

Jemena Limited

Northern Gas Pipeline Derogation from Part 23 of NGR

Response to the AEMC Issues Paper

Public

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1. INTRODUCTION

The Australian Energy Market Commission (AEMC) has received a rule change proposal that seeks to revoke the 15 year derogation afforded to the Northern Gas Pipeline (NGP) from the operation of Chapter 6A of the National Gas Law (NGL). On 15 November 2018, the AEMC commenced a public consultation on the proposal by releasing a consultation paper.

Jemena appreciates the opportunity to respond to this consultation. We strongly believe that the Commission's decision should be to retain the derogation as it contributes to the National Gas Objective (NGO) and that the revocation of the derogation will not further the NGO. Jemena considers that the revocation would in fact detract from the NGO because it is likely to have a chilling effect on the genuine efforts of infrastructure investors to increase gas supply and increase competition.

Given the nature of the rule change request, and unique situation of comparing the derogation—that only came into effect last year — with a counterfactual assessment of whether removing it would contribute to the NGO, our submission is supported by a detailed report prepared by Houston Kemp Economists. Our response to the consultation paper should therefore be considered as this covering submission together with the Houston Kemp report.

The overarching outcome of the NGP will be to supply more gas to the East coast and increase competition. As explained in Section 2 of the Houston Kemp report, the pipeline was conceived of by the Northern Territory government as a link between the northern and eastern gas markets, contributing to the development of a national gas grid, a more competitive gas market, and helping to improve security of supply. It was made possible due to surplus gas that was available to the government-owned Power and Water Corporation (PWC) under its 25 year contract with ENI for gas from the Blacktip field.

However, the objectives set out by the government were wider this, since it considered the development of new gas supplies as important to long term employment and economic growth in the Territory.

As a result, Jemena considers that the assessment by the AEMC should not be limited only to expected outcomes for the users and investors in the NGP but should consider more generally expected outcomes for efficient investment in, and efficient operation and use of, natural gas services. As noted in Section 3.2 of the Houston Kemp report, it is important that the assessment framework considers the potential implications for efficient investment of the proposed rule change on:

- the ability to provide similar derogations in the future for greenfield pipelines; and
- more generally, the credibility of regulation, given that only a year has elapsed since the derogation providing a 15 year period of relief from regulation was provided and the NGP has not yet commenced operations.

The current arrangements for providing gas transportation services on the NGP, including the requirements of the NGP access principles and the underpinning project development agreement (PDA), contribute to the NGO. As noted in Section 4 of the Houston Kemp report, the current arrangements contribute to the NGO because:

- the access principles provide an obligation on Jemena to negotiate in good faith and to supply firm forward haulage and as-available haulage services in line with transparent and orderly procedures;
- the access principles set maximum tariffs for firm forward haul and firm nitrogen removal services, which are based on the outcomes of the competitive tender for the NGP and escalate at CPI each year;
- the prices established under the competitive tender held for the development of the NGP should be presumed to be reflective of efficient costs and, under the rolled-in-tariff provisions in the access principles, prices will change in line with efficient costs where expansions are made, which ensures that pipeline users share in any economies of scale;

- the access principles also require Jemena to connect the NGP to lateral pipelines at charges reflecting reasonable costs, where it is technically feasible to do so; and
- the access principles contain a dispute resolution mechanism culminating in binding arbitration by an independent party in accordance with external guidelines if the parties are unable to agree.

More importantly, under the PDA the penalty for non-compliance with the terms of the access principles can extend to coverage being imposed on the NGP.

The outcome of any arbitration process under the Part 23 access regime is fundamentally uncertain and, in the context that the NGP remains only 1/3 contracted for the long term at this stage, the tariff could be much higher under a Part 23 arbitrated outcome. Under Part 23 rules, the benefits of economies of scale created by expansions cannot be passed on to shippers with existing contracts.

We maintain that the derogation for the NGP is consistent with an established practice of providing incentives to new pipelines (in the form of a 15 year period in which regulation does not apply) in order to promote efficient investment in natural gas services – a practice that has previously been held to contribute to the NGO. This is covered in Section 5 of the Houston Kemp report.

The rest of this covering Jemena submission is structured as follows:

- Further background information relevant to the decision before the AEMC is set out in Section 2.
- An overview of our response is provided in Section 3 and further details are covered in the accompanying Houston Kemp report.
- Specific responses to the questions in the AEMC's consultation paper are covered in Section 4.
- Given the nature of the proponents application, this submission also responds to what we believe are numerous unfounded claims. This is covered in Section 5.

2. BACKGROUND

The North East Gas Interconnector (**NEGI**) now under Jemena known as the NGP was conceived of as a link between the northern and eastern gas markets, contributing to the development of a national gas grid, a more competitive gas and energy market, and helping to improve security of supply by tapping into the NT reserves.

It was subsequently developed as a result of a competitive tender conducted by the Northern Territory government. This process commenced in October 2014 with an industry briefing and concluded on 17 November 2015, when Jemena was selected as the winning tenderer from a final shortlist of four bidders.

Section 2.1 of the Houston Kemp report outlines the extensive and competitive process deployed by the NT Government and the competitive tension and number of bidders through various bid stages, including right to the very end of the selection process where negotiations were held with Jemena and one other party.

Investing in the NGP is a risky endeavour for Jemena. While most new pipelines are constructed on an extensive base of foundation contracts that provide for a high degree of revenue certainty, only a third of the NGP's capacity is currently contracted under firm long term arrangements. Further, the NGP is subject to significant competition from other gas supply chains, since the east coast gas markets for the gas that it transports, are already served by sources of gas from the east coast and potentially from LNG import terminal in the future.

During the tender process, the Northern Territory government initially sought proposals to develop the NEGI as a covered pipeline. Jemena was not willing to develop on this basis. We understand that none of the other respondents, except one, were willing to develop on the basis of coverage. Subsequently, the NT Government required a set of principles outlining the terms on which access to the NEGI would be provided in lieu of coverage. These access principles are given effect by the project development agreement (**PDA**) between Jemena and the Northern Territory government.

Importantly, and only after the completion of the NEGI tender process, a number of events occurred of significance to the regulation of gas pipelines. These events began with the completion of the Australian Competition and Consumer Commission's (ACCC) East Coast Gas Inquiry report in 2016, and culminated in new rules being made on 1 August 2017 to implement a scheme for binding arbitration and information disclosure as Part 23 of the National Gas Rules (NGR).

The commencement of Part 23 of the NGR represented a material change to the regulation of gas pipelines. It subjected many uncovered pipelines to a significant degree of regulatory oversight. The derogation for the NGP was developed by the Northern Territory government in consultation with the Gas Market Reform Group (**GMRG**).

However, if the proposed rule change was implemented and the derogation revoked, the NGP would be subject to the Part 23 access regime, as well as to the NGP access principles and the PDA creating overlap, confusion and increased costs.

3. OVERVIEW OF OUR RESPONSE

3.1 THE ASSESSMENT FRAMEWORK

We requested Houston Kemp to assess the proposed rule change by examining:

- the current arrangements, in which the derogation from Part 23 is in place and the NGP access principles apply, and how they contribute to the NGO; and
- whether the proposed rule, in which both Part 23 and the NGP access principles would apply, would contribute to the NGO

Jemena considers that this assessment should not be limited only to expected outcomes for the users and investors in the NGP but should consider more generally expected outcomes for efficient investment in, and efficient operation and use of, natural gas services.

Jemena also considers the derogation for the NGP is consistent with an established practice of providing incentives to new pipelines in order to promote efficient investment in natural gas services – a practice that has previously been held to contribute to the NGO. It is important that the assessment framework considers the potential implications for efficient investment of the proposed rule change on:

- the ability to provide targeted relief from regulation in the future for greenfields pipelines; and
- more generally, the credibility of the regulatory framework, given that only a year has elapsed of the 15 year period of relief from regulation provided by the derogation.

3.2 CURRENT ARRANGEMENTS CONTRIBUTE TO THE NGO

The arrangements under which Jemena provides access to services on the NGP were determined as part of the competitive tender process. This includes not only the arrangements with the foundation shipper, but also an access regime that was requested by the Northern Territory government as a condition of the tender process. Over the term of the derogation, the NGP access principles in broad terms provide for:

- an obligation on Jemena to negotiate in good faith and to supply firm forward haulage and as-available haulage services;
- set maximum tariffs for firm forward haul and firm nitrogen removal services which only escalate at CPI each year;
- a process for updating published maximum tariffs in the event that the NGP is expanded (for expansions up to 300 TJ/day), under a formula that provides for them to fall if the expansion reduces the average cost of the pipeline;
- the provision of information relevant to obtaining access, including standard terms and conditions;
- a requirement to connect the NGP to lateral pipelines at reasonable rates where it is technically feasible to do so; and
- a dispute resolution mechanism culminating in binding arbitration in accordance with external guidelines if the parties are unable to agree.

Under the PDA, the penalty for non-compliance with the terms of the access principles can extend to coverage being imposed on the NGP.

As noted in section 4 of the Houston Kemp report, “the NGP access principles contribute to the NGO. Combined with the competitive tender process which established the initial maximum tariffs, the principles provide a substantial degree of certainty for current and future customers that the tariffs charged by Jemena will reflect costs and change over time so as to allow customers the benefit of reductions in these costs. The dispute resolution mechanism provides access to independent arbitration should this be required.”

3.3 REVOCATION OF THE DEROGATION WILL NOT CONTRIBUTE TO THE NGO

If the derogation were to be revoked, the NGP access principles (and the underpinning PDA) would continue to apply but the Part 23 access regime would also be available to potential access seekers.

An assessment of whether the additional availability of the Part 23 access regime would further the NGO requires a fact-based analysis. The rule change proponents have not identified how investment in, or the operation and use of, natural gas services by any parties would be affected by revocation of the derogation.

Over the near term, the price outcomes provided for under the Part 23 access regime are likely to be similar to or identical to those arising from the competitive tender process conducted by the Northern Territory government.

Over the longer term, where market conditions may change, it is less likely that the price outcomes under the Part 23 access regime and the NGP pricing principles would necessarily be aligned. The NGP access principles offer certainty that prices will not increase, and may decrease where low cost capacity expansions can be pursued.

By comparison, the outcome of any arbitration process under the Part 23 access regime is fundamentally uncertain and, in the context that the NGP remains only 1/3 contracted for the long term at this stage, the tariff could be much higher under a Part 23 arbitrated outcome. Under Part 23 rules, the benefits of economies of scale created by expansions cannot be passed on to shippers with existing contracts.

There are no grounds to form an expectation that the Part 23 access regime would on its own give rise to expected outcomes that better contribute to the NGO than the NGP access principles.

It is also inappropriate to apply two schemes of regulation to the NGP with the effect that a Part 23 price determination can only be equal to or less than the price cap set in the access principles.

In terms of information provision, the additional information disclosure that would be required under Part 23 was proposed in the context of pipelines constructed substantially before the NGP, to address concerns in relation to a lack of (predominantly historical) information that would enable shippers to be able to negotiate a cost reflective charge. These concerns do not arise in relation to the NGP, as the terms of the access principles themselves ensure that charges are cost reflective, and change in line with efficient costs (as set out in the Houston Kemp report).

Further, the arbitration provisions under Part 23 do not add anything material in relation to the ability to seek binding arbitration of an access dispute by an independent party. The key difference between the arbitration regimes is the inclusion of pricing (and associated principles) within the scope of arbitration under Part 23 which is not required under the access principles, where maximum prices (and how they may change) are determined by the access principles themselves.

Beyond the narrow circumstances of outcomes for the NGP, revocation of the derogation for the NGP can reasonably be expected to make new risky investments in greenfields pipelines less attractive, since it removes a mechanism for overcoming the effect of regulatory risks in discouraging these investments.

The derogation for the NGP is consistent with an established practice of providing incentives to new pipelines (via a fixed period during which regulation does not apply) in order to promote efficient investment in natural gas services – a practice that has previously been held to contribute to the NGO, as set out in the box below. The

current situation whereby the NGP enjoys a derogation under the Part 23 access regime is consistent with these arrangements.

It also opens the potential for 'forum shopping' by access seekers, given that the access principles establish a maximum price, which may in future be either above or below that determined by an arbitrator under Part 23. While these regimes may give rise to similar pricing outcomes in the short term, they are unlikely to have the same profile of prices over time. This opens the prospect that access seekers may select the access regime that gives them the most favourable terms and conditions at any point in time. This in turn reduces the prospect of recovery of the reasonable costs of the NGP investment, since shippers would be able to switch between access regimes where they considered that would lower their costs.

Finally, there are likely to be costs and complexities involved in maintaining two access regimes in parallel with each other, given their overlapping scope and potentially difficulties in resolving conflicting requirements.

4. RESPONSE TO QUESTIONS ASKED BY THE AEMC

In this section, Jemena responds to the specific questions raised by the AEMC in its consultation paper. Houston Kemp's report does not explicitly address these questions because its analytical framework is expressly focused on whether the rule change proposal would contribute to the NGO.

The questions raised by the AEMC relate to monopoly power, information asymmetry, special circumstances, regulatory complexity and costs and benefits – intermediate considerations which do not by themselves establish whether the rule change proposal would contribute to the NGO.

4.1 QUESTION 1: MONOPOLY PRICING OUTCOMES

Jemena considers that the NGP access principles will give rise to similar outcomes with respect to constraining the exercise of market power as the Part 23 access regime, because market power concerns do not arise under either.

Jemena's firm tariffs were determined through a competitive market process and should be presumed to be cost reflective. The access principles set out a basis for updating these tariffs that provides certainty that they will continue to reflect the costs of the expansions and extensions to which the principles apply. Jemena has no ability to unilaterally change these tariffs or this approach.

Tariffs under the Part 23 access regime would be determined to be consistent with the objective of the scheme, which is to reflect the outcomes of a workably competitive market. Jemena expects that tariffs developed on this basis would similarly be cost reflective, albeit with a lesser degree of certainty than the NGP access principles provide.

Houston Kemp explain why the concerns of monopoly pricing raised by the ACCC which gave rise to the Part 23 access regime do not apply to the NGP over the term of the derogation.

4.2 QUESTION 2: INFORMATION ASYMMETRY OUTCOMES

Jemena considers that the NGP access principles will give rise to similar outcomes with respect to information asymmetry as the Part 23 access regime.

Information disclosure is valuable to shippers to the extent that it assists them in being able to effectively negotiate gas pipeline services on reasonable terms and conditions at prices that reflect costs. The NGP access principles provide certainty that shippers can achieve these conditions. It also ensures that shippers provide the technical information they need to be able to effectively use services on the NGP.

4.3 QUESTION 3: SPECIAL CIRCUMSTANCES IMPACTING THE NGP

There are a number of special circumstances impacting the NGP which are addressed in our responses to the other questions raised by the AEMC:

- the NGP is a new pipeline connecting a new source of natural gas to east coast markets;
- The current contracting arrangements have the effect of the NGP being exposed to much greater risk than most newly constructed pipelines (see Section 2.2 of the Houston Kemp report)

- the NGP was developed under a highly competitive tender process run by the Northern Territory government;
- the derogation provided Jemena the ability to continue to develop this pipeline on the terms that were agreed under Northern Territory government's tender process; and
- the rule change proposal would remove this regulatory holiday before it had even begun to apply.

As noted in Section 5 of the Houston Kemp report, there is an established practice of providing incentives to new pipelines in order to promote efficient investment in natural gas services. This practice has been held to contribute to the NGO because the prospect of regulation can create uncertainty which could cause new pipelines to be underbuilt or deferred

Consistent with this, new gas pipelines to connect further sources of gas to the interconnected grid are likely to require similar exemptions or derogations from regulatory obligations imposed under the NGR. If the rule change proposal is accepted, it would be expected to have a chilling effect on new investment in gas pipelines. This is problematic given that investments in new gas pipelines are likely to be required in order to alleviate tight demand conditions in east coast gas markets.

4.4 QUESTION 4: REGULATORY COMPLEXITY

The rule change proposal for revocation of the NGP derogation would give rise to material additional regulatory complexity.

As part of its agreement with the Northern Territory government, over the term of the derogation Jemena is bound by the NGP access principles which set out mandated requirements in relation to the provision of access, determination of prices, publication of information and access to arbitration. None of these requirements would fall away if the derogation were to be revoked.

It follows that there would be overlapping regulatory requirements for gas transportation services on the NGP that would give rise to unnecessary complexity relating to resolving potentially conflicting requirements.

4.5 QUESTION 5: COSTS AND BENEFITS

As set out above, Jemena considers that the rule change proposal will not be expected to give rise to any benefits in the form of reduced prices or information disclosure that would enable shippers to achieve this.

However, the rule change proposal would give rise to real costs in the form of reduced investment in gas pipelines to connect east coast markets to new sources of gas. Such investment would, over the long run, be expected to give rise to lower prices for natural gas and benefit consumers.

The rule change proposal would also give rise to unnecessary costs arising from the overlapping regulatory arrangements that would apply over the term of the access principles. Section 5.4 of the Houston Kemp report explains how the access principles are a legally binding agreement and the introduction of the Part 23 access regime must increase complexity, including cost of regulatory compliance.

5. RESPONSE TO UNFOUNDED CLAIMS MADE BY RULE CHANGE PROPONENTS

The rule change proponents make a number of unreferenced, incorrect or misleading claims about the development of the NGP and the obligations imposed on Jemena by the access principles. This section responds to some of these claims with facts that demonstrate their inaccuracy.

Jemena submits that, given the significant number of untrue allegations that the rule change proposal is founded on, the AEMC should exercise great caution in accepting any claim of fact made by its proponents.

5.1 THE NGP WILL BE AN UNREGULATED MONOPOLY

The rule change proposal asserts that:¹

The effect of the NGP Derogation is to create an unregulated monopoly pipeline, with no limits on tariffs, for 15 years.

This statement and the further claims that support it are incorrect because an unregulated monopoly is conceptually able to increase tariffs without any constraints.

However, the tariffs that apply (and will apply in future) on the NGP were determined in a competitive process and will be updated to reflect reductions in costs achieved from expansion over time.

The maximum tariffs that apply to the NGP under the access principles were determined through a multi-stage competitive tender process conducted by the Northern Territory government. Tariffs and tariff structures were evaluated as part of the tender. Announcing Jemena's success in the tender, the Chief Minister noted that it had offered cheaper tariffs than its competitors.²

In its east coast gas inquiry, the ACCC also stated that it regards the rate of return earned by Jemena under the NGP tender as a competitive benchmark against which to assess other pipeline owners:³

The differences between the returns depicted in this chart, the return on equity estimated by the AER and the return adopted in the winning bid for the NGP are substantial and are consistent with the significant degree of market power that existing pipeline operators can use when negotiating the prices to access incremental projects.

Further, the access principles provide that tariffs continue to reflect costs over the term of the derogation. On Jemena's instigation, the access principles are designed so that reductions in average cost achieved through expansions or extensions are shared with existing shippers in lower tariffs.⁴

The rule change proponents have misunderstood how the access principles set out maximum pipeline tariffs for firm forward haulage and firm nitrogen removal, subject to escalation for CPI. As a result, firm tariffs to shippers cannot exceed these published rates, and Jemena is not unilaterally able to change these tariffs.

¹ IEEFA and EJA, *Request to change National Gas Rules*, 18 July 2018, pp 2-3.

² Northern Territory government media release, *NT announces Jemena to build gas pipeline to east coast*, 17 November 2015.

³ ACCC, *Inquiry into the east coast gas market*, April 2016, p 105.

⁴ NGP access principles, annexure 1.

These tariffs were a key outcome of the competitive tender process, as set out in section 2 of the Houston Kemp report, and therefore reflect the efficient costs of providing the pipeline services.

Section 4.1 of the Houston Kemp report explains that firm tariffs will be revised upon expansions or extensions of the pipeline that fall within the scope of the access principles (ie, up to 300 TJ/day) – called a ‘rolled in tariff’.

Under this formulation (which was proposed by Jemena as part of its tender proposal), the rolled in tariff can never increase, and can only decrease. The essential economic principles on which this calculation rests are that:

- expansions with incremental costs that are higher than the highest user charge will incur an additional charge above the firm tariff that reflects these higher costs; and
- expansions with incremental costs that are lower than the highest user charge will share these savings with existing users.

5.2 TARIFF CHANGES REQUIRE ONLY NOTIFICATION TO THE NORTHERN TERRITORY GOVERNMENT.

The rule change proponents claim that for tariffs to be changed under the access principles requires merely notification to the Northern Territory government. This is a selective reading of the pricing framework that is not consistent with Jemena’s understanding of how the access principles will operate.

Clause 24 of the access principles must be read in the context of clauses 23 to 26, the formulation for firm tariffs set out in Annexure 1 and the requirements of the PDA. Specifically:

- clause 23 requires Jemena to set tariffs at levels no higher than the maximum tariffs set out in Annexure 1 of the access principles;
- clause 25 provides for Jemena to change tariffs following the commissioning of an expansion or extension, but the formulation in Annexure 1 mean that firm tariffs charged to existing shippers cannot increase as a result of such changes; and

It is clear in this context that the requirement for Jemena to notify the Northern Territory government of changes in tariffs relates only to tariff changes that are otherwise permitted by the access principles – indexation for CPI or following an expansion or extension of the pipeline. This is consistent with the contractual obligations upon Jemena in the PDA.

5.3 JEMENA IS FREE TO CHANGE THE ACCESS PRINCIPLES

The rule change proponents assert that the NGP access principles are subject to change by Jemena at any time. In support of this claim, they cite the definition of ‘access principles’ which:⁵

...means these access principles as amended by Jemena from time to time.

This is not correct and represents a misunderstanding of the requirements of the access principles. When understood in the context of the requirements of the PDA, this concern does not arise.

The NGP access principles are an annexure to the confidential PDA between Jemena and the Northern Territory government. Under the PDA, Jemena does not have the ability to unilaterally change the NGP access principles.

⁵ IEEFA and EJA, *Request to change National Gas Rules*, 18 July 2018, pp 2-3.



The misunderstanding arises because clause 7 of the access principles requires Jemena at all times to publish these principles on its website. The access principles that Jemena publishes may change from time to time only in accordance with the provisions of the PDA. Consistent with this, and because the access principles are published outside the context provided by the PDA, the definition of ‘access principles’ in the published version has been amended from the original to read:⁷

...these access principles as amended by Jemena from time to time.

Further, the access principles contain a dispute resolution mechanism culminating in binding arbitration by an independent party in accordance with external guidelines if the parties are unable to agree.

More importantly, the penalty for non-compliance with the terms of the access principles can extend to coverage being imposed on the NGP.

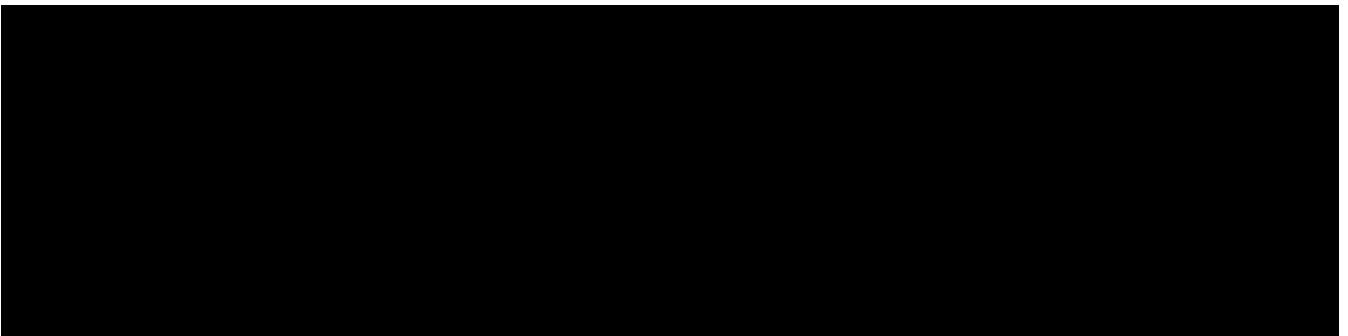
It follows that Jemena does not have the ability to unilaterally change the NGP access principles without raising the risk of serious consequences under the PDA.

5.4 TENDER PROCESS WAS FLAWED

The rule change proponents describe the tender outcome as ‘flawed’ because:⁸

The tender process for the NGP was for a 14-inch pipeline. Jemena applied for and won the tender. The NGP diameter was then reduced to 12 inches, which had led to a 25% reduction in capacity. The tender process was not repeated.

These are serious allegations of irregularities in the tender process for the NGP. These claims are unreferenced and incorrect. Jemena’s proposal to develop the NGP was based on a 12 inch pipeline with a commitment to develop a larger pipeline if sufficient demand emerged to justify this.



⁶ North East Gas Interconnector Project Development Agreement, clause [REDACTED]

⁷ NGP access principles glossary, available online at <https://jemena.com.au/getattachment/industry/pipelines/Northern-Gas-Pipeline/Services/NGP-Access-Principles.pdf.aspx>.

⁸ IEEFA and EJA, *Request to change National Gas Rules*, 18 July 2018, p 4.

⁹ Jemena, *North East Gas Interconnector Final Proposal*: [REDACTED]

¹⁰ North East Gas Interconnector Project Development Agreement, clause [REDACTED]

5.5 THE COST OF THE NGP IS HIGH, ALLOWING JEMENA TO CHARGE UNCOMMERCIAL PRICES.

We note the view of the proponents of the rule change that NGP is an expensive pipeline, compared to others on the east coast.¹¹ By itself, this observation does not provide any information about whether these prices reflect efficient costs or the outcomes of a workably competitive market. Rather, there is evidence that the tariffs for the NGP reflect the efficient costs of constructing the pipeline, and that actual costs incurred by Jemena are in line with expectations. For example:

- Jemena's tariffs were a key component of its successful tender proposal and the Northern Territory Chief Minister stated that these were lower than those of other tenderers;¹² and
- construction of the NGP (including nitrogen removal facilities) is reported by Jemena to have cost approximately \$800 million,¹³ which is in line with the expectations of industry experts at the time of the competitive tender, which were \$800 million to \$900 million, given the route of the pipeline.¹⁴

High costs are not the same as inefficient costs. The NGP's tariffs are higher than the other pipelines cited by the rule change proponents but:

- these tariffs are consistent with costs incurred by Jemena, which were tested in a competitive tender process; and
- the tariffs that the rule change proponents cite reflect different pipelines with different ages, locations and sizes from the NGP.

5.6 THERE IS A LACK OF DEMAND FOR THE NGP AND IT WILL BE UNCOMPETITIVE

The rule change proponents claim that the costs of the NGP are so high that gas it delivers will be uncompetitive in east coast markets.¹⁵

Jemena does not agree that this is likely to be the case. However, if this scenario were to be realised then the NGP will be underutilised and Jemena will likely make substantial losses from its investment in the pipeline.

This highlights the substantial risks that Jemena faced in developing the NGP, which continue to persist, and further information is provided in Section 2.2 of the Houston Kemp report on the capacity contracts under firm arrangements.

¹¹ IEEFA and EJA, *Request to change National Gas Rules*, 18 July 2018, p 6.

¹² Northern Territory government media release, *NT announces Jemena to build gas pipeline to east coast*, 17 November 2015.

¹³ Jemena website, <https://jemena.com.au/pipelines/northern-gas-pipeline>, accessed 21 November 2018.

¹⁴ Australian Financial Review, *NT opens tender process for gas pipeline link*, 13 November 2014.

¹⁵ IEEFA and EJA, *Request to change National Gas Rules*, 18 July 2018, p 5.

The rule change proponents do not explain how they reconcile their negative view of the competitiveness of the NGP with other assertions that Jemena stands to make massive profits from transporting vast amounts of gas from the Northern Territory to east coast markets – claims that are also false, as we set out below.

5.7 JEMENA HAS A PERVERSE INCENTIVE TO OVERINVEST IN THE PIPELINE AND MAKE MONOPOLY PROFITS

The rule change proponent assert that, under ‘conservative’ assumptions, Jemena could serve 700 TJ per day and make unreasonable gains of \$5 billion. This gives rise to ‘perverse incentives’ to overinvest in the pipeline.¹⁶

These claims do not sit easily with the previous assertion that there is a lack of demand for the pipeline. They are also incorrect and without basis, resting on the assumptions that:

- Jemena’s firm tariffs result in it earning an excessive rate of return for services it provides on the NGP; and
- the derogation would apply to expansions up to and including capacity of 700 TJ/day.

Annexure 1 of the access principles only applies to expansions up to and including capacity of 300 TJ/day. Neither the access principles nor the derogation applies to expansions of the NGP beyond this capacity. The rule change proponents’ claims to the contrary – including a claim that the derogation would apply to a \$4 billion extension to the NGP – are incorrect.

Further, the claims that Jemena makes excessive returns from services that it provides on the NGP are entirely without merit, for the reasons set out in section 5.5 above. The ACCC inquiry report makes clear that it regards the rate of return earned by Jemena under the NGP tender as a competitive benchmark against which to assess other pipeline owners.¹⁷

¹⁶ IEEFA and EJA, *Request to change National Gas Rules*, 18 July 2018, pp 7-8.

¹⁷ ACCC, *Inquiry into the east coast gas market*, April 2016, p 105.