJ per year in South Australia are currently contestable, meaning that they can negotiate with producers or other suppliers for gas supply by seeking access to pipelines.

The applicant considers that there are potentially 2,500 domestic customers that could access the Mildura distribution network and hopes to connect approximately 50 per cent of these customers during the next ten years. The applicant states that in relation to larger customers, initial marketing campaigns have resulted in the connection of the potential loads identified, with the exception of one approximately 50 TJ load which is currently being negotiated. The applicant submits that:

As with any greenfields project, the highest penetration rates are in the earliest stages of the project. Therefore, while there is potential to

increase load, the penetration rate is expected to be lower as time progresses.

The Australian Gas Association submits that the ability to exercise market power is “extremely limited” in the case of the Riverland Pipeline due to the factors identified in the *Eastern Gas Pipeline decision* in relation to regional energy markets, in particular that existing forms of energy provide a countervailing force on the price of gas and pipeline services. It also argues that the owner and operator of the Riverland Pipeline have strong incentives to maximise the throughput of gas and not withhold access, due to excess capacity in that pipeline.

Energy SA agrees that under present circumstances it is unlikely that other retailers would wish to sell gas delivered using the Riverland Pipeline, and that in general pipeline owners have an incentive to maximise capacity utilisation. However, Energy SA points out that the Electricity Supply Industry Planning Council has recently emphasised the need for augmentation of the electricity supply in the Riverland area, that gas-fired electricity generation is one option under consideration and that laterals from the Riverland Pipeline to supply gas to Loxton and Renmark are proposed. Energy SA suggests that these developments may attract new retailers in the area, and indicates some concern that revocation of coverage would jeopardise these projects or limit the available options.

In response to Energy SA’s comments, a submission by the applicant reiterated that it has a commercial incentive to increase gas throughput in the pipeline. It also noted that: the proposal for gas-fired electricity generation was mooted by Origin Energy, which already has access to the pipeline; and that the proposal would demand more gas than the pipeline could deliver, thus requiring the construction of a new pipeline.

Analysis

Submissions to the Council did not precisely identify any particular markets in which access might promote competition.

However, the most likely market in which access *might* promote competition is the South-East Australian Gas Sales Market. As noted above, the Council considers that this market is separate from the market in which the Riverland Pipeline provides its services.

The Council has not received any indication that any retailer other than Origin has sought, or is likely to seek, access to the Riverland Pipeline in order to supply gas in the South-East Australian Gas Sales Market. Equally, no customer or potential customer has indicated that it has sought, or is likely to seek, access to the Riverland Pipeline for the purpose of purchasing gas from a supplier other than Origin.

The Council notes that proposals to supply electricity to the Riverland using local gas-fired generation may depend on access to gas transportation services to increase competition in electricity markets. However, the Council has not to date received any indication that this access would be unobtainable or difficult to obtain in the absence of coverage. Further, the Council notes that other proposals for the augmentation of the Riverland's electricity supply do not require access to gas.

The Council is also aware that proposals to supply South Australia with gas from interstate may involve interconnection with the Riverland Pipeline. However, the Council is not aware of any such proposal for interconnection currently being pursued, and has not to date received any indication that this interconnection would be unobtainable or difficult to obtain in the absence of declaration. The Council notes that in the event that such a proposal were pursued, it would be open to parties to apply for re-coverage of the Riverland Pipeline.

If persons other than Origin were likely to seek regulated access (through coverage) to the Riverland Pipeline for the purposes of supplying gas in the South-East Australian Gas Sales Market, then the Council considers that there would be strong arguments that regulated access would promote competition in the South-East Australian Gas Sales Market. Such arguments may also draw on the fact that, although ring-fenced, Origin is partly vertically integrated through its relationship with the applicant, the owner of the Riverland Pipeline. Such a relationship may increase the market power of the applicant in the market in which it provides gas transportation services.

However, the applicant has stated that the excess capacity in the Riverland Pipeline provides it with a natural incentive to expedite access to the pipeline. The Council also notes the comments of the Tribunal in the *Eastern Gas Pipeline decision* in relation to regional markets, where the Tribunal found that the threat of coverage under the National Code was one of the factors which would restrain the exercise of market power by the owner of a pipeline.

In circumstances where no party has indicated a desire to seek access to the Riverland Pipeline, the Council is not satisfied that access (or increased access) to the Riverland Pipeline would promote competition in any other market. The Council therefore considers that the Riverland Pipeline does not meet criterion (a).

As discussed above, the Council notes that if a third party does require access to the Riverland Pipeline in the future, then the National Code allows any person to apply to the Council for the that pipeline to covered again under the National Code.

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

Background

Criterion (b) would appear to be designed to identify potential coverage of pipelines where the development of competing pipelines would be inefficient.¹³ The intent is that competitive infrastructure (whether in actual or potential terms) should not be covered under the National Code. In other words, access regulation should be limited to infrastructure where competing facilities are not economically viable.

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

Thus we accept that if a single pipeline can meet market demand at less cost (after taking into account productive allocative and dynamic effects) than two or more pipelines, it would be “uneconomic”, in terms of criterion (b), to develop another pipeline to provide the same services.

In the *Sydney Airport decision*, the Tribunal held that “another” facility must be one capable of providing services competitive with those provided by the relevant facility. Services which are merely complementary to those provided by the relevant facility should not be regarded as competing services for the purposes of this criterion.

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

In considering whether it is economic to build another pipeline, the Council adopts a social test rather than a private test. While a private test would consider whether it is viable for an individual to invest in a new facility, a social test considers whether building a new facility represents an efficient use of resources from the viewpoint of the community. The Tribunal endorsed

13 Re Application for Review of the Declaration by the Commonwealth Treasurer Published on 30 June 1997 of Certain Freight Handling Services Provided by the Federal Airports Corporation at Sydney International Airport (2000) ATPR 41-754 at 40,791-40,793.

this wider social test in the *Sydney Airport decision* and the *Eastern Gas Pipeline decision*.

The Council considers that the objectives of the legislative scheme are best met by having regard to the provision of competing services by another existing pipeline rather than limiting its consideration to the development of new pipelines. In the *Eastern Gas Pipeline decision*, the Tribunal agreed that the provision of services by existing pipelines should be taken into account in determining whether it is economic to develop another pipeline.

Views Put to the Council

The Council has not received any submissions on this criterion.

Analysis

In considering whether it is would be uneconomic to develop another pipeline to provide these services, the Council notes that gas pipelines typically have high construction costs and low operating costs, making the marginal cost of reticulating a unit of gas very low. Moreover, up to the point of fully expanded capacity, average costs of reticulation per unit of gas decline. These features are indicative of natural monopoly characteristics. In lay terms, it is almost always cheaper to transport gas through existing pipelines (if spare capacity exists or can be added) than it is to build another pipeline to transport gas.

Moreover, investment in new pipelines is, in economic language, “sunk”. That is, the investment is fixed or committed, and if the investment is a failure, little or none of it can be retrieved. This means that entry and exit costs to provide these services are high, and that incremental or gradual entry – a common form of entry in other industries – is not feasible in the gas transportation industry.

Finally, it is not uncommon for existing pipelines to have spare capacity. From a pipeline company’s point of view, it is often prudent to cater to the unpredictability of future requirements by building a larger capacity pipeline. This is because the costs of laying a new pipeline rise slowly compared with increases in the capacity of that pipeline. In other words, it is much less expensive – per unit of capacity – to lay a large capacity pipeline than a small capacity pipeline.

In summary, therefore, it is generally not economic to develop another pipeline where an existing pipeline has existing spare capacity (or can develop it through a relatively inexpensive upgrade of the network). Having said this, the Council recognises it will always be necessary to consider the facts of particular pipelines.

The Council notes that the Riverland Pipeline is the only pipeline currently serving the Riverland areas, and that it has substantial excess capacity and is likely to continue to do so into the future. For the reasons set out above, the Council considers that the Riverland Pipeline is not currently economic to duplicate, and that as a result the Riverland Pipeline satisfies criterion (b).

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

Background

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

Views Put to the Council

The Council has not received any submissions on this criterion.

Analysis

The Council considers that typically, third party access to gas pipelines does not pose undue risks to human health and safety where appropriate measures are taken by the operator. Third party access to gas pipelines has been permitted in relation to many pipelines in Australia without being considered to unduly compromise human health or safety.

For these reasons, the Council considers that the Riverland Pipeline satisfies criterion (c).

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

Background

One matter of public interest is whether any benefits of access, such as cheaper prices and more efficient use of resources, are outweighed by regulatory or compliance costs. Other matters of public interest include environment considerations, regional development and equity.

Views Put to Council

The applicant notes that it has spent considerable resources in the preparation and submission of an Access Arrangement and accompanying Access Arrangement Information for the Riverland Pipeline, which are currently before the ACCC for approval.

However, the applicant notes that at the time of preparation of the Access Arrangement the Mildura Pipeline had not yet been completed, and that consequently the forecasts underlying the Access Arrangement for the Riverland Pipeline (which supplies the Mildura Pipeline) were therefore based on best estimates of load growth. The applicant states that these estimates have been revised during the intervening period following the availability of actual throughput figures.

As a result of this revision, the applicant has suspended the ACCC's consideration of the Access Arrangement. It states that in order to present an appropriate Access Arrangement to the ACCC, it would need to undertake a complete reanalysis of forecasts and tariff structure, and that the resources required for this task would cost in the order of \$95,000 for the Riverland Pipeline.

The applicant argues that this cost would have a disproportionate effect on end-user prices given the relatively low throughput of the pipeline, and that the public detriment associated with this cost outweighs any public benefit associated with coverage of the pipeline.

In relation to the Riverland Pipeline, the applicant estimates that the lump sum regulatory cost would constitute 5 per cent of the forecast revenues for 2000/2001, and notes that there would also be ongoing annual regulatory costs and future five-yearly Access Arrangement review costs.

The applicant submits that the public benefit associated with coverage is likely to be limited since, due to the small size of the market, the number of access requests is likely to be low. The applicant also submits that the spare capacity in the Riverland Pipeline provides an incentive to negotiate and expedite third-party access to the pipeline in order to recover the applicant's fixed costs. That is:

natural market forces already exist and the application of the regulatory regime and associated costs will only serve to increase costs to end users, as well as to the relevant regulatory body.

The Australian Gas Association also argues that the regulatory costs imposed by coverage outweigh the potential benefits of coverage and disadvantage end-users through the imposition of high regulatory costs.

Analysis

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

Given that the Council is not satisfied that regulated access to the Riverland Pipeline would promote competition in another market, the Council cannot identify any relevant benefits which might offset the regulatory and compliance costs associated with regulated access in relation to these pipelines.

Accordingly, the Council considers that the Riverland Pipeline does not meet criterion (d).

Appendix 1: Submissions received by the Council

The Council received submissions from the following organisations:

First round submissions

- Australian Gas Association
- Energy SA

Second round submission

- Envestra Limited.