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AEMC – Review into the scope of economic regulation applied to covered pipelines

EnergyAustralia is one of Australia's largest energy companies with over 2.6 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion dollar energy generation portfolio across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market (NEM) and an annual gas portfolio of over 100PJ.

We welcome the opportunity to provide a response to the Australian Energy Market Commission's (the Commission) draft report on economic regulation of gas pipelines (the Review). As a large gas shipper and retailer, we support many of the recommendations outlined in the report including:

- Information disclosure requirements for covered and uncovered pipelines to remove information asymmetry when negotiating access;
- Clearer guidance on how regulators should determine which services are to be regulated as reference services to better capture those services that could be subject to monopoly pricing;
- Clarity on the dispute resolution process, including clear trigger points, to improve the effectiveness of this mechanism;
- Publication of dispute commencement and outcome, and enabling of joint resolution hearings to improve transparency and the effectiveness of dispute resolution processes.

However, we propose that further analysis is needed to address the application of coverage tests, the treatment of unspent capital expenditure allowances, and the risk allocation non-price terms and conditions which remain an issue due to pipeline service provider's abilities to exercise market power. The areas we believe require further assessment are described below.

Application of coverage tests

As highlighted by the Commission, the introduction of Part 23 is likely to reduce the relative difference in competition between the status quo and the counterfactual, raising the threshold requirement for a pipeline to be regulated. This could precipitate scheme pipelines applying to be reclassified as non-scheme service providers under Part 23. The Commission has not provided any specific recommendations to address this issue on the grounds that it is speculative and there is no evidence that it will occur. There may be no current indication that it will occur, but it is important that it could possibly occur. Regulatory reforms should be designed to avoid the eventuality that the regulations can be side-stepped.

EnergyAustralia is concerned that the introduction of Part 23 to the regulatory framework pose a credible risk of supporting the deregulation of covered pipelines. While the new information and arbitration guidelines provide some form of regulation and pricing pressure, they do not eliminate monopoly characteristics of distribution pipelines. There remain large barriers to entry for distribution pipeline services and shippers have limited countervailing power.

Distribution pipeline access arrangements provide shippers with clear benchmarks for reference services. Given the number of services provided, shippers would face difficulties in determining reasonable prices, and negotiating contracts would be a significant regulatory burden and risk for shippers. When references prices are set through a regulatory process, retailers can have confidence that reference prices are reasonable and can then seek to negotiate alternate prices for specific services or non-reference services where an opportunity is identified.

The application of coverage tests was considered by Dr Vertigan in the *Examination of the current test for the regulation of gas pipelines* report prepared for COAG.[1] This review concluded that addressing information asymmetry by publication of asset valuation, and addressing market power disparity through the threat of binding arbitration, should alleviate difficulties experienced by shippers when negotiating with unregulated pipelines. However, the review focussed primarily on the appropriateness of changing rules that may lead to regulation of currently unregulated pipelines, it did not consider in detail the impact of deregulation of currently regulated pipelines.

As outlined by the Commission, one option for resolving the potential issue of deregulation would be to re-examine the process for assessing the application of the coverage test. The Commission has outlined a two-stage approach which appears to preserve the current threshold requirement for regulation. EnergyAustralia support the Commission examining this option further during the Review. While we appreciate that the changes in regulation are broadly appropriate, we are not satisfied that the coverage test is fit for purpose.

Market power in setting non-price terms and conditions

The Review has considered the effectiveness of regulation of non-price terms and conditions of Access Arrangements regarding risk allocation. The Commission has acknowledged concerns raised by pipeline users that these terms and conditions often allocate unreasonable risk to users and has recommended that the rules are amended to *"clarify that the regulator is to have regards to risk sharing arrangements implicit in the economic elements of the access arrangement".* In EnergyAustralia's view, this response

[1] http://www.coagenergycouncil.gov.au/publications/examination-current-test-regulation-gas-pipelines-consultation-paper, published 14 December 2016.

is insufficient to address the exercise of monopoly power by service providers when negotiating terms of access.

The current regulatory approach has led to the inclusion of terms and conditions that have insufficient levels of detail to ensure market risk is reasonably and fairly attributed and as such, these terms are subject to the interpretation of the monopoly distribution pipeline.

For example, distribution pipelines are entitled to bill the retailer for a customer's consumption under circumstances where the distributor has not finalised market transactions that are required by the retailer to commence billing the customer. The certainty of revenue reduces the incentive for service providers to resolve the market system transaction delays, leading to inefficient and poor service delivery to customers.

Distributors are also entitled to unilaterally change business-to-business communication processes (where not governed by AEMO) without consultation. These changes can have adverse effects on retailers and may therefore not reflect the most efficient means of providing a service. Efforts by distribution service providers to improve the efficiency of their processes can trigger manual workarounds or IT system changes for retailers which then result in inefficient cost increases for customers. The ability of distribution networks to force these changes on retailers is not in the economic interests of customers and arises from the service providers ability to set the terms of access.

To address these issues, we suggest the AEMC develop a more rigorous framework to guide regulators in assessing whether non-price terms and conditions reasonably allocate market risk.

Returning unspent capital expenditure to customers

EnergyAustralia recognise that it is a fundamental feature of the incentive framework for networks to gain the benefits of finding efficient and safe ways to reduce spending against their capital expenditure allowance. However, in cases where projects do not proceed, it should be appropriate for the regulator to assess whether this decision is a result of action taken by a service provider, or is a result of exogenous changes in the market. Where a network has undertaken alternative investment, or deferred the requirement for the investment by some other means, there should be a financial reward for this behaviour. However, if the decision to defer the investment is due to no action taken by the service provider, and a delay cannot be reasonably justified, it is unreasonable and inappropriate to charge customers to recover the cost of an investment that is no longer required and will not be made. The unspent investment allowance can then result in higher costs for customers for no direct or indirect benefit.

If you would like to discuss this submission please contact Georgina Snelling on 03 8628 11126 or at Georgina.snelling@energyaustralia.com.au.

Regards

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