

DECISION ON COVERAGE

I, Eric Ripper

Deputy Premier; Treasurer; Minister for Energy

Western Australia's Relevant Minister in relation to Coverage decisions under the National Third Party Access Code for Natural Gas Pipeline Systems

Make the following decision in relation to the

Application to the National Competition Council requesting that coverage of Goldfields Gas Pipeline System (PL24) be revoked

As required in section 1.34 of the National Third Party Access Code for Natural Gas Pipeline Systems ("the Code"), and after consideration of the material described below, I make the following decision:

that Coverage of the Goldfields Gas Pipeline System (GGP), subject to the license WA:PL24 issued under the *Petroleum Pipelines Act 1969*, is not revoked.

This decision has effect from 16 July 2004.

Description of the Covered Pipeline the Subject of This Decision

My decision relates to the GGP described in Schedule 2 of the Code and which is covered by pipeline licence WA:PL24 issued under the *Petroleum Pipelines Act 1969*.

Revocation Process and Background

An application under section 1.25 of the Code to revoke coverage of the GGP was received by the National Competition Council (NCC) on 27 March 2003. The applicant is Goldfields Gas Transmission Pty Ltd (ABN: 87 004 273 241). I shall refer to it as GGT.

The NCC's Final Recommendation, its draft recommendation and public submissions in response to the public consultation processes can be downloaded from the NCC website at www.ncc.gov.au (via the "energy" and "gas" tabs).

On 17 December 2003 I invited all parties who had made a submission to the NCC to provide any further material for me to consider in making my decision. I received submissions from GGT, WMC Resources (WMC), and the Australian Pipeline Industry Association Inc (APIA) during January 2004.

The GGT submission included a covering letter, a Part A attachment and a Part B attachment. The Part A attachment discussed proposals to enhance the regulatory regime under the *Goldfields Gas Pipeline Agreement Act 1994* (the "Agreement Act") and some aspects of the covering letter referred to those matters. The Agreement Act has not been amended and as such I cannot pre-empt amendment or revision of the Act. I therefore did not consider the Part A attachment in reaching my decision. I did consider the GGT's Part B attachment.

On 5 March 2004 I provided the NCC with a copy of GGT's Part B attachment, and the submissions from WMC and the APIA. I asked the NCC to consider these submissions and advise whether the material affected the conclusions reached in its Final Recommendation.

The NCC provided advice to me on the 12 May 2004 reaffirming its Final Recommendation.

On 11 May 2004 I received a further submission from GGT in relation to the implications of the "Report of the Review Committee into Western Power Corporation's management of the power crisis of 16 to 18 February 2004" (the "Cronin Report"). I have considered GGT's submission and the implications of this report in reaching my decision. I did not seek the NCC's advice as it relates to the capacity of the electricity transmission line from Muja to Kalgoorlie, which is a matter the Office of Energy and Western Power have expert knowledge.

Provisions of the Code

I make the decision based on sections 1.34 and 1.36 of the Code, which provide that:

1.34 *Within 21 days after a revocation recommendation is received by the Relevant Minister, the Relevant Minister must make a decision:*

- (a) that Coverage of the Covered Pipeline is revoked; or*
- (b) that Coverage of the Covered Pipeline is not revoked.*

If the Relevant Minister decides that Coverage of the Covered Pipeline is revoked, the Relevant Minister may do so to a greater or lesser extent than requested by the applicant if, having regard to the part of the Pipeline that is necessary to provide Services that Prospective Users may seek, the Relevant Minister considers it appropriate.

1.36 *The Relevant Minister must decide not to revoke Coverage of the Covered Pipeline, to any extent, if the Relevant Minister is satisfied of all of the matters set out in paragraphs (a) to (d) of section 1.9, but the Relevant Minister must decide to revoke Coverage of the Covered Pipeline (either to the extent described, or to a greater or lesser extent than that described, in the application) if not satisfied of one or more of those matters.*

In reaching this decision, I have considered the following criteria for Coverage contained in section 1.9 of the Code:

- (a) that access (or increased access) to Services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline;*
- (b) that it would be uneconomic for anyone to develop another Pipeline to provide the Services provided by means of the Pipeline;*
- (c) that access (or increased access) to the Services provided by means of the Pipeline can be provided without undue risk to human health or safety; and*
- (d) that access (or increased access) to the Services provided by means of the Pipeline would not be contrary to the public interest.*

REASONS FOR THE DECISION

Sections 1.25 to 1.33 of the Code provide for the NCC to undertake an assessment of the merits of the application. It provides for the NCC to seek public submissions, issue a draft recommendation, consider the submissions from the pipeline owner and any other party, and issue a final recommendation.

I am satisfied, in relation to the GGP, of all the matters set out in paragraphs (a), (b), (c) and (d) of Section 1.9 of the Code. I have therefore made a decision not to revoke coverage after consideration of the NCC's Final Recommendation and the various submissions and advice provided to me.

Criterion (a) that access (or increased access) to Services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline.

I am satisfied that the NCC has undertaken an adequate examination of the issues in criterion (a), in addition I have examined the issue of the expansion of capacity of the pipeline in greater detail. I am satisfied that it has consulted widely and considered the views of the GGT and other interested parties. I am satisfied the NCC has considered the implications from the decisions of the Commonwealth Minister in respect to the revocation of part of the Moomba to Sydney pipeline, and the Australian Competition Tribunal in respect to the Moomba to Adelaide pipeline and Gasnet. I am satisfied that the NCC's conclusions are supported by the information available to it. I am not aware of any State specific issues that have not been considered by the NCC.

I accept the NCC's conclusion that the dependent markets of relevance for criterion (a) assessment are:

- a downstream gas sales market at locations within reasonable proximity to the GGP;
- a downstream retail gas sales market in the Kalgoorlie-Boulder area; and
- a downstream electricity sales market in the area in the vicinity of Kalgoorlie connected to the South West Interconnected System (SWIS).

I note the NCC's finding that the upstream market for natural gas production and sales in the Varanus Island Hub is also a dependent market of relevance for criteria (a). I also note that criterion (a) only requires satisfaction as to at least one market, so I have limited my consideration of criterion (a) to the downstream markets outlined above.

I accept the NCC's conclusion that there are no alternative sources of gas in the downstream markets for gas serviced by the GGP. I accept the NCC's conclusion that any competitive alternative available in the downstream markets that could potentially constrain GGT's ability to exercise market power in those markets would, of necessity, have to be a different product to gas.

While I acknowledge the arguments against the use of the SSNIP¹ test outlined by GGT and KPMG in its submission to me dated 30 January 2004, I am satisfied with the NCC's advice of 12 May 2004 and that the NCC used other factors in determining whether alternative energy supplies are close substitutes.

¹ SSNIP means a small but significant and non-transitory increase in price.

I therefore have accepted the NCC's conclusions that:

- electricity transmitted by the Muja-Kalgoorlie transmission line is not a close substitute for, or economic alternative to, the supply of gas for mining ventures located in the area in the vicinity of Kalgoorlie connected to the SWIS. I have considered the findings contained in the Cronin Report and have accepted the advice from the Office of Energy that these relate to the supply from Kalgoorlie to support the SWIS in times of restricted supply and when the economics of transporting the power is not a major factor in those circumstances. The proposed upgrade of the transmission line from the Parkeston Power Station to the Boulder Substation will not alter the capacity and the line losses in transporting power from Muja to Kalgoorlie. Accordingly, there will be no impact on competition in the Kalgoorlie electricity market in normal circumstance from this upgrade;
- LPG is not a close substitute to reticulated gas for Alinta's residential and commercial customers in the Kalgoorlie-Boulder area; and
- diesel is not a close substitute to natural gas for remote mining ventures.

I therefore accept the NCC's conclusion that GGT does not face effective competition in any of the downstream markets.

I concur with the NCC's conclusion that due to the absence of effective competition to GGT in the dependent markets, the commercial incentives facing GGT will not constrain pricing to the competitive level (that which is based on long run economic costs).

I accept the NCC's conclusion that GGT would have the ability and incentive to engage in monopoly pricing in the downstream gas sales market in the absence of access regulation and monopoly pricing would be likely to adversely affect competition in the dependent markets.

I note the use by the NCC of the Western Australian Regulator's draft decision as a benchmark in assessing whether GGT is engaging in monopoly pricing. I considered the arguments made by GGT in its submission of 30 January 2004 in relation to the appropriateness of this benchmark. I also note the NCC's further advice to me on page 4 of attachment 2 of the letter dated 12 May 2004 that:

"it acknowledged that the Regulator may revise his assessed Reference Tariffs in light of the Epic decision. However, the practical effect of the Epic decision on the Regulator's approach to the determination of a final Reference Tariff is unlikely to result in such a departure from the Draft Decision that the 30% difference between the Reference Tariff and GGT's "A4" discounted posted tariff would disappear."

I further accept that the comparison between the draft decision and GGT's posted tariffs was only one element used by the NCC to determine whether GGT has the ability to engage in monopoly pricing and that the overall conclusion was based on an analysis of the structure of dependent markets and the commercial incentives faced by GGT.

I therefore accept the NCC's conclusion that GGT may currently be charging monopoly tariffs in the downstream gas sales market, with a resultant adverse effect on competition in the relevant dependent markets.

I accept the NCC's conclusion there are no structural characteristics in the downstream markets that would prevent coverage from promoting competition in those markets in the future.

I accept the NCC's conclusion that any constraint imposed by the Agreement Act is not sufficient to effectively constrain GGT's ability and incentive to exercise market power.

While I concur with the NCC's analysis and conclusions outlined above, I have given further consideration to the issue of pipeline capacity and have relied upon advice from the Office of Energy in reaching my decision.

I accept the GGT's argument that the GGP is substantially full and most existing users have long-term contracts that do not allow lower tariffs from a regulated outcome under the Code to apply. Therefore the ability of coverage to promote competition would be facilitated by the expansion of the pipeline.

I have considered GGT's stated intention to not invest to increase capacity under the Code if it does not receive a sufficient commercial return.

The refusal to expand is a powerful argument given the economic importance of increased energy consumption to a state such as Western Australia. I also appreciate there may be an incentive for a pipeline owner to state in advance that it will not expand under the Code.

However the Code will provide tariffs and other terms and conditions that have been assessed by the independent economic regulator as the efficient costs of providing services commensurate with the risks involved. On this basis it can be expected that this would allow GGT to expand in a manner where the incremental benefits exceed the costs. I accept the GGT may therefore have an incentive to expand.

Finally, the Code itself recognises that a full or near full pipeline confers considerable economic power upon the owner and provides the ability for users or potential users to fund the full cost of expansion themselves, even if the pipeline owner refuses.

On balance I conclude that:

- it is reasonable to expect that the level of tariffs set under the Code will offer a commercial incentive for GGT to invest in the expansion of the pipeline; and
- even if GGT does refuse to expand, the Code provides an enforceable ability for users or potential users to fund expansion to meet their own needs.

I therefore accept the NCC's recommendation concerning criteria (a) and find that:

- GGT has the ability and incentive to exercise market power by engaging in monopoly pricing;
- the Agreement Act is not an alternative regulatory framework to the Code;
- the Agreement Act currently does not impose an effective constraint on GGT's ability and incentive to engage in monopoly pricing; and
- the Code is likely to be an effective constraint on GGT's ability and incentive to engage in monopoly pricing and that, accordingly, continued coverage is likely to promote competition in:

- the downstream gas sales market at locations within reasonable proximity to the GGP;
- the downstream retail gas sales market in the Kalgoorlie-Boulder area; and
- the downstream electricity sales market in the area in the vicinity of Kalgoorlie connected to the SWIS.

My decision is that criterion (a) is met.

Criterion (b) that it would be uneconomic for anyone to develop another Pipeline to provide the Services provided by means of the Pipeline.

I am satisfied that the NCC has undertaken an adequate examination of the issues in criterion (b), that it has consulted widely, considered the views of the GGT and other interested parties and that the conclusions are supported by the information available to the NCC. I am satisfied in its advice of 12 May 2004 that the NCC has considered the implications from the Commonwealth Minister's decision in respect to the revocation of part of the Moomba to Sydney pipeline. I am not aware of any State specific issues that have not been considered by the NCC.

I accept the NCC's conclusion that the service provided by the GGP is a gas transportation service from the DBNGP Compressor Station One at Yarraloola to Kalgoorlie and all points in between, via the East Pilbara and North East Goldfields regions of Western Australia. I accept the NCC's advice that the GGP is not currently or in the foreseeable future, part of an integrated gas pipeline network.

I accept the NCC's conclusion that growth in demand for the services of the GGP is unlikely to exceed the amount of capacity that can be added through additional compression (a further 60 per cent of current capacity). The cost of installing this additional compression is likely to be significantly cheaper than the cost of building a new pipeline. Were demand marginally to exceed the capacity of the GGP at maximum compression (as is suggested by the most optimistic forecast available to the NCC), it is likely that looping would still be cheaper than building a new pipeline to service that demand.

I accept the NCC's comment that it is possible for a lateral pipeline to be constructed from the DBNGP to (at least partly) to compete with the GGP. I accept the NCC's conclusion that such a development would not be economic at present as it would be less costly to expand the capacity of the GGP through compression.

I accept the NCC's conclusion in respect to criterion (b) that for the likely range of reasonably foreseeable demand for the transportation of gas on the GGP, it is more efficient for the GGP to provide those services rather than for those services to be provided by a duplicate pipeline.

I therefore accept the NCC's recommendation and my decision is that it would be uneconomic for anyone to develop another pipeline to provide the services provided by the GGP.

My decision is that criterion (b) is met.

Criterion (c) that access (or increased access) to the services provided by means of the pipeline can be provided without undue risk to human health or safety.

I am satisfied that the NCC has undertaken an adequate examination of the issues in criterion (c), that it has consulted widely, considered the views of the GGT and other interested parties and that the conclusions are supported by the information available to the NCC. I am not aware of any State specific issues that have not been considered by the NCC.

I accept the NCC's conclusion that access (or increased access) can be safely provided to the services of the GGP.

I therefore accept the NCC's recommendation and my conclusion is that access (or increased access) to the services provided by means of the pipeline can be provided without undue risk to human health or safety.

My decision is that criterion (c) is met.

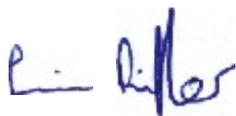
Criterion (d) that access (or increased access) to the services provided by means of the pipeline would not be contrary to the public interest.

I am satisfied that the NCC has undertaken an adequate examination of the issues in criterion (d), that it has consulted widely and considered the views of the GGT and other interested parties. I am satisfied that the NCC's conclusions are supported by the information available to it. I am not aware of any relevant State specific issues that have not been considered by the NCC.

I note the GGT's argument that it may not expand the pipeline if covered by the Code, which would reduce economic and regional development in the future. In reaching my decision in criteria (a) I concluded that the capacity of the GGP could be expanded under the Code by either GGT or third party users making that investment. I have therefore concluded there should be no adverse impact to economic and regional development from coverage by the Code and that continued coverage would promote competition.

I accept the NCC's conclusion that the benefits associated with continued coverage of the GGP under the Code outweigh the costs.

My decision is that criterion (d) is met.



**ERIC RIPPER MLA
DEPUTY PREMIER; TREASURER;
MINISTER FOR ENERGY**

2 July 2004