

12 June 2019

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Dear Commissioners

Northern Gas Pipeline – Derogation from Part 23

This submission is made by Equity Generation Lawyers on behalf of the Institute for Energy Economics and Financial Analysis (**IEEFA**), one of the rule change proponents.

The Commissioners are unable to reject the Proponents' rule change request. To do so will be a failure of the Australian Energy Markets Commission's (**AEMC**) statutory functions and reserve powers.

The AEMC, in making its final determination cannot, in good faith, rely on, separately or in combination:

- (a) the Draft Determination;
- (b) the various submissions by Jemena, the Northern Territory government and others in support of retaining the derogation.

The Draft Determination is untenable for the reasons set out in earlier submissions. Importantly, it appears to be a mere desktop review of material provided to the Commission. There is no evidence of AEMC investigations, analyses, inquiries, correspondence or basic knowledge sharing with government departments such as the Australian Tax Office (**ATO**) or the Australian Competition and Consumer Commission (**ACCC**).

Pursuant to s 69(2) of the *National Gas (South Australia) Act 2008* the functions and powers of the AEMC give the AEMC:

power to do all things necessary or convenient to be done for or in connection with the performance of its functions.

AEMC must exercise its functions, including rule making, with regard to the National Gas Objective. That objective is in turn is founded upon 'the long term interests of consumers'.

The failure by the Commission to pro-actively consider and investigate the issues on behalf of consumers is almost absolute. AEMC appears to have no data at all from the Northern Territory (**NT**) or Jemena in relation to costs and forecasts of the Northern Gas Pipeline (**NGP**) which would enable it to opine on the consumer over-charge, despite its powers to do all things necessary and convenient.

The Proponents have used their best efforts, based on public information and legal analysis, to estimate an overcharge to consumers based on the Derogation. That over-charge was estimated to be \$2.6 billion for the term of the Derogation. The estimate is staggering. In light of its magnitude, it is astonishing that the Commission has not obtained information from the relevant parties and attempted to calculate its own figures.

In fact, the Project Development Agreement (**PDA**) that underpins the Derogation remains hidden from public view, the actual costs incurred building the pipeline are secret, as are the expected returns for Jemena based upon the Access Principles tariffs.

The Commission's refusal to deal with climate change in a manner that contradicts the disclosures of an \$11 billion company as outlined in previous submissions is reprehensible. I annex a report by the Centre for Policy Development *Public Authority Directors' Duties and Climate Change* published in January 2019. I urge you to consider it as it applies to the Commission.

In addition to the physical risks posed by climate change to the safety, security and reliability of supply of gas, at bare minimum, the AEMC should be aware of medium-term carbon pricing projections that we understand will cause demand destruction for gas use by consumers in Australia and render the NGP a stranded asset. The Commission is, as far as the Draft Determination suggests, completely unaware of this standard commercial consideration for long-term energy infrastructure projects. The implications for consumers are profound.

Instead, the AEMC relies on hearsay information, and considers that information without justification or rigour. Of the many examples include Jemena's rates of return on the pipeline. The AEMC appears not to have asked Jemena what its expected rate of return was, and whether that rate was based on the Firm Tariff, or whether it included the fee for no service nitrogen removal requirement, or even increases in CPI, and even whether such increases are compounded and annualised. Instead the AEMC meekly refers to Jemena's and the Northern Territory's submissions, which in turn refer to what the ACCC thinks about the rate of return, based on information provided to it by Jemena.

What was that information? Did it relate to actual or foreseen costs? Did it incorporate the interest rate costs on the \$800 million convertible notes subject to the ATO audit? Did it include the nitrogen removal charge, which is listed separately in the Access Principles but applies regardless of whether the service is applied? Did the calculations relate to full capacity of the pipe, or some of it?

The lack of rigour or interrogation by the AEMC given its powers and functions bears serious reflection by the Commissioners.

The Draft Determination relies heavily on the existence of a competitive tender process. Again, the AEMC looks only to comments by the pipeline proponents and those in support of maintaining the derogation.

To reach the conclusion about the competitive nature of the tender process in the Draft Determination the AEMC relies upon Jemena's comments that were, for an unknown reason, communicated to the Commission by its economist, Houston Kemp, and not by Jemena.

AEMC also relies on a public statement from the NT Minister about the process. However, the Northern Territory is not a consumer of gas. It is a supplier. It bowed to Jemena's pressure for the pipeline not to be a covered pipeline. It has a vested interest in the pipeline going ahead to minimise losses from a wholly unreasonable and uncommercial 25 year take or pay contract struck with Italian company ENI in 2006 to enable development the offshore Blacktip gas field that sends profits offshore at the expense of the NT taxpayer.

The AEMC has failed in its functions to adequately consider its consumer mandate in 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.

If indeed the AEMC had consulted with the ACCC, an action well within its statutory power, and on some views, required to be performed by the Commission in order to discharge its functions to the requisite standard of care, the ACCC would no doubt have directed the AEMC to the ACCC's [Gas inquiry 2017-2020](#) interim report that concluded, based on the tariffs in the Access Principles, that (at p90):

For gas from the NT to be commercially attractive to gas users in the East Coast Gas Market, particularly those in the Southern States, the delivered price of NT gas must be competitive with the delivered gas prices being offered by other suppliers. The two main drivers behind the delivered price of NT gas into the East Coast Gas Market are the costs of production and transportation...

In order to transport gas from the NT to Ballera, the following pipelines will need to be used ... [including] Jemena's Northern Gas Pipeline (NGP) which connects to the AGP at Tennant Creek in the NT, and runs to Mount Isa in Queensland (\$1.45/GJ firm forward haulage and \$0.74/GJ for firm nitrogen removal service – total of \$2.19/GJ)...

At these prices, the NT gas is unlikely to be competitive in the East Coast Gas Market, particularly the Southern States. Suppliers will likely need to negotiate better prices for transportation to make delivered price of NT gas attractive to gas users in the East Coast Gas Market.

The effect of the Derogation is that it locks in the tariffs in the Access Principles. In effect, it prevents customers from negotiating better prices for transportation, as can occur under the Part 23 framework, with oversight by the Australian Energy Regulator (**AER**), independent arbitrators, and without the pipeline owner having the final decision.

It follows then that the ACCC, which has a consumer mandate, effectively states that the Derogation prevents *affordable* gas reaching the only potential consumers under the Access Principles, and that those tariffs account for a significant part of transport costs for only a small proportion of the transport distance. On that basis alone the National Gas Rules should be amended to remove the Derogation.

The failure to consult the ACCC, a consumer advocate, is exemplary of the AEMC's passivity. Instead, the Commission states in the Draft Determination (p8):

The Commission also notes that there were no submissions from users or potential users of the NGP that indicate any concern with the level of the published maximum tariffs for the pipeline.

The reason for this is obvious. The only major, long-term consumer of NGP gas is Incitec Pivot. For its 10 year contract it is getting a cut-price deal via a contract with the Northern Territory (not Jemena) that hedges the Northern Territory's losses from a 2006 contract. Incitec Pivot saves \$55 million a year.

Does the AEMC know whether or not NT is subject to, or passing on, the Access Principles tariff to Incitec Pivot? Even if the NT might appear to be doing so, is the NT taking a haircut on other costs or inputs simply so the NGP gets used?

There is a distinct lack of rigour around analysis on the affordability of gas from the NGP in the Draft Determination. Consider Incitec Pivot's one year arrangement for emergency access to 32TJ/day via the NGP for its Gibson Island plant. The gas is as an urgent short-term measure to keep the Gibson Island plant from shutting down. As [reported](#) in June 2018:

The new, temporary, gas supply lifeline from NT won't be cheap for Incitec.

The company expects to pay an additional \$50m a year on its current supply contract rates which expire in the next six months.

As of May 2019 Incitec Pivot was still trying to secure 'affordable' gas for Gibson Island to 2022, after which the company expects to come up with another gas supply option ([here](#) p22). There is no other reading of this information except that gas supplied via the NGP pursuant to the one year contract is unaffordable.

Current or potential *consumers* will not respond to the AEMC's inquiry when, under the Access Principles, Jemena has the final say on access disputes and the regulator is frozen out from pricing oversight. The NGP is a monopoly service. In what world would a potential customer upset a supplier that holds all the power? It is inconceivable the AEMC is not alive to this dynamic.

Jemena says "the demand for remaining capacity is subject to considerable uncertainty." It follows that potential consumers probably do not know who they are. It is the AEMC's job to look out for those consumers. Indeed, the economics associated with the Derogation, and the fact the the AEMC's Draft Determination recommends it remain, means such consumers may never exist.

Instead of interrogating these issues, the AEMC relies on submissions by the pipeline *owner*, the foundation *supplier*, pipeline *advocates* and other potential *suppliers* to the pipeline. It has failed to look after the Australian *consumer*.

It is worthwhile mentioning again the cognitive dissonance exhibited by the AEMC in its statements that Part 23 must apply to new pipelines whilst completely ignoring the 210 TJ/day tariffs for a brand new pipe under the Access Principles. It completely defies logic.

AEMC has failed, after repeated requests, to provide the Project Development Agreement (**PDA**) to the public despite the fact that the PDA informs how the access principles work and therefore, how the Derogation functions.

AEMC must under s 77 *National Gas (South Australia) Act 2008* make documents *applied, adopted or incorporated* by a rule available, unredacted, to the public. The Derogation refers to the Access Principles, which in turn, relies upon the PDA for no less to define whether the principles are valid: see [clause 2](#) of the Access Principles. AEMC has failed not only to make the

PDA available on its website but also failed to make the relevant NT and Queensland licences for the NGP, directly referred to in the rule, available to the public.

Finally, the Commission's failure to adequately interrogate the Northern Territory Department of Treasury and Finance (**DTF**) and Jemena at the 7 May 2019 hearing, which we understand was the first AEMC hearing in 10 years, is concerning. AEMC did not ask Jemena or the NT DTF about any of the issues set out in prior submissions, including the reasons why the NT, after consultation with Jemena, drafted the derogation such that it would apply to 210 TJ/day of a new pipe, when it knew it was only going to build a 90TJ/day pipe.

The flawed process and Draft Determination cannot provide a basis for the Proponents' rule change request to be rejected. The rule change request must be accepted and implemented.

Yours sincerely

A handwritten signature in black ink, appearing to read 'DBO', followed by a horizontal line extending to the right.

David Barnden
Principal Lawyer