

4 April 2019



Submission on AEMC's Draft Rule Determination

National Gas Amendment (Northern Gas Pipeline – Derogation From Part 23) Rule 2019

Dear Mr Singh

### **Northern Gas Pipeline – Derogation From Part 23**

This letter contains Environmental Justice Australia's submissions in response to the Draft Rule Determination. We are grateful for the opportunity to make this submission.

As foreshadowed, the submissions of IEEFA will follow. We thank you for you keeping the portal open for those submissions.

#### **Summary**

In short, the AEMC's Draft Rule Determination is untenable. It permits industry to set the agenda irrespective of the rules. It backs in extreme financial mismanagement by the NT government. The AEMC appears blind to the fact that its actions are facilitating fossil fuel extraction that will have unacceptable climate change impacts that extend to the security and supply of gas to consumers.

On risks to gas supply, the Commission contradicts the financial filings of disclosures by A\$11 billion company to the Singapore Stock Exchange in circumstances where it is bound to disclose material risks to its business. The AEMC completely ignores the relationship between energy markets and climate change.

The AEMC has failed to investigate and comment on how the market for access to a brand new, different pipeline, is being manipulated under the guise of the Access Principles. At the same time the Draft Determination says the situation with the NGP is an anomaly and such derogations should not apply in the future.

The Draft Determination fails to interrogate circumstances that put into question the existence of a competitive tender process, particularly one that may be based on misconduct being investigated by the ATO. The AEMC appears to be saying that potential illegal conduct is fine under the National Gas Objective. The implication is that players can do whatever they want if the consumers get a good deal.

We reject the Draft Determination. We suggest the AEMC receive training on climate change risks in order to fulfil their duties under the *Public Governance Performance and Accountability Act 2013*.

Those duties are the same as duties of senior managers of corporations. They require the Commissioners to inform themselves about climate change in order to discharge their duties. Yet the Draft Determination decides that potentially unacceptable climate change risks have no impact on the safety, security or supply of gas. Nothing could be further from the truth.

## 1. AEMC supports industry evading regulation

Evidence before the AEMC is that Jemena refused to submit itself to the National Gas Rules in negotiations with the Northern Territory government. The Houston Kemp report states:<sup>1</sup>

*During the tender process, the Northern Territory government sought proposals to develop the NGP as a covered pipeline, or asked respondents to propose alternative arrangements. We understand that Jemena did not and was not willing to submit a proposal on this basis. Jemena instead proposed to develop the NGP on the basis of access principles in lieu of coverage, which we understand were initially proposed by the Northern Territory government.*

The AEMC is now backing in a process in which the NT government actively sought to have the NGP subject to the National Gas Rules and Jemena refused. The Draft Determination supports industry evasion of regulation.

## 2. AEMC supports a process driven by extreme financial mismanagement by the NT government.

In 2006 the NT entered a take or pay contract with ENI's offshore Blacktip gas project. From 2009, the NT was required to pay for 23 PJ of gas per year. That amount is about the demand required to produce electricity for the Darwin and Katherine region. However, under the contract, the volume NT *must* pay for, regardless of whether it uses it, ramps up to 37 PJ/a.<sup>2</sup> The problem is that there is no demand for the excess gas. The contract runs for 25 years to 2034.<sup>3</sup>

The over-contracting comes as no surprise, even back in 2006. The NT Utility Commission's December 2006 [review](#) stated at [2.35]:

*Contract quantities available from Blacktip will be in excess of projected requirements under the Commission's high growth scenario through to 2015-16 and beyond.*

By 2018 the NT took 65 TJ per day from ENI's Blacktip field<sup>4</sup> leaving 36 TJ a day unused.<sup>5</sup> Having paid for this extra 36 TJ a day of gas for every single day to 2034, but having no

<sup>1</sup> [www.aemc.gov.au/sites/default/files/2019-01/Jemena%20-%20Houston%20Kemp%20Report%20-%20Public.PDF](http://www.aemc.gov.au/sites/default/files/2019-01/Jemena%20-%20Houston%20Kemp%20Report%20-%20Public.PDF) p5

<sup>2</sup> [www.eni.com/docs/it\\_IT/eni-com/media/dossier/australia/eni-australia-2016-engBROCHURE.pdf](http://www.eni.com/docs/it_IT/eni-com/media/dossier/australia/eni-australia-2016-engBROCHURE.pdf) p4

<sup>3</sup> [https://www.aemc.gov.au/sites/default/files/2018-03/Final%20report\\_2.pdf](https://www.aemc.gov.au/sites/default/files/2018-03/Final%20report_2.pdf) pp9,10

<sup>4</sup> Ibid.

prospects of using it, the NT government contracted Jemena to build a new \$800 million pipeline to funnel the gas to somewhere it could be used.

The extra Blacktip gas is shipped to Darwin. It then flows through the Amadeus Gas Pipeline to a junction at Tennant Creek where the new NGP joins and along the 622 kilometre link to Mt Isa. Gas can be used by industry at Mt Isa, or backhauled to Sydney or Melbourne through an existing pipeline network at minimal cost.<sup>6</sup>

NT is the foundation customer for the NGP. Jemena has a contract with the NT government to ship 31 TJ of the over-contracted gas each day to Mt Isa.<sup>7</sup> That contract runs for 10 years. The gas is ultimately sold by the NT to Incitec Pivot at a reduced price.

Incitec Pivot says it saves \$55 million a year buying gas from the NT government via the NGP.<sup>8</sup> It is unclear how the NT government will make money on the contract. The government cites commercial in confidence reasons not to release financial information on the sales price to the taxpayer.<sup>9</sup> Yet the agreement is in all likelihood not commercial at all. It is also unclear how much the NT government is being charged and whether the Access Principles apply to it.

The NT is, in effect, providing a fossil fuel subsidy to industry consuming the gas. At the same time it subsidises Jemena's pipeline by being the foundational customer paying above market prices to use it.

We query how it is possible to have a 'competitive' tender process when the NT, the initial proponent of the pipeline, is already at a negotiating disadvantage as it needed to ship unused gas it was forced to pay for as a result of a 2006 contract, and is now making a loss.

### **3. AEMC fails to understand the significance of a transfer pricing audit for a competitive process**

A legitimate competitive tender process cannot be underpinned by illegal behaviour. Yet this is high risk because Jemena is subject to a transfer pricing audit regarding \$800 million of convertible notes. Those notes were part of a company restructure that was announced less than a week after the creation of the Jemena Northern Gas Pipeline Pty Ltd. The convertible notes are in exactly the same amount as the proposed cost of the Northern Gas Pipeline and the duration of the notes to 2050 is almost exactly the same as the expected operational life of the pipeline (30 years). There is no reason to believe the convertible notes are not related to the NGP.

---

<sup>5</sup> Assuming by 2018 NT was contracted to take 37 PJ/a. This is 3,700 TJ/a or 101.4 TJ a day.

<sup>6</sup> [www.asx.com.au/asxpdf/20170127/pdf/43fkj0hhz09qfh.pdf](http://www.asx.com.au/asxpdf/20170127/pdf/43fkj0hhz09qfh.pdf) p3

<sup>7</sup> [http://jemena.com.au/about/newsroom/media-release/2018/jemena-and-senex-partner-to-fast-track-new-gas-\(1\)](http://jemena.com.au/about/newsroom/media-release/2018/jemena-and-senex-partner-to-fast-track-new-gas-(1))

<sup>8</sup> <https://www.abc.net.au/news/rural/2015-11-18/nt-gas-pipeline-to-benefit-fertiliser-giant-incitec-pivot/6950326>

<sup>9</sup> [https://parliament.nt.gov.au/data/assets/pdf\\_file/0008/438551/Aqst77-Lambley-Fracking-Gas-Pipeline-Mining.pdf](https://parliament.nt.gov.au/data/assets/pdf_file/0008/438551/Aqst77-Lambley-Fracking-Gas-Pipeline-Mining.pdf) p3

The fact of a transfer pricing audit is not up for debate. The ATO states a transfer pricing audit will occur if a company does not have proper processes and cannot demonstrate the methods they have used to determine pricing. An audit may lead to penalties.<sup>10</sup>

Media reported on concerns about Jemena's bid on 3 December 2015. Critics suggested overseas cheap capital was a factor in the negotiations. Jemena represented that its Asian investors permitted company could take a 10 to 20 year long term view.<sup>11</sup> Again, this places convertible notes, a part of the restructure announced 4 September 2015 on the Singapore Stock Exchange and an increase in the company's Medium Term Notes Programme by US\$1 billion as part of the capital structure.<sup>12</sup> If potential illegal activity underpinned the competitive tender process then it is difficult to see how this is not a relevant consideration. AEMC's response was (at p48):

*Any possible investigation by the ATO is not relevant to the AEMC's consideration.*

We invite AEMC to reconsider its position given its reliance on the 'competitive' nature of the tender process in the Draft Determination.

#### **4. AEMC fails to understand how the derogation relates to further gas development and extreme climate change impacts in the NT**

The Derogation, and the NGP's Access Principles, are essential for further development of the unconventional gas fields that provide an unacceptable climate change risk.

Economists HoustonKemp are clear about this. They recognise that, lifting the moratorium on fracking, will mean that gas will be pumped by Jemena out of the middle of the NT to somewhere it could be sold. In a section of the economists' report that highlights risks to the NGP stemming from the NT fracking policies, the NGP is described as the first step in getting the gas out:<sup>13</sup>

*The NGP can be understood in this context as an initial investment that could enable a series of subsequent investments to substantial volumes of gas from the Northern Territory to east coast gas markets.*

We can see then that the NGP, and the Derogation, are essential for further expansion and extensions that will enable fracked gas to be exported from the NT. But it is crystal clear that the initial investment is \$800 million for a pipe that ships 90 TJ/day. And the Draft Determination refers to this volume for the NGP at p 5.

<sup>10</sup> [https://www.ato.gov.au/print-publications/international-transfer-pricing---introduction-to-concepts-and-risk-assessment/?page=3#Applying\\_the\\_arm\\_s\\_length\\_principle](https://www.ato.gov.au/print-publications/international-transfer-pricing---introduction-to-concepts-and-risk-assessment/?page=3#Applying_the_arm_s_length_principle)

<sup>11</sup> <https://www.smh.com.au/business/jemena-sees-nt-pipeline-as-core-for-2b-northern-gas-investment-20151202-gld1bb.html>

<sup>12</sup> <https://links.sgx.com/FileOpen/announcement.ashx?App=Announcement&FileID=368539;>  
<https://links.sgx.com/FileOpen/announcement.ashx?App=Announcement&FileID=368532>

<sup>13</sup> [www.aemc.gov.au/sites/default/files/2019-01/Jemena%20-%20Houston%20Kemp%20Report%20-%20Public.PDF](http://www.aemc.gov.au/sites/default/files/2019-01/Jemena%20-%20Houston%20Kemp%20Report%20-%20Public.PDF) p6

However, the derogation applies to 300 TJ/day. And the regulatory holiday from the remaining capacity, being new capacity for a different pipeline, is precisely what will encourage the extraction of significant amounts of unconventional gas.

We reiterate the key finding of the Independent Scientific Inquiry into Hydraulic Fracturing in the NT that the climate change risks associated with fracking form an **unacceptable risk**. There is a clear link between the NGP in its existing form, subject to the Derogation, the regulatory holiday for a *new* pipeline beyond 90 TJ and unacceptable climate change risks.

The AEMC's Draft Determination facilitates unacceptable climate change risks.

## 5. **AEMC fails to recognise the market is being manipulated by Jemena under the Access Principles**

The evidence submitted by Jemena puts beyond doubt that the Derogation will apply to future investments that will expand or extend the NGP of 90 TJ/day. It will apply for an extra 210 TJ / day.<sup>14</sup>

*[The Access Principles to which the Derogation applies] provide for...*

*a process for updating maximum tariffs in the event that the NGP is expanded up to 300 TJ/day, under a formula that does not permit these tariffs to rise, but provides for them to fall if the expansion reduces the average cost of the pipeline*

Thus, the Derogation applies to a *new pipeline* that will expand the NGP. We are not aware of any no evidence to suggest that the current NGP can handle volumes beyond 90 TJ/day.<sup>15</sup> In fact, we understand 90 TJ/day to be the maximum volume at the NGP's maximum pressurised capacity.

Yet AEMC glosses over this fact and talks about timing. It ignores shrewd negotiation by industry meant to lock in regulatory holidays for greenfield pipelines not yet officially proposed. The AEMC refuses to acknowledge the impact of the Derogation on a new parallel pipeline to the NGP and states:

*The exclusion of the NGP from the Part 23 regime through the NGR itself is an anomaly, reflecting the timing of the Northern Territory Government tender process compared to the development of the Part 23 regime.*

*For investment in new pipelines, the regulatory context is now that the Part 23 framework applies to all pipelines that are not covered pipelines. This includes those that have obtained a 15-year no coverage determination from the NCC, unless they meet the specific exemption criteria set out in Part 23 itself.*

The AEMC agrees with Jemena's submission that removing the Derogation would lead to an increase in complexity of the arrangements for seeking access to the NGP. Yet it completely

<sup>14</sup> [www.aemc.gov.au/sites/default/files/2019-01/Jemena%20-%20Houston%20Kemp%20Report%20-%20Public.PDF](http://www.aemc.gov.au/sites/default/files/2019-01/Jemena%20-%20Houston%20Kemp%20Report%20-%20Public.PDF) p5

<sup>15</sup> Decision EPBC2015/7569 is based on a 90 TJ/day pipeline with a life of 30 years.

ignores the complexity of the arrangements for seeking access to the proposed 700 TJ/day new parallel pipeline to the NGP. Again, we stress, that this 700 TJ/day pipeline is different to the NGP as we know it which is the subject of this inquiry. It is a new pipeline that Part 23 should apply to.

The result is that the Derogation will apply to some of the proposed expansion volume, but not all. Jemena, therefore is free to determine whether or not it applies the Access Principles to certain customers of any 700 TJ expansion or extension. In that way Jemena can arbitrarily discriminate against future pipeline users based on the overly complex arrangements it proposed, and it negotiated.

We suggest AEMC is alive to this market dynamic when considering the tenor of prospect user statements about the integrity of the competitive process and competitive market results. Further, we note that even Central Petroleum thinks that the NT tariff is high, and it appears confused by the rationale behind the Access Principles, referring to the cost of the NGP and not the financial risk.<sup>16</sup>

The Derogation leads to two regimes applying concurrently to a parallel pipe, and therefore there are two different avenues for Jemena, and prospective users, to select how to seek access to the expanded NGP's services and resolve disputes. It may allow Jemena to forum shop to resolve access disputes over its new pipeline and arbitrarily discriminate against its customers.

This makes a mockery of the AEMC's comment in the Draft Determination in which it acknowledges that it to industry and existing financial arrangements:<sup>17</sup>

*As a result of two regimes applying concurrently to the NGP, there are two different avenues for users and prospective users to select how to seek access to the NGP's services and resolve disputes.*

The AEMC's Draft Decision also fails to interrogate why the Derogation was worded as it was, being pegged to the Access Principles, rather than being aligned with the NGP's 90 TJ capacity, absent any expansion.

Given the AEMC's admission that without the Project Development Agreement, the rule change proponents were in the dark about the meaning and legal status of the Access Principles we submit that one option open to the AEMC is to limit the Derogation to 90 TJ/day. However many of the serious issues would remain.

Without having access to the Project Development Agreement dated 17 November 2015, and without the Access Principles being dated, we assume the Access Principles were also dated 17 November 2015 because they "are a part of the project development agreement".<sup>18</sup>

---

<sup>16</sup> Draft Determination, p 16

<sup>17</sup> At p38

<sup>18</sup> Draft Determination p38

Further, the Access Principles also refer to 2015 dollars suggesting our assumption is likely to be correct.<sup>19</sup> The Access Principles foreshadow a volume of 90 TJ/day.<sup>20</sup> However, strangely, they incorporate expansion or extension to 300 TJ/day. This is the same as the gas supply agreements, the earliest of which we could find was dated December 2015.<sup>21</sup>

The NGP diameter was made smaller, but even the larger diameter initial proposal would only carry 120TJ/day through a 14 inch pipe.<sup>22</sup>

The absolute best case scenario appears to have been around 200 TJ/day, as reported on 3 December 2015 in the AFR.<sup>23</sup> That article referred to potential supply from unconventional gas sources in the Betaloo Basin for increased volumes well below the 300 TJ/day level. The link between the volumes under the Access Principles and increased emissions is clear.

The decision to “reduce” the NGP capacity from 120 TJ/day to 90 TJ/day was reported by the media for the first time in April 2016.<sup>24</sup> This is well before the proposed Derogation.

Since that time, any capacity over 90 TJ/day would be for a completely new pipeline. The Derogation, if it should apply at all, should only apply to the NGP that was constructed, and not any new pipeline.

The AEMC appears to agree (DD p45):

*In the future, the Commission expects service providers and proponents of new pipelines in a similar situation as the NGP to make use of the competitive tender process under the NGR instead of a derogation.*

However, the result of its decision, and the Derogation, which was proposed by industry, is to provide a regulatory holiday for 210 TJ/day of a 700 TJ/day new pipeline.

Jemena’s comments rejecting our claim that the derogation would apply to a \$4 billion extension to the NGP is incorrect and apt to mislead.<sup>25</sup> The Derogation clearly applies to that proposed expansion. Indeed, the evidence submitted by Jemena suggests the Derogation as it stands makes the expansion possible.

## 6. The AEMC fails to investigate circumstances around the proposal of the Derogation

---

<sup>19</sup> Access Principles Annexure 1, p8

<sup>20</sup> Access Principles 19(b), p4

<sup>21</sup> <https://web.archive.org/web/20170309120442/http://jemena.com.au/documents/pipeline/negi/ngp-gta-standard-form.aspx>

<sup>22</sup> <https://www.smh.com.au/business/jemena-forced-to-reduce-nt-gas-pipeline-size-amid-drilling-opposition-20160401-qnwqmc.html>

<sup>23</sup> <https://www.smh.com.au/business/jemena-sees-nt-pipeline-as-core-for-2b-northern-gas-investment-20151202-gld1bb.html>

<sup>24</sup> <https://www.smh.com.au/business/jemena-forced-to-reduce-nt-gas-pipeline-size-amid-drilling-opposition-20160401-qnwqmc.html>

<sup>25</sup> Jemena p13

The proponents rule change request cited statements by Jemena that it had worked with the NT government to secure the derogation and attached a report that raised questions about that process. The fact that the Derogation applies beyond the 90 TJ/day NGP raises even further questions.

We understand the AEMC has failed to investigate the circumstances around the proposal of the derogation by the NT government. We believe this is an oversight given it appears Jemena is exerting market power of the NT government whilst consumers will ultimately suffer a loss as a result of high tariffs.

## **7. The AEMC fails to understand the physical impacts of climate change.**

At p47 of the Draft Rule Determination the AEMC refers to the following issue:

*The derogation applicable to the NGP will promote the production of shale gas in the NT. The production of shale gas would lead to increased risk of climate change. In addition, Jemena accepts that increased extreme weather events due to climate change can damage gas infrastructure and threaten gas supplies. The derogation is foreseen to adversely impact the safety, reliability and security of supply of natural gas.*

The AEMC's response to that issue is on p46:

*Decisions on the use of fracking and the production of gas, and the potential implications of these actions, are matters for the Northern Territory Government. These issues do not fall within the AEMC's statutory decision-making framework.*

AEMC refers to the 'potential implications of these actions'. In our submissions we referred to the findings of the Independent Scientific Inquiry into Hydraulic Fracturing in the Northern Territory that found fracking scenarios to carry unacceptable greenhouse gas risks. In both these fracking scenarios, the NGP was duplicated.<sup>26</sup>

The blanket statement that the potential implications of the production of gas do not fall within the AEMC's statutory decision-making framework ignores the security, safety and reliability of supply, fundamental tenets of the National Gas Objective.

## **8. AEMC's statutory decision-making framework includes safety, reliability and security of supply**

The statutory decision making framework is relatively simple. AEMC must consider the National Gas Objective which is:

*to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, safety, reliability and security of supply of natural gas*

---

<sup>26</sup> Final report pp 229, 239, 356, 357,

It is beyond our understanding how climate change does not invoke considerations in the National Gas Objective. Climate change is a long term issue. The Derogation lasts for 15 years. The NGP operating life is 30 years. Climate change is not going away. The IPCC states the world must decrease emissions by 50% within 12 years to have a chance of limiting climate change to 1.5C. The proponent company agrees that the reliability and security of supply of natural gas may be negatively impacted by the physical impacts of climate change. We cannot understand how AEMC does not.

The AEMC's ability to succumb to industry submissions on complexity of the regime under the Derogation whilst it throws out any consideration of climate change impacts is curious.

Suffice to say that, the Draft Determination dismisses climate change impacts in a manner that reflects gross oversight on behalf of AEMC. The AEMC's approach in the Draft Rule Determination is inconsistent with other regulatory bodies, for example the *Australian Prudential Regulatory Authority*, that understand climate change risks fit neatly into existing statutory decision-making frameworks and industry guidance.

AEMC is seemingly unmoved, unconcerned, or ignorant to the debate around climate change and Australia's energy systems. The position is untenable.

**9. AEMC contradicts the financial filings of disclosures by A\$11 billion company to the Singapore Stock Exchange bound to disclose material risks.**

Submissions by the rule change request proponents refer to Singapore Stock Exchange publications by Jemena's parent company, SGPS (Australia) Assets Pty Ltd. In particular a statement on 4 September 2015:

*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.*

There is no doubt that climate change is expected to have an impact on the security of supply of energy to Australian consumers.

AEMC's statement that climate change risks and associated issues "do not fall within the AEMC's statutory decision-making framework" defies comprehension and common sense.

**10. AEMC misunderstands statements about NGP gas from fracking.**

The Draft Determination states in relation to the NGP's initial 90 TJ capacity:

*Houston Kemp considered that "the demand for the remaining capacity is subject to considerable uncertainty". It was highlighted that the tariffs reflected in the access*

*principles were “based on assumptions that NGP would become fully contracted” and that a failure to achieve full contracting of the NGP capacity puts at risk cost recovery for Jemena.*

*In addition to the excess capacity currently on the NGP, Houston Kemp highlighted that the NGP currently faces material demand risks as usage of the NGP is linked to the development of the Northern Territory onshore shale gas reserves. Changes in government policy towards hydraulic fracking (which is required to bring shale gas to market) will therefore impact on the use of the NGP.*

The issue, as highlighted above, is demand for capacity *beyond* the 90TJ NGP, which, if any derogation should apply, it should apply only to that capacity. Further, the AEMC should have regard to the actual cost of the NGP with regard to tariffs and should thoroughly investigate the final costing.

With respect to the size of the pipe, Jemena provided the following information to Australian Government for assessment under the EPBC Act ([here](#) at p14)

*Jemena notes that the NGP has been sized to match the Northern Territory’s stated current surplus gas production, which does not include any gas sourced from unconventional onshore gas reservoirs. The current surplus, without any unconventional gas, is sufficient to fill the NGP as currently designed and Northern Territory demand for 21 years.*

Jemena has a statutory obligation not to provide false information under the EPBC Act.

## **11. AEMC misunderstands the nature of its power with respect to the PDA**

AEMC states (DD p38):

*As the NGP access principles are a part of the project development agreement, the NGR cannot override any of its provisions.*

This, we submit, is a fundamental misunderstanding of the law. It appears the AEMC is refusing to apply the NGRs to Jemena because of the existence of a contract. The free and unfettered exercise of the AEMC’s statutory discretion, including making determinations to change the NGRs and have them apply to the NGP, is preserved no matter what the content of the contract: *Ansett Transport Industries (Operations) Pty. Ltd. v. The Commonwealth (1977) 139 CLR 54* per Mason J at 77 at paragraph [31].

The AEMC appears to stultify its statutory discretion because of a contract that the public has not seen and does not know what it contains when there is no legal reason to. We are concerned by the AEMC’s self-defeating, potentially illegal response.

## **12. AEMC statements on Commission hearings**

The rule change proponents have relied on the AEMC’s statement that it had until 4 April 2019 to written request a hearing into this matter with the Commission. In accordance with

such a statement we now make that request and confirm the AEMC's invitation for a hearing on 7 May 2019.

David Barnden  
Principal Lawyer