



13 December 2018

SUBMISSION

RULE CHANGE: Northern Gas Pipeline – Derogation from Part 23

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Submitted at: www.aemc.gov.au/contact-us/lodge-submission

Dear Mr Singh

RULE CHANGE: Northern Gas Pipeline – Derogation from Part 23

Please find our submissions in response to the AEMC Consultation Paper on the proposed rule change. These submissions augment our initial rule change request and annexures.

Q1: Do the regulatory arrangements applicable to the NGP under the access principles produce similar outcomes to the access regime under Part 23 of the NGR with respect to constraining the exercise of market power by a pipeline service provider?

No.

The NGP access principles contain the highest gas pipeline tariffs in Australia. The principles allow Jemena, the NGP operator, to terminate negotiations and arbitration with 7 days' notice, with no recourse.ⁱ

The principles do not mandate oversight of pricing and pipeline access by the Australian Energy Regulator. Part 23 does.ⁱⁱ The principles do not mandate disclosure. Part 23 does.ⁱⁱⁱ The principles themselves, including pricing, can be changed at any time by Jemena merely by notification of changes to the NT Government.^{iv} This is not possible under Part 23.

The NGP's corporate owner (SGSPAA) freely admits the double standards to investors in stock exchange documents. SGSPAA states that the NGP is *not* subject to economic regulation. It states that the NGP *does not* have to submit access arrangements to the regulator. Furthermore, the company states the NGP is *not like* SGSPAA's other gas transmissions assets that "are committed to the provision of voluntary, non-discriminatory pipeline access to third parties" and that "customers have equal access to a publicly available given tariff".^v

The result is seen in the comparison of charges under the access principles. The NGP is by far the most expensive pipeline in the country. It is 27% more expensive than the second

most expensive pipeline, the Carpentaria Gas Pipeline. It is 575% more expensive than the Moomba to Sydney Pipeline System.^{vi}

Onshore Australian Pipeline Costs Per Kilometre			
Pipeline	Tariff (\$/GJ)	Distance (Kilometres)	Tariff of 1 GJ/KM (cents/km)
Northern Gas Pipeline	1.40	622	0.23
Carpentaria Gas Pipeline	1.48	840	0.18
Eastern Gas Pipeline	1.21	795	0.15
Queensland Gas Pipeline	0.94	629	0.15
South West Queensland Pipeline	0.98	756	0.13
Roma-Brisbane Pipeline	0.57	440	0.13
South East Australian Gas Pipeline	0.80	680	0.12
Longford to Melbourne Gas Pipeline	0.25	250	0.10
Moomba to Adelaide Pipeline System	0.67	1185	0.06
Moomba to Sydney Pipeline System	0.90	2035	0.04
Average Tariff			0.13

Source: AEMO, Jemena

Core Logic modelled a reasonable rate of return for pipelines such as the NGP at a rate of 7%.^{vii} The access principles lead to an overcharge of \$2.76 billion for an expanded NGP based on full utilisation rates over a 15 year time frame.^{viii}

Q2. Do the regulatory arrangements applicable to the NGP under the access principles produce similar outcomes to the access regime under Part 23 of the NGR with respect to information asymmetry?

No.

The NGP access principles require Jemena to publish only the principles themselves, as well as standard terms and conditions for access. It must publish the available services and tariffs. Importantly even these minimal requirements can change, as the access principles can be changed at any time by Jemena.

Under part 23 Jemena must publish for the NGP:^{ix}

- The standing price/offer for all services offered by the pipeline

- Methodology used to calculate the standing price (which enables shippers to understand whether the prices are cost-reflective)
- Financial information for the pipeline and weighted average prices paid by users for each service.

Under the AER's financial reporting guidelines, which is incorporated into Part 23, the company must report on the following:^x

- pipeline service and access information;
- individual pipeline financial statements including revenues and costs, assets and details of how the accounts have been prepared;
- asset valuation – calculated using the recovered capital methodology that takes into account previous returns the pipeline specified in Part 23;
- weighted average prices for pipeline services.

No such requirement exists in the access principles.

The objective of Part 23 is as follows:^{xi}

The objective of this Part is to facilitate access to pipeline services on non-scheme pipelines on reasonable terms, which, for the purposes of this Part, is taken to mean at prices and on other terms and conditions that, so far as practical, reflect the outcomes of a workably competitive market

The ACCC says the rationale behind Part 23 is to reduce information asymmetries identified in the ACCC's 2015 Inquiry^{xii} and the resulting limitations on the ability of shippers to identify monopoly pricing of pipeline services and subsequent imbalance in bargaining power when negotiating transportation arrangements with pipeline operators.^{xiii} The framework provides for the publication and exchange of information to facilitate timely and effective commercial negotiations.

The requirements for information disclosure under Part 23 of the NGR are significantly more stringent than those purported by the NGP access principles.

Q3. Are there any special circumstances regarding or impacting the NGP due to which the application of the Part 23 framework for non-scheme pipelines may be inappropriate? What are these circumstances, and how may they impact on the NT and/or east coast gas market?

There are no such special circumstances.

But there are special circumstances *in favour* of application of the Part 23 framework. The derogation is curious, especially given Jemena's [statement](#) that the decision to grant an exemption "was on the basis that the dispute resolution processes in place for the NGP provides similar protections" to the NGR. The significant protections in Part 23 have been stripped away and Jemena is in complete control of pricing and any arbitration under its access principles. To say that there are similar protections is inaccurate and arguably misleading.

Additional special circumstances that the AEMC may wish to consider in favour of removing the derogation:

- (a) the NGP is considered uneconomical without subsidies from the Northern Territory Government;
- (b) Jemena has engaged in questionable conduct regarding tax evasion and is under investigation by the ATO;
- (c) commentators suggest the NGP only exists as a result of NT government over-contracting of gas supply;
- (d) the NGP will “promote gas exploration and production activity in the NT” and lead to serious environmental and financial consequences those in the NT and other market participants.

Notably, exploration and production of shale gas can lead to significant health, safety and environmental risks. The situation in Australia carries dangers above US shale industry because NT geology means a much greater number of wells are required to extract the same amount of gas.^{xiv}

SGSPAA says “the NT has large prospective shale gas reserves totalling over 285,000 PJ”. SGSPAA says gas can flow for 150 years. The life of the NGP is 50 years.^{xv} The [IPCC](#) states the world will have to curb carbon emissions by 49% on 2017 levels by 2030 to achieve a 50% chance of limiting warming to 1.5°C. To do that, from 2020 to 2050 the primary energy supplied by natural gas decreases by 13% to 60% with a transition away from natural gas.^{xvi}

The May 2018 [Final Report](#) by the Independent Scientific Inquiry into Hydraulic Fracturing in the Northern Territory found lifecycle greenhouse gases from hydraulic fracturing (producing shale gas) in the NT would account for 7% of Australia emissions for 2015 under a high production scenario that involves the construction of the expanded NGP. The climate change risks are deemed “unacceptable” by the inquiry.^{xvii}

The National Gas Objective is concerned with “the long term interests of consumers of national gas with respect to the price, quality, safety, reliability and security of supply of natural gas”. With respect to the safety, reliability and security of supply, SGSPAA itself recognises that climate change can damage its own gas infrastructure or third party gas supply.^{xviii}

SGSPAA states:^{xix}

As a result of global climate changes, extreme weather events (for example, wind, floods, tidal storm surges, heatwaves and dust-storms) of increasing intensity and frequency are predicted. Extreme weather events may negatively affect the networks in the form of infrastructure damage and network outages. The occurrence of any of these events may negatively affect SGSPAA Group’s electricity and gas networks and third party power generators or gas suppliers in a manner that may disrupt the supply of electricity or gas and thereby have an adverse effect on SGSPAA Group’s operations, profits and financial position.

It follows that industry that the NGP will promote and facilitated by the derogation is foreseen to adversely impact the safety, reliability and security of supply of natural gas.

Q4. Does the proposed rule lead to an increase or a decrease in the complexity of the regulatory arrangements?

A decrease.

The proposed rule leads to a decrease in the complexity of the regulatory arrangements. It removes special treatment for the NGP and permits the NGR to operate across the board to all pipelines in a manner that aligns with softening pipelines' monopoly powers and in accordance with the National Gas Objectives.

Q5. What are the likely costs and benefits associated with the proposed rule for market participants within the NT and the east coast gas markets?

The benefits to market participants in the east coast gas markets, if the proposed rule change is implemented, include:

- (a) potential savings to consumers of \$2.76 billion;
- (b) removal of ad-hoc market distortion;
- (c) a gas supply and infrastructure which more accurately reflects the market and the true cost of production;
- (d) removal of subsidy that has broader impacts caused by climate change and shale gas extraction.

The impacts extend to the east coast gas markets, including to consumers in both Sydney and Melbourne. A key supplier of the NGP is Central Petroleum. On 27 January 2017 in the company's Quarterly Report published on the ASX for the 3 months to 31 December 2016, the Managing Director acknowledged gas flowing through the NGP would be destined for consumers in Australia's east coast demand centres. The company expected that the new rules in Part 23 would apply to the NGP thus providing a benefit to consumers. Mr Richard Cottee, Managing Director, stated:^{xx}

Well before the NGP becomes available to transport gas from the Northern Territory to Australia's east coast demand centres we expect the implementation of significant and beneficial reform of domestic gas transportation regulations. These reforms were recommended by Dr Michael Vertigan and adopted in principle by the Council of Australian Governments ("COAG") Energy Minister's meeting on 14 December 2016. The reforms include establishing appropriate economic parameters for all pipeline services (not just point-to-point forward haul) reflecting appropriate cost of services parameters. The regulations would also provide easier access to faster and clearer arbitration (especially if the "Final Offer" proposal, developed by Dr Vertigan, is adopted). As explained in the recent investigation by The Australian newspaper (16 January 2017), once our gas reaches Mt Isa, it is basically back haul all the way to Sydney AND Melbourne which requires a very low level of pipeline service at a commensurately low cost. These reforms will substantially cheapen the cost of transporting Northern Territory gas into the domestic centres of demand.

However, those advantages to consumers have completely evaporated as a result of the derogation.

The NGP's owner foresees that the ongoing development of energy regulation may negatively impact its business.^{xxi} It has duly notified investors of the AEMC's ability to implement a rule change.^{xxii} As such, the AEMC need not be concerned that the removal of the exemption will have unanticipated impacts on SGSPAA. A stable, consistent energy market across the board can only provide certainty to the NGP and other market participants.

Conclusion

The AEMC should not allow the derogation to the National Gas Laws for the Northern Gas Pipeline to stand.

It should insist on compliance with the Law as the derogation is neither within the letter of the law or the spirit of the National Gas Objective.

It also runs counter to the principles contained in the Australian Competition and Consumer Commissions recent reports.

It entrenches monopoly pricing, lack of transparency and information asymmetry. The result, ultimately is a less competitive market and poor consumer outcomes.

The derogation allows:

- the highest gas pipeline tariffs in Australia, a country renowned for high pipeline costs;
- dispute resolution procedures inconsistent with the National Gas Law;
- poor price discovery by gas pipeline users;
- the ability for NGP to raise prices, with no review, for a period of 15 years;
- the transfer of wealth from the gas producers and consumers to the monopoly pipeline owners domiciled overseas;
- what is in effect a subsidy that distorts the market and is paid for by consumers;
- the facilitation of unwanted, well documented, and potentially severe adverse climate impacts.

If a shale gas industry is developed in the Northern Territory it will not result in wealth creation for the people of Australia or the exploration and production companies involved. The wealth will be siphoned off by the monopoly pipeline owners with the blessing of the AEMC.

We strongly assert that the AEMC should change the rules to remove the derogation such that the National Gas Laws are fully operational for the Northern Gas Pipeline.

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- ⁱ Access Principles at Annexure 2 [2f]: “A party in compliance with this clause 2 may terminate the dispute resolution process by notice to the other party at any time after 7 days following reference of the dispute to its chief executive officer” cf Part 23 National Gas Rules r 578.
- ⁱⁱ Part 23 National Gas Rules r 569 requires the arbitrator to take into account “pricing principles”. The outcome of arbitration is a naturally an agreement between the parties. The Part 23 exemption triggers section 216C(2)(a) of the National Gas Law. That section says Chapter 6A of the Law does not apply to pipelines excluded by the Rules. Chapter 6A of the National Gas Law covers access disputes. It sets out how access to pipelines is negotiated and if there is a dispute, how it is referred to arbitration; a process overseen by the scheme administrator, the Australian Energy Regulator (s 216A). See AEMC, [Review into the scope of economic regulation applied to covered pipelines](#), p248 for more detail.
- ⁱⁱⁱ Part 23 National Gas Rules r 553
- ^{iv} Access Principles at [24]: “Jemena must notify the Northern Territory of any proposed increase/decreases in tariffs and provide information to the Northern Territory as to the date at which the proposed tariff changes will take effect and the reasons for the proposed tariff changes” cf Part 23 National Gas Rules which
- ^v SGSPAA May [2018 Offering Circular](#) p93
- ^{vi} *The Northern Gas Pipeline: A submission by the Institute for Energy Economics and Financial Analysis*, 4 October 2016.
- ^{vii} Page 10 Gas Production and Transmission Costs – Eastern and South Eastern Australia – Core Energy Group https://aemo.com.au/-/media/Files/Gas/National_Planning_and_Forecasting/GSOO/2015/Core--Gas-Production-and-Transmission-Costs.ashx
- ^{viii} EJA/IEEFA Rule Change Request
- ^{ix} Part 23 National Gas Rules rr 552-557; AER, *Financial reporting guideline for non-scheme pipelines*, December 2017.
- ^x As above
- ^{xi} Part 23 National Gas Rules, r 546
- ^{xii} www.accc.gov.au/system/files/Gas%20inquiry%20April%202018%20interim%20report.pdf p12; See EJA/IEEFA Rule Change Request at [15]-[17].
- ^{xiii} Para 15, EJA’s rule change request
- ^{xiv} Scientific Inquiry into Hydraulic Fracturing in the Northern Territory [Final Report](#), pp43,86,132
- ^{xv} SGSPAA [May 2018 Offering Circular](#) p117
- ^{xvi} IPCC [1.5 Report](#) pp TS-9,4-42
- ^{xvii} Scientific Inquiry into Hydraulic Fracturing in the Northern Territory [Final Report](#), pp230, 239
- ^{xviii} SGSPAA [May 2018 Offering Circular](#), p13
- ^{xix} SGSPAA [May 2018 Offering Circular](#), p12
- ^{xx} Central Petroleum Limited, [Operating Activities Report and ASX Appendix 5B for the Quarter ended 31 December 2016](#), p3
- ^{xxi} SGSPAA May 2018 Offering Circular, p12
- ^{xxii} SGSPAA [May 2018 Offering Circular](#) p9.