

Northern Territory Government

**Northern Gas Pipeline Derogation from Part 23 of the
National Gas Rules**

Submission to the Consultation Paper

December 2018

Introduction

Historically, the Northern Territory gas market has been isolated from the eastern and western gas markets, and consists of a number of interconnected pipeline systems with a small number of gas suppliers. However, the Territory gas market is entering a phase of significant change which is being driven by the following structural, regulatory and policy changes:

- The Territory is now physically connected to the Australian east coast gas market through the construction of the Northern Gas Pipeline (NGP) from Tennant Creek to Mount Isa in Queensland.
- The Northern Territory Government has lifted the moratorium on hydraulic fracturing and is in the process of designing the regulatory framework to facilitate sustainable unconventional onshore gas exploration and development. The Territory's onshore gas reserves are considered to be some of the most prospective in the country, with the Beetaloo Basin estimated to hold 6.6 trillion cubic feet of gas¹.
- The Northern Territory Government announced a Five Point NT Gas Strategy (the Strategy) to drive the Territory Government's vision to develop the Territory as a world class hub for gas production, manufacturing and services by 2030. The Strategy includes five targets:
 1. Get more LNG in Darwin and expand Darwin's LNG Export Hub.
 2. Grow the gas supply and service industry.
 3. Establish a gas manufacturing industry.
 4. Grow research, innovation and training capacity.
 5. Contribute to national energy security on the East Coast.

The NGP, and any potential extension and expansion of this pipeline², is a critical piece of infrastructure to enable the successful development, and delivery of, new gas supplies to market (both within the Territory and to the east coast of Australia). The Territory considers it is important that the commercial incentives underpinning the NGP, which were developed through a competitive tender process, are preserved to ensure certainty for any further investment in expansion of the NGP.

It is on this basis that Territory Government make this submission to the Australian Energy Market Commission (AEMC) on the Consultation Paper for the rule change request from Environmental Justice Australia and the Institute for Energy Economics and Financial Analysis (the proponents). The Territory Government's submission to the rule change request is structured on the following basis:

- The body of the submission outlines the rationale for the derogation exempting the NGP from the Part 23 Framework that was sought by the Territory Government and agreed by the Council of Australian Governments Energy Council in 2017.
- [Attachment A](#) provides responses to the individual questions contained in the AEMC consultation paper.

¹ Origin Energy, *Beetaloo Basin drilling results indicate material gas resource*, 15 February 2017, <https://www.originenergy.com.au/about/investors-media/media-centre/beetaloo-basin-drilling-results-indicate-material-gas-resource.html>

² Australian Energy Market Operator, *2018 Gas Statement of Opportunities*, https://www.aemo.com.au-/media/Files/Gas/National_Planning_and_Forecasting/GSOO/2018/2018-Gas-Statement-Of-Opportunities.pdf

1. The Northern Gas Pipeline Access Principles

In 2014, the Territory Government tendered for the right to construct and operate the North East Gas Interconnector (now the NGP) to link the Northern Territory gas market with the East Coast gas market.

At its 38th meeting on 10 October 2014, the Council of Australian Governments reflected in its meeting communique that:

COAG supported the work being undertaken by the Northern Territory to establish a competitive process for the private sector to bring forward proposals for the construction and operation of a pipeline to connect the Northern and Eastern Gas Markets. COAG agreed that connecting these gas markets is the next step to developing a national gas grid and will contribute to the development of a more national and competitive domestic gas market, helping to improve supply security.³

As a result of this competitive process, the Territory selected Jemena to construct, own and operate the NGP pursuant to a Project Development Agreement (PDA) signed in November 2015.

Under the regulatory environment existing at the time (and prior to 1 August 2017), most transmission pipelines like the NGP were non-scheme pipelines not subject to access regulation. Nonetheless, in inviting tenders for the NGP, the Territory Government required the development of Access Principles under which all prospective users would be able to gain access to pipeline services on the NGP on a non-discriminatory basis. The Access Principles⁴, which are legally binding, set out:

- that Jemena must provide access seekers with access to:
 - firm services at tariffs no higher than those set out in Annexure 1 to the Access Principles
 - nitrogen removal services at tariffs no higher than those set out in Annexure 1 to the Access Principles
- a dispute resolution procedure that requires Jemena and an access seeker to submit a dispute to arbitration if the dispute remains unresolved following the negotiation process specified in the Access Principles
- arrangements for queuing, and pipeline connections, extensions and expansions.

2. The Part 23 Framework and pipelines developed through a competitive process

In April 2016, the Australian Competition and Consumer Commission (ACCC) published the final report of its Inquiry into the East Coast Gas Market which investigated the competitiveness of wholesale gas prices in eastern and southern Australia. The report detailed the ACCC's findings that 'existing transmission pipelines on the east coast have market power and their ability and incentive to exercise

³ Council of Australian Governments 2014, Meeting Communique, 10 October,
https://www.coag.gov.au/sites/default/files/communique/coag_communique_10_october_2014.pdf.

⁴ Jemena 2018, *Northern Gas Pipeline – Access Principles*,
<https://jemena.com.au/getattachment/industry/pipelines/Northern-Gas-Pipeline/Services/NGP-Access-Principles.pdf.aspx>.

that power is not being effectively constrained at this time⁵. However, in contrast to *existing* pipelines, the ACCC found that “competition for the market” can impose an effective constraint on the behaviour of *new* pipeline[s]⁶.

In response to the ACCC’s Inquiry findings, in August 2016 the Energy Council directed the Independent Chair of the Gas Market Reform Group (GMRG), Dr Michael Vertigan, to examine the current regulatory test for the regulation of gas pipelines. Stakeholder consultation during Dr Vertigan’s Examination confirmed the ACCC’s findings that competition to build a new pipeline can be effective in limiting market power:

Stakeholders agree with the ACCC that competition to build a new pipeline can be effective in limiting market power. A number of stakeholders identified additional examples (to the NGP and QSN Link) to support that competition to build a pipeline can impose an effective constraint on the access behaviour of new pipelines.⁷

Dr Vertigan recommended that, rather than amending the regulatory test, a new Information Disclosure and Arbitration Framework for non-scheme pipelines be established to reduce the information asymmetry and imbalance in bargaining power that shippers can face when negotiating with operators of otherwise unregulated pipelines.

Dr Vertigan’s recommendations were endorsed by Energy Council on 14 December 2016 and the GMRG commenced work on the final design of the Part 23 Framework and the legislation to implement it.

The application of the Part 23 Framework to the NGP and other pipelines developed through a competitive process was raised with the GMRG during consultation on the final design. Jemena, in its April 2017 submission to the GMRG on the Implementation Options Paper, submitted that the exemptions from the Part 23 Framework should be extended to cover pipelines like the NGP:

Jemena considers that exemptions from the statutory arbitration scheme should apply to greenfield pipelines which have resulted from a competitive process (such as the NGP) and/or otherwise are subject to access arrangements by way of binding agreement with the relevant State or Territory Government.⁸

Jemena provided arguments in support of this position, including that tariffs for the NGP have been set through a competitive tender process and that it is subject to an open access regime.

Notwithstanding the ACCC’s findings that the constraints on the exercise of market power for new pipelines can be effective, in its Final Design Recommendation for the Part 23 Framework the GMRG

⁵ Australian Competition and Consumer Commission 2016, *Inquiry into the East Coast Gas Market*, April, p. 101.

⁶ Australian Competition and Consumer Commission 2016, *Inquiry into the East Coast Gas Market*, April, p. 101.

⁷ Vertigan, Dr. M. 2016, *Examination of the Current Test for the Regulation of Gas Pipelines – Report*, 14 December.

⁸ Jemena 2017, *Gas Pipeline Information Disclosure and Arbitration Framework – Jemena Submission on the Implementation Options Paper*, April, <http://gmrg.coagenergycouncil.gov.au/sites/prod.gmrg/files/submissions/gas-pipeline/jemena.pdf>

acknowledged Jemena's proposed exemption categories but did not address Jemena's arguments as it did for a number of other exemption categories proposed by stakeholders, other than to state:⁹

The GMRG does not believe that the additional exemption categories suggested by stakeholders. Should a dispute arise in relation pipelines with these characteristics, these matters would likely be considered by the arbitrator in making a determination.¹⁰

Subsequently, exemptions (other than the NGP derogation) under the initial rules for the Part 23 Framework implemented in August 2017 were limited to non-scheme pipelines not providing third party access (exemption from information disclosure provisions and arbitration of access disputes); single shipper pipelines (exemption from information disclosure provisions) and pipelines with an average injection of less than 10 terajoules per day (exemption from publishing service usage information, service availability information and financial information). The NGP does not fall into any of these categories.

3. Northern Gas Pipeline derogation from the Part 23 Framework

In the context of significant uncertainty about the merit of applying the Part 23 Framework to a pipeline like the NGP, a derogation exempting the NGP from the Part 23 Framework was sought by the Territory Government. The proposed derogation was agreed by Energy Council was included in the initial Rules for the Part 23 Framework that came into effect on 1 August 2017. The explanatory statement for the initial rules states:

The derogation provided for under Part 2 exempts the Northern Gas Pipeline (NGP) from the operation of Part 6A of the NGL for a period of 15 years from when the pipeline is commissioned. The NGP is being developed by Jemena Northern Gas Pipeline Pty Ltd (Jemena) following a competitive tender process conducted by the Northern Territory Government in 2015 and is due to be completed in late 2018. The Project Development Agreement signed by Jemena and the NT Government sets out the access principles that were agreed to as a result of the competitive process and are intended to address many of the same issues the framework is designed to address.¹¹

Consistent with the consideration made by Energy Council, assessing the merit of the proponent's rule change request to remove the derogation for the NGP requires consideration of whether the NGP Access Principles achieve the same objectives as the Part 23 Framework.

The overarching objective of the Part 23 Framework, including both the information disclosure and arbitration mechanisms, is to facilitate access on reasonable terms to services provided by non-scheme pipelines. This is taken to mean at prices and terms and conditions that, so far as practical, reflect the outcomes that would occur in a workably competitive market.¹²

The Access Principles provide binding competitively determined prices, an obligation to provide non-discriminatory access to third parties and a mechanism to resolve disputes. The information

⁹ Gas Market Reform Group 2017, *Gas Pipeline Information Disclosure and Arbitration Framework Final Design*, June, pp. 39, 52-53.

¹⁰ Gas Market Reform Group 2017, *Gas Pipeline Information Disclosure and Arbitration Framework Final Design*, June, p. 53.

¹¹ Gas Market Reform Group 2017, *Gas Pipeline Information Disclosure and Arbitration Framework - Initial National Gas Rules - Explanatory note*, August, p. 47.

¹² Gas Market Reform Group 2017, *Gas Pipeline Information Disclosure and Arbitration Framework Final Design*, June.

available, both at the time the derogation was made and at present, indicates that the binding prices set out in the Access Principles reflect a competitive market outcome and therefore do achieve the same objective as the Part 23 Framework.

For its 2016 ‘Inquiry into the east coast gas market’ the Territory Government provided information to the ACCC on the NGP tender process. The ACCC found that the outcome of the competitive tender process for the construction and operation of the NGP suggests that ‘competition for the market’ can impose an effective constraint on the behaviour of new pipelines. In relation to the NGP, the ACCC endorsed the Territory Government’s inclusion of the Access Principles as a tender outcome and concluded that ‘the rate of return adopted in the winning bid [for the NGP] suggests that there was a reasonable level of competition between these bidders’¹³.

In submissions to Dr Vertigan’s 2016 ‘Examination of the current test for the regulation of gas pipelines’, Central Petroleum and Santos, oil and gas explorers and producers in Central Australia and potential purchasers of transport on the NGP, endorsed the outcomes from the competitive tender process for the NGP. Central Petroleum stated that ‘whilst the NGP tariff is a significant cost for NT production (17 per cent of delivered cost), Central believes it is reasonable given the cost of the NGP development and the fact it was derived through a competitive process’¹⁴. Santos stated that its experience, including with the NGP, was that ‘the competitive tension to tender for the right to secure pipeline rights elicits competitive market results’¹⁵.

The Territory’s rationale for preserving the NGP’s derogation from Part 23 of the NGR is explored further in the responses to the individual questions in the AEMC Consultation Paper in [Attachment A](#).

4. Conclusion

The Territory Government considers that the derogation for the NGP from Part 23 of the NGR should be maintained on the following grounds:

- The Access Principles were developed through a competitive tender process and reflect a competitive outcome.
- The Access Principles in the PDA achieve the same outcomes that Part 23 of the NGR would achieve.
- Applying Part 23 of the NGR on top of the Access Principles amounts to regulatory duplication which would lead to confusion amongst access seekers and potentially forum shopping.

The Territory considers it is important that the commercial incentives underpinning the NGP, which were developed through a competitive tender process, are preserved to ensure certainty for future investment in the expansion of the NGP. This will be critical to ensure the Territory can develop its onshore gas potential and deliver to markets, both in the Territory and to the east coast of Australia.

¹³ Australian Competition and Consumer Commission 2016, *Inquiry into the East Coast Gas Market*, April, p. 97.

¹⁴ Central Petroleum 2016, *Submission to the Examination of the Current Test for the Regulation of Gas Pipelines*, October, p. 21,

<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Central%20Petroleum%20response%20to%20gas%20pipeline%20coverage%20test%20consultation.pdf>.

¹⁵ Santos 2016, *Submission to the Examination of the Current Test for the Regulation of Gas Pipelines*, October, p. 3,

<http://www.coagenergycouncil.gov.au/sites/prod.energycouncil/files/publications/documents/Santos%20response%20to%20gas%20pipeline%20coverage%20test%20consultation.pdf>.

Question 1: Monopoly Pricing Outcomes

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?

Northern Territory Government Response

The Territory Government considers that the Access Principles achieve the same outcomes for the NGP that would be achieved by the Part 23 Framework for other pipelines – prices and other terms and conditions for transportation of gas that, so far as practical, reflect the outcomes of a workably competitive market. Specifically:

- The Access principles implement prices, terms and conditions for the NGP that reflect the outcome of the competitive tender process to construct and operate the NGP. Through the tender process, the Territory leveraged the Power and Water Corporation as the foundation gas transportation customer for the benefit of all future gas shippers.
- The Access Principles require that Jemena provide access to the NGP on a non-discriminatory basis at competitive prices fixed in real terms for 15 years, and outline the NGP's access policy including arrangements for queuing, connections, extensions and expansion, and dispute resolution.
- The dispute resolution procedure requires that any dispute between an access seeker and Jemena arising out of or in connection with the Access Principles, including a failure to negotiate the terms of a contractual access agreement, must be submitted to arbitration under the Institute of Arbitrators and Mediators Australia Arbitration Rules, which are binding.

To this end, the Territory considers the Access Principles constrain the exercise of market power by Jemena and reflect the outcomes of a workably competitive market.

A basic financial analysis of the NGP by one of the rule change proponents, the Institute for Energy Economics and Financial Analysis (IEEFA), undertaken in 2016 (and attached to the proponent's rule change request) contradicts the proponent's assertion that the Access Principle prices represent monopoly prices. For the size of the pipeline and estimated construction cost, IEEFA estimated that a commercial tariff for the NGP if it was fully contracted would be \$2.01 per gigajoule (GJ), which is above the Access Principles firm tariff of \$1.40 per GJ (2015 dollars).¹⁶

Question 2: Information Asymmetry Outcomes

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?

Northern Territory Government Response

The Territory considers that the NGP access principles will give rise to similar outcomes with respect to information asymmetry as the Part 23 Framework. The NGP access principles provide a mechanism to allow shippers to negotiate gas pipeline services on reasonable terms and conditions (this is also articulated in the response to question 1).

¹⁶ Institute for Energy Economics and Financial Analysis 2016, *Pipe Dream: A Financial Analysis of the Northern Gas Pipeline*, May, p. 30, https://www.aemc.gov.au/sites/default/files/2018-08/Annexure%20%20Pipe-Dream-A-Financial-Analysis-of-the-NEGI-MAY-2016_0.pdf.

The Part 23 Framework comprises an information disclosure mechanism, designed to inform shippers whether they should seek access, and an arbitration mechanism with cost-based pricing principles, to address the imbalance of bargaining power between pipeline service providers and access seekers. Both these outcomes are addressed by the NGP Access Principles, which bind Jemena to competitively determined terms and conditions of access to the NGP and provide an arbitration mechanism in the event of disputes. Under the NGP Access Principles, the publication of financial information as required by the Part 23 Framework to enable access seekers to determine the reasonableness of price offers is made redundant by the establishment of competitively determined binding access prices.

Question 3: Special Circumstances Impacting the NGP

Are there are 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?

Northern Territory Government Response

The existence of the binding NGP Access Principles is a special circumstance which the Territory Government considers makes the application of the Part 23 Framework to the NGP inappropriate. The NGP Access Principles were negotiated by the Territory Government for the benefit of all access seekers. The application of the Part 23 Framework, in addition to the NGP Access Principles, may result in regulatory duplication, confusion amongst access seekers and forum shopping. In assessing the proponent's rule change request, the AEMC should consider the incremental benefits of the application of the Part 23 Framework for consumers in the context of the incremental costs, which may include additional information disclosure costs for the service provider, the cost of frivolous or speculative arbitrations for access seekers and the service provider, and increased regulatory uncertainty potentially adversely affecting future investment in the NGP.

Question 4: Regulatory Complexity

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

Northern Territory Government Response

In its original application seeking a derogation for the NGP from the Part 23 Framework, the Territory articulated the following concerns relating to regulatory complexity: the application of the Framework in addition to the Access Principles would result in overlapping access frameworks, causing confusion and forum shopping, and resulting in additional administrative burden for shippers and Jemena, for uncertain benefits.

On this basis, to provide certainty to the service provider and the wider gas industry and the Territory, the Northern Territory requested a derogation to ensure the NGP would be exempt from the entire Framework for a period of 15 years from the commencement of the operation of the pipeline.

The Territory considers that this concern of regulatory complexity and duplication remains valid.

Question 5: Costs and Benefits

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

Northern Territory Government Response

The Territory considers there is a strong possibility that the application of the Part 23 Framework, in addition to the NGP Access Principles, may result in costs exceeding benefits. As noted in its response to question 4, the Territory considers the AEMC should consider the incremental benefits of the application of the Part 23 Framework for consumers in the context of the incremental costs, which may include additional information disclosure costs for the service provider, the cost of frivolous or speculative arbitrations for access seekers and the service provider, and increased regulatory uncertainty potentially adversely affecting future investment in the NGP.