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Application by Allgas Energy Pty Ltd for Light Regulation of the Allgas Gas Distribution Network

Final decision

28 April 2015

Contents

Abbreviations and defined terms	1
1 Final Decision	2
2 Background	3
The Application	3
Allgas and the Allgas Network	3
Council process	7
Submissions on the application	7
3 Deciding on light regulation	9
Effectiveness of regulation alternatives.....	10
Applicant’s contentions	10
Council’s consideration	11
Costs of form of regulation alternatives	13
Applicant’s contentions	13
Council’s consideration	14
National gas objective.....	14
Form of regulation factors	15
Other matters	17
Council’s conclusions	17

Abbreviations and defined terms

ABS	Australian Bureau of Statistics
AEMC	Australian Energy Markets Commission (www.aemc.gov.au)
AER	Australian Energy Regulator (www.aer.gov.au)
AGL	AGL Energy Ltd
AGN	Australian Gas Networks Limited (Formerly Envestra Ltd)
Alinta	Alinta Energy
Allgas	Allgas Energy Pty Ltd – the applicant
Allgas Network	Allgas Gas Distribution Network – the pipeline subject to this application
APA	APA Group
BREE	Bureau of Resources and Energy Economics
Council / NCC	National Competition Council (www.ncc.gov.au)
NGL	National Gas Law – the Schedule to the <i>National Gas (South Australia) Act 2008</i>
NGO	National Gas Objective – as set out in s 23 of the NGL
NGR	National Gas Rules – Rules made under s 294 of the NGL including amendments by the AEMC
Origin	Origin Energy Ltd
QGDN	(AGN's) Queensland Gas Distribution Network
RB Pipeline	Roma to Brisbane gas pipeline

1 Final Decision

- 1.1 This final decision is issued in accordance with the National Gas Law (**NGL**) and National Gas Rules (**NGR**) in response to an application by Allgas Energy Pty Ltd (**Allgas**) for light regulation of the covered Allgas Gas Distribution Network (**Allgas Network**) in south east Queensland. The Council's reasons for decision are set out in this report.
- 1.2 **Pursuant to s114 of the NGL and in accordance with the NGR, the Council determines that the services provided by the Allgas Network be light regulation services.**
- 1.3 This determination comes into force 60 business days from the date it is made (s115 of the NGL).

**National Competition Council
28 April 2015**

2 Background

The Application

- 2.1 On 27 January 2015 Allgas applied for light regulation of the Allgas Network pursuant to s 112 of the NGL. Allgas submitted its application in accordance with the NGR and containing the information required by Rule 34. The application is available on the Council's website (www.ncc.gov.au).
- 2.2 The application contains some information which Allgas considers to be commercially confidential. The Council accepts that this information is commercially sensitive and should be protected under s 90 of the NGL.

Allgas and the Allgas Network

- 2.3 Allgas owns the Allgas Network. Allgas is owned by GDI (EII) Pty Ltd, which in turn is owned by Marubeni Corporation (40%), SAS Trustee Corporation (40%) and the APA Group (**APA**) (20%). APA also operates the Allgas Network on behalf of Allgas under an outsourcing agreement.
- 2.4 As well as its ownership interest and operation of the Allgas Network, APA has a 100% interest in the Roma to Brisbane transmission Pipeline (**RB Pipeline**) which is used to supply gas to the Allgas Network and to the Queensland Gas Distribution Network (**QGDN**). While the QGDN is owned by Australian Gas Networks Ltd (**AGN**) (formerly Envestra Ltd), APA provides asset management services to AGN for the QGDN. According to AGN and Allgas, APA does *not* have any influence over the operational, contracting or pricing decisions of the QGDN (application, Table 2.2).
- 2.5 The Allgas Network distributes gas transmitted via the RB Pipeline to customers in south east Queensland and northern NSW as follows:
 - Brisbane region: consisting of over 1,800 km of distribution mains used to supply customers located south of the Brisbane River between: Dinmore and Springfield in the west and Cleveland in the east; and Marsden and Loganlea in the south and Lytton in the north.
 - South Coast Region: consisting of over 700 km of distribution mains used to supply customers located between Albert River in the north and Banora Point in northern NSW, including customers located in the Gold Coast and Tweed Heads.
 - Western region: consisting of over 570 km of distribution mains used to supply customers located in Toowoomba and Oakey.¹
- 2.6 The application contains maps illustrating the scope of the Allgas Network, which are reproduced in Appendix A.

¹ The Allgas Network also distributes gas to customers in Moura, but this part of the network does not form part of the covered pipeline and so is not referred to in the application.

- 2.7 Unlike most of the previous light regulation applications the Council has considered², Allgas's application involves distribution pipelines rather than transmission pipelines. The NGL and NGR do not distinguish between transmission and distribution pipelines for the purposes of light regulation. Consequently, the same criteria apply to both.
- 2.8 The Council notes that Allgas's application involves similar circumstances and considerations to those in relation to the application for light regulation of the QGDN (also a distribution network) which the Council considered in late 2014.
- 2.9 According to Allgas, in 2013-14 the Allgas Network distributed approximately 9.4 PJ of gas to 92,805 end-users. The three shippers who currently use the Allgas Network are AGL (**AGL**), Origin Energy (**Origin**) and Alinta Energy (**Alinta**). Allgas observes that the limited number of retailers operating in the Allgas Network is due to several factors including the small size of the Queensland retail gas market, the fixed costs associated with gas supply and transportation, and the development of LNG facilities in Queensland.
- 2.10 The Allgas Network is currently used to distribute gas to residential customers, to small commercial and industrial customers, and to several large commercial and industrial customers. Table 1 provides a breakdown of the number of customers the Allgas Network supplied in 2013-14 and the volume of gas it delivered to each segment.
- 2.11 Allgas states that the total volume of gas it delivered in 2013-14 was 6% lower than was expected when the last access arrangement process was conducted (9.4 PJ vs 10.1 PJ), while customer numbers were just 1% lower than expected.³ According to Allgas, this reflects a fundamental trend in the Allgas Network, which is that customers are consuming less gas, on average, than they have in the past. Over the last five years this trend has contributed to a 12% reduction in the volume of gas delivered by the Allgas Network (10.6 PJ in 2009-10 to 9.4 PJ in 2013-14).
- 2.12 Allgas is concerned by the scale of this reduction given the expectation that demand will continue to fall in response to some of the structural changes underway in the broader market. Allgas says it therefore has a strong incentive to encourage greater utilisation of the Allgas Network through its price and non-price offerings.

² A light regulation determination was made in relation to the covered part of the Moomba to Sydney Pipeline on 18 November 2008, for the Central West Pipeline on 19 January 2010 and for the Kalgoorlie to Kambalda Pipeline on 29 June 2010. All of these are transmission pipelines. On 5 November 2014 the Council made a light regulation determination in respect of the QGDN, a distribution pipeline.

³ AER, Final decision: APT Allgas Access arrangement proposal for the Qld gas network, June 2011, p. 67.

Table 1: Allgas Network demand for distribution services 2013-14

Customer Type		Number of End-Use Customers	Volume (PJ) Delivered	% Revenue
Residential customers ⁴		88,400 (95%)	1.09 (12%)	45%
Small commercial and industrial customers (<10 TJ)		4,299 (5%)	1.98 (21%)	26%
Large commercial and industrial customers ('Demand Customers') (>10 TJ)	Reference tariff (regulated)	101 (<0.1%)	4.80 (51%).	29%
	Negotiated tariff	5 (<0.1%)	1.56 (16%)	
Total		92,805	9.44	

- 2.13 The application (Figure 3.1) also shows that annual average gas consumption for new residential customers in Queensland (9 GJ pa) is significantly lower than in Victoria (50 GJ pa), the ACT (45 GJ pa), and South Australia and NSW (20 GJ pa). This is attributable to the milder winters in Queensland and the smaller number of appliances in the average Queensland household that are connected to gas.
- 2.14 Table 2 shows overall consumption of natural gas by the residential sector and per residential dwelling in each of the relevant jurisdictions in 2012-13, as reported by the Bureau of Resources and Energy Economics (BREE). Although calculated in a different manner and for a slightly different period, these statistics support Allgas's observations about the lower residential consumption of gas in Queensland compared to other jurisdictions.

Table 2: Gas consumption by residential sector 2012-13

Jurisdiction	Total gas consumption by residential sector (PJ) ^(a)	Average annual gas consumption per residential dwelling (GJ) ^(b)
Victoria	103.8	44.7
NSW	25.7	9.0
SA	11.8	16.1
Queensland	3.0	1.6

Source: (a) BREE 2014, Table 1F. (b) Calculated, residential dwelling numbers ABS data, December 2012

⁴ Residential customers includes both single dwelling customers and large multi-story residential buildings, with each multi-unit residential building served by a single meter and counted as a single customer. This impacts the calculation of average consumption per 'Residential' customer.

- 2.15 Allgas refers to Australian Bureau of Statistics (**ABS**) estimates that in 2011 around 19% of households in Brisbane were connected to gas. This compares to penetration rates of around 90% in Melbourne, 85% in Perth, 75% in the ACT and Adelaide, and 50% in Sydney.⁵ Allgas advises that the volume of gas supplied to residential customers has fallen slightly in the last year, and that growth in residential customer numbers has also fallen slightly in the past three years from 2,783 in 2010-11 to 2,367 in 2014-14.
- 2.16 Allgas attributes the declining trend in residential gas consumption in Queensland to a number of policy and structural changes which have occurred over the last five years, including:
- the development of more energy efficient appliances;
 - changes to State and Federal government policies, which have resulted in a shift away from supporting the use of natural gas;
 - the increasing penetration of solar panels in Queensland, which in 2013 had reportedly reached 22%;⁶
 - the development of the LNG export industry in Queensland, which has resulted in a significant increase in the price payable for wholesale gas under medium to long-term contracts from its historic levels.
- 2.17 These observations reflect the conclusions of the Australian Energy Markets Commission (**AEMC**) regarding the state of competition in gas sales in South East Queensland. In its recent Retail Competition Review the AEMC concluded:
- Rivalry appears lower in the retail gas market [in South East Queensland] than the electricity market, with just two gas retailers competing. Switching rates are lower than for electricity, with fewer gas options to choose from. Additional retailers have not entered the gas market primarily due to the small size of the market, with low penetration of gas pipelines to households and small businesses and a low level of average gas demand. Competition is not expected to increase over the next few years for this reason, coupled with issues securing competitively priced gas in the wholesale market. (AEMC 2014, page v)
- 2.18 Regarding its small commercial and industrial customers, Allgas says that the average volume of gas consumed by this customer segment has been steadily declining (from 522 GJ in 2010-11 to 462 GJ in 2013-14). Allgas attributes this decline in consumption to the same factors attributed to the decline in residential consumption.
- 2.19 Allgas says that it is difficult to compare average consumption levels for its large commercial and industrial customers over time given the small number of these customers. However, Allgas notes that the total volume of gas transported to this customer segment has fallen over the last five years from 7.8 PJ to 6.4 PJ per annum.

⁵ ABS, 4602.0.55.001 Environmental Issues: Energy Use and Conservation, March 2011, Table 6.

⁶ <http://reneweconomy.com.au/2013/people-power-rooftop-solar-pv-reaches-3gw-in-australia-99543>

2.20 Allgas attributes this decline to several factors, including:

- the structural changes occurring in the upstream gas market, which have given rise to a significant increase in wholesale gas prices;
- lower than expected growth of the Queensland economy in the last few years, which has affected a number of industries including the building and construction industries. In turn, this has affected some of Allgas's larger customers that produce building materials;
- large customers putting greater emphasis on energy efficiency, which has resulted in less gas being required for the same amount of production; and
- a range of other commercial reasons, including some large industrial customers either consolidating their production sites or moving their operations offshore.

Council process

2.21 In determining this matter the Council followed the standard consultative procedure set out in Rule 8 of the NGR. The Council published a notice of the application on its website and in *The Australian* newspaper on 27 January 2015, and provided 15 business days for written submissions. The closing date for submissions was 23 February 2015.

2.22 The Council received one timely submission on the application from Origin. After the deadline for submissions, the Council received a submission from AGL. The Council accepted the late submission on that occasion without delaying consideration of the application or apparent unfairness to any party. Allgas responded to Origin's submission in a letter to the Council dated 13 March 2015. The submissions and Allgas's letter were published on the Council's website.

2.23 The Council consulted with the AER as provided for by Rule 35(1)(b). The AER had no particular comments on the merits of Allgas's application.

2.24 The Council released its draft decision in favour of light regulation on 20 March 2015. It provided a period of 15 business days for submissions on the draft decision, with a closing date of 14 April 2015. The Council did not receive any submissions.

2.25 In making its final decision, the Council has taken into account the application, Origin's and AGL's submissions on the application, Allgas's response to Origin's submission, and its own research and analysis.

Submissions on the application

2.26 In its submission, Origin noted that in the application for light regulation of the QGDN, the applicant detailed its price expectations for the first few years of light regulation and its intention to apply the most recent terms and conditions approved by the Australian Energy Regulator (**AER**) as the basis for negotiations with users. Origin noted that Allgas's application did not provide similar assurances. Origin referred to

Allgas's claim that there would be anticipated cost savings to end users under light regulation, and said that it expected there would be an initial price reduction if the Allgas Network is subject to light regulation. Origin sought similar assurances to those provided in relation to the QGDN.

- 2.27 Allgas responded to Origin's submission in a letter to the Council dated 13 March 2015 (published on the Council's website). In the letter, Allgas accepted that consumers should benefit from the reduced regulatory burden under light regulation and stated its intention to pass through the lower regulatory costs to customers once light regulation takes effect. Allgas noted that there are many factors influencing network pricing, which makes it difficult to predict future price outcomes with certainty. However, Allgas said that it does not expect network tariffs will increase by more than the consumer price index in the first five years of light regulation. Further, Allgas said that it does not propose to change the terms and conditions relative to those currently approved by the AER in the current access arrangement.
- 2.28 In its submission, AGL did not oppose light regulation of the Allgas Network but expressed concerns in relation to the market power associated with gas distribution networks, the ability to substitute other fuel sources for gas in the short to medium term, and the likelihood and cost of disputes in a light regulation environment.

3 Deciding on light regulation

3.1 Section 122 of the NGL sets out the principles governing the making of light regulation determinations:

(1) In deciding whether to make a light regulation determination ... the NCC must consider—

(a) the likely effectiveness of the forms of regulation provided for under this Law and the Rules to regulate the provision of the pipeline services (the subject of the application) to promote access to pipeline services; and

(b) the effect of the forms of regulation provided for under this Law and the Rules on—

(i) the likely costs that may be incurred by an efficient service provider; and

(ii) the likely costs that may be incurred by efficient users and efficient prospective users; and

(iii) the likely costs of end users.

(2) In doing so, the NCC—

(a) must have regard to the national gas objective; and

(b) must have regard to the form of regulation factors; and

(c) may have regard to any other matters it considers relevant.

3.2 In essence, the determination of whether or not to apply light regulation to a network turns on a comparison of the effectiveness and costs of the two forms of regulation provided for in the NGL—light regulation and full regulation.

3.3 The key difference between the two forms of regulation relates to the requirement to submit an access arrangement to the AER for approval. An access arrangement provides for up-front price regulation as it must specify a reference tariff which the AER has approved. There is no requirement for service providers of light regulation pipelines to submit an access arrangement, although they may voluntarily submit a limited access arrangement to the AER.⁷

3.4 Light regulation does not free a service provider to increase tariffs or change terms and conditions at will. The negotiate/arbitrate process that operates under light regulation substitutes ex post regulation for ex ante regulation. It does not remove regulatory oversight of access prices and other terms and conditions.

3.5 Access disputes in relation to light regulation pipelines are dealt with through an arbitration process, whereby the AER can determine access prices and other terms if negotiations between the parties prove unsuccessful and they notify the AER of an access dispute. This process is similar to the negotiate/arbitrate process for services declared under Part IIIA of the *Competition and Consumer Act (Cth)* (CCA).

⁷ The requirements for a limited access arrangement are set out in Rule 45 of the NGR.

- 3.6 Although the Council has now made light regulation determinations for four pipelines (including the recent QGDN determination), to date no access disputes concerning a light regulation pipeline have been notified to the AER.
- 3.7 Irrespective of the form of regulation, service providers must disclose a range of information concerning covered pipelines, although the scope of the information disclosure required for light regulation pipelines is less than under full regulation. Many of the other obligations on covered pipelines under the NGL apply to both full and light regulation pipelines. Appendix B of this report contains a table comparing the main elements of full and light regulation.

Effectiveness of regulation alternatives

- 3.8 The critical issues in an application for light regulation are: whether light regulation is likely to be as effective as full regulation in constraining the use of market power and promoting access to pipeline services; and the relative costs of the two approaches. If light regulation is similarly effective as full regulation but involves lower costs, light regulation is the more appropriate form of regulation.

Applicant's contentions

- 3.9 Allgas submits that "light regulation of the services provided by the Allgas Network will be no less effective than full regulation in terms of promoting access" for four main reasons (Application, p3).
- 3.10 First, Allgas considers that it does not possess a significant degree of market power. It says that the barriers to supplying certain parts of the Allgas Network are low due to the proximity of the RB Pipeline.
- 3.11 Second, Allgas argues that any market power it does have will be more than offset by the commercial imperative it has to encourage greater utilisation of the network, given the 12% reduction in demand over the last five years and the following market characteristics:
- gas is a fuel of choice for residential and small customers in Queensland, as evidenced by the low penetration rates and the low and declining average rates of gas consumption;
 - gas does not have a clear competitive advantage over other fuels in Queensland, such as electricity and LPG. The competitive position of gas is likely to decline given the projected increase in wholesale gas prices brought about by LNG developments and government policies that favour other energy forms;
 - the structural changes underway in the broader market that are expected to prompt further reductions in the demand for gas.
- 3.12 Further, Allgas says that its market power will be constrained by:

- the ability of its demand customers in the Brisbane and Western regions could connect directly to the RB Pipeline, either by relocating their operations or by building a connecting pipeline. Allgas submits that this risk of bypass is reflected in the way it has structured its demand services tariff (Table 3.7 in the application), and that negotiated discounted tariffs apply to large customers where the bypass risk is greatest (application, p24).
- the substitution threat posed by other energy sources, such as electricity and LPG (particularly for smaller and commercial customers); and
- the countervailing power possessed by:
 - the retailers operating in the Allgas Network (AGL, Origin and Alinta), that are sophisticated players with extensive experience in negotiating access to gas pipelines;
 - large industrial and commercial customers (demand customers) in the Brisbane and Western regions that can credibly threaten to bypass the Allgas Network by connecting directly to the RB Pipeline, or using an alternative energy source; and
 - smaller gas customers, particularly when their appliances are reaching the end of their lives.

3.13 Allgas says that these constraints will apply irrespective of the form of regulation and will impose discipline on Allgas when negotiating price and non-price terms and conditions of access.

3.14 Third, Allgas says that the information required by users to enable them to negotiate effectively will be available under light regulation, and that further cost information can be found in public information and industry sources. Allgas expects retailers to draw on their experience in developing and/or operating distribution networks and their knowledge of the prices and conditions applying in other networks.

3.15 Fourth, Allgas notes that the dispute resolution mechanism and other safeguards set out in the NGL will provide users with an appropriate level of protection if negotiations break down. Further, section 118 of the NGL allows a person to apply to the NCC to have a light regulation determination revoked.

Council's consideration

3.16 In the Council's view, the Allgas Network enjoys, and will continue to enjoy, market power in distribution of gas in the relevant parts of Queensland. It is highly unlikely that any party would seek to develop an alternative means of distributing gas to the area served by the Allgas Network. The Council considers that significant barriers to entry for the provision of pipeline services are likely to remain for the foreseeable future.

3.17 There is some potential for competition between the Allgas Network and the neighbouring QGDN and from the possibility of some large gas users connecting

directly to transmission pipelines. The Council notes, however, that the most relevant transmission pipeline, the RB Pipeline, is owned and operated by APA which is also a significant shareholder in Allgas and operates the Allgas Network. In the Council's view, competition from the QGDN and the threat of direct connection to the RB Pipeline should be regarded as significantly limited.

- 3.18 The Council considers that the most significant constraint on market power associated with the Allgas Network is the ability for end users to substitute other forms of energy, namely electricity and LPG. This factor offsets some of the market power which the Allgas Network would otherwise enjoy. Importantly, the level of constraint imposed is unlikely to be reduced if light regulation applies to the Allgas Network.
- 3.19 The Council notes that under light regulation Allgas is still required to disclose a range of information regarding the Allgas Network, including details of its negotiations with access seekers. Though these requirements are generally less than under full regulation, Allgas must still publish its terms and conditions of access, including the prices on offer, and capacity information on its website. The Council considers this information will assist prospective users in determining the reasonableness of prices offered and, if necessary, to trigger an access dispute. While some of this information may become less relevant over time, dramatic changes in relation to the operation of the Allgas Network seem unlikely.
- 3.20 The Council agrees with Origin that it is desirable for Allgas to provide users with information concerning its intentions regarding prices and terms and conditions for supply under light regulation, as this may help ensure that light regulation is effective. The Council notes Allgas's letter of 13 March 2015 in this regard.
- 3.21 The Council accepts that an aggrieved party may face significant costs if an access dispute requires arbitration and that it is less likely smaller incremental changes to terms and conditions of access will give rise to arbitration proceedings. However, the Council considers the position of gas in the Queensland energy market is such that Allgas is unlikely to push matters to that point given the likelihood that it would lose customers for its distribution services and face further reductions in throughput.
- 3.22 If an access dispute is notified to the AER, the Council considers that the AER is in no less a position to determine an appropriate outcome than if the pipeline were subject to full regulation. The NGL also provides some scope for consumer advocacy groups and other interested parties who do not have a direct relationship with Allgas to participate in arbitration of access disputes.⁸
- 3.23 For the above reasons, the Council's view is that light regulation is likely to be similarly effective as full regulation in protecting users and other parties that are dependent on access to the Allgas Network.

⁸ The Council notes, however, that unlike some other parts of the NGL, the provisions dealing with arbitration of access disputes have not been updated to reflect an enhanced role for consumer advocates and representatives in regulatory processes.

Costs of form of regulation alternatives

Applicant's contentions

- 3.24 Allgas submits that the main costs it will incur if the Allgas Network continues to be subject to full regulation are:
- the costs of preparing the full access arrangement, associated information, and participating in the review process;
 - where relevant, the costs of participating in a merits review process; and
 - the ongoing costs of complying with the access arrangement and NGL provisions and responding to rule changes that affect distribution networks.
- 3.25 The next access arrangement for the Allgas Network is due to be submitted to the AER in July 2015 to take effect from 1 July 2016.
- 3.26 Allgas estimates that it would spend around \$2.65 million on an access arrangement and merits review process if the Allgas Network remains subject to full regulation, with an additional \$20,000 per annum for ongoing compliance costs, making a total of \$2.75 million over a five year period. This estimate is based on:
- the costs Allgas incurred during the last access arrangement review in 2010-11, which progressed to a merits review (\$0.9 million);
 - the costs incurred in the APA GasNet access arrangement and merits review process in 2013 (\$2.2 million);
 - changes to the regulatory process, which require service providers to consult with customers prior to submitting their access arrangement to the AER; and
 - revisions to the rate of return provisions in the NGR
- 3.27 Allgas suggests that the costs to the AER of reviewing an access arrangement, participating in a merits review process and monitoring compliance would be in the vicinity of \$1.75 million. Allgas bases this estimate on AEMC's finding that the direct costs to a regulator of a revenue or pricing assessment process ranges from \$0.5 million to \$3.0 million.⁹ Further, Allgas suggests \$0.1 million as a conservative estimate of the costs that stakeholders would incur in the access arrangement review process. Allgas therefore estimates that full regulation would cost approximately \$4.6 million over a five year period (Allgas Energy: \$2.75 million, AER: \$1.75 million and users and other stakeholders: \$0.1 million).
- 3.28 If the Allgas Network is subject to light regulation, Allgas estimates the total cost of negotiating access over a five year period would be around \$0.4 million. If Allgas decides to submit a limited access arrangement to the AER, it suggests that the cost of light regulation could increase by \$0.1 million and by a further \$0.3 million if there is an access dispute. Allgas says that the costs of light regulation are likely to fall

⁹ AEMC 2009, page 10.

within a range of \$0.4 - \$0.8 million over a five year period (Allgas Energy: \$0.2-\$0.3 million, AER: \$0-\$0.2 million and users and prospective users: \$0.2-\$0.3 million).

- 3.29 Accordingly, Allgas submits that the cost of full regulation is likely to be \$3.8 - \$4.2 million higher than the cost of light regulation over a five year period, with a likely cost to end users of \$2.25 - \$2.45 million.

Council's consideration

- 3.30 The Council does not consider the outcome of this application is particularly sensitive to the level of costs associated with full versus light regulation. In the Council's view, Allgas's estimates are broadly reasonable and there is no need for the additional precision which might result from more extensive analysis.
- 3.31 In the Council's view, a shift to light regulation has the potential to result in significant cost savings for Allgas. Some savings for other parties such as the AER, retailers and end users are also likely, although these may be small. This remains the situation even if the costs of developing and gaining approval for an access arrangement reduce over time as parties become more efficient in meeting the relevant regulatory requirements.
- 3.32 In this regard, the Council considers that the development of a robust consultation process between providers of pipeline services and users of those services (including end-users) is a positive development which may reduce regulatory disputes rather than become an additional regulatory impost. The Council also notes that AEMC's commentary in 2009 on the costs of regulation, which Allgas cites (application, p50), is now somewhat out of date. The Council expects the costs of full regulation will reduce as all parties gain experience and become more efficient in the regulatory process. Nevertheless, the costs of full regulation of the Allgas Network will remain significant.
- 3.33 Whether the potential cost savings from a shift to light regulation will eventuate is critically dependant on the number and nature of any access disputes. A small number of arbitrations may be less costly than full regulation. However, if the outcome of light regulation is a series of access disputes and arbitrations, then the potential for cost savings will quickly disappear and the regulatory determination of tariffs and terms under full regulation is likely to be more cost effective. The Council considers that the number of access disputes in relation to the Allgas Network under light regulation is likely to be low.
- 3.34 For the above reasons, the Council accepts that the costs of light regulation of the Allgas Network are likely to be substantially less than those under full regulation.

National gas objective

- 3.35 In making a light regulation determination the Council must have regard to the National Gas Objective (**NGO**) contained in s 23 of the NGL. That section provides:

The objective of this Law [the NGL] is to promote efficient investment in, and efficient operation and use of, natural gas for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.

- 3.36 Drawing on its conclusions regarding the effectiveness of light regulation and the likely costs of each form of regulation, Allgas submits that light regulation will generate a greater degree of productive, allocative and dynamic efficiency in the provision of natural gas services than will occur if it continues to be subject to full regulation. Allgas expects that these efficiencies will, over time, flow through to end-users in the form of lower network charges and higher quality services. According to Allgas, given that light regulation will be as effective as full regulation in promoting access, light regulation is more consistent with the NGO than the continued application of full regulation (application, p58).
- 3.37 In the Council’s view, where light regulation is similarly effective to full regulation but involves a lower cost, it is the most suitable form of regulation and a light regulation determination is consistent with the NGO. The Council agrees that the shift to light regulation would provide cost savings and would not disadvantage users or end users, particularly with recourse to binding arbitration providing a restraint on the exercise of market power.

Form of regulation factors

- 3.38 Section 16 of the NGL sets out the form of regulation factors the Council must consider in deciding whether to apply light regulation to the Allgas Network. The Council’s *Gas Guide* contains a summary of the Council’s views on how each form of regulation factor might, in principle, affect its determination of a light regulation application.
- 3.39 Table 3 provides a summary of Allgas’s submissions in relation to the form of regulation factors.

Table 3: Application of form of regulation factors to the Allgas Network

Form of regulation factor (s 16)	Applicant’s views
(a) the presence and extent of any barriers to entry in a market for pipeline services	<p>A prospective entrant who wants to compete directly with the Allgas Network to provide transportation services to <i>all</i> the geographic areas the network serves is likely to face the following relatively high barriers to entry:</p> <ul style="list-style-type: none"> • the high capital costs associated with constructing a distribution network, most of which are sunk; and • the relatively low penetration of gas and average demand in the regions serviced by the Allgas Network. <p>A prospective entrant who wants to compete to provide transportation services to parts of the network could develop a pipeline connecting the RB Pipeline to demand customers in the Brisbane or</p>

Form of regulation factor (s 16)	Applicant's views
	<p>Western regions of the Allgas Network. Alternatively a group of demand customers could fund the development of such a pipeline. The barriers to entry in this case would be far lower because:</p> <ul style="list-style-type: none"> • the cost of building a dedicated pipeline and delivery point on the RB Pipeline to serve a group of customers in a particular part of the network is much lower than the cost of replicating the whole network; and • the new pipeline would be used to supply customers that consume greater volumes of gas, which would enable the prospective entrant to achieve economies of scale.
<p>(b) presence and extent of any network externalities (that is, interdependencies) between a natural gas service provided by a service provider and any other natural gas service provided by the service provider</p>	<p>The network externalities associated with operating a distribution network do <i>not</i> confer any market power on Allgas Energy due to the low rates of gas penetration and consumption in the Allgas Network and the competitiveness of electricity and LPG.</p> <p>It could <i>potentially</i> be viewed that APA's 100% interest in the RB Pipeline confers market power on Allgas. However:</p> <ul style="list-style-type: none"> • APA only has a minority interest in Allgas (20%), which gives it <i>no</i> incentive to behave in a manner that will put the volumes transported on the RB Pipeline at risk; and. • The RB Pipeline is subject to regulation, which means that even if APA had an incentive to use its interest in the RBP to confer market power on the Allgas Network (which it doesn't), it will be prevented from doing so by sections 133 and 136 of the NGL. <p>APA's interest in the RB Pipeline should not therefore be considered an additional source of market power for Allgas.</p>
<p>(c) presence and extent of any network externalities (that is, interdependencies) between a natural gas services provided by a service provider and any other service provided by the service provider in any other market</p>	<p>There are no network externalities between the services provided by the Allgas Network and other services provided by Allgas or its owners.</p>
<p>(d) the extent to which any market power possessed by a service provider is, or is likely to be, mitigated by any countervailing market power possessed by a user or prospective user (countervailing market power)</p>	<p>The three retailers who supply gas in the Allgas Network are sophisticated players in the energy market and have countervailing power. Demand customers can credibly threaten to bypass the Allgas Network by connecting directly to the RB Pipeline. Small customers can substitute gas appliances with electricity or LPG.</p>
<p>(e) the presence and extent of any substitute, and the elasticity of demand, in a market for a pipeline service in which a service provider provides that service</p>	<p>Demand customers in the Brisbane and Western regions of the Allgas Network could connect directly to the RB Pipeline. The prices that Allgas charges large customers in close proximity to the RB Pipeline already reflects the risk posed by this bypass option. Competition from this source is a credible threat to Allgas and imposes an important constraint on its</p>

Form of regulation factor (s 16)	Applicant's views
	behaviour.
(f) the presence and extent of any substitute for, and the elasticity of demand in a market for, electricity or gas (as the case may be)	<p>Natural gas is a fuel of choice, meaning it is subject to more competition from substitutes (electricity and LPG), particularly given that there is little need for space heating in Qld.</p> <p>The substitutability of gas and LPG is particularly strong for commercial customers that exhibit a seasonal demand for gas.</p>
(g) the extent to which there is information available to a prospective user or user, and whether that information is adequate, to enable the prospective user or user to negotiate on an informed basis with a service provider for the provision of a pipeline service to them by the service provider	The information disclosure requirements under the NGL and the NGR, plus other publicly available information, will enable users and prospective users to negotiate effectively if the Allgas Network is subject to light regulation.

3.40 The Council generally accepts Allgas's views regarding the form of regulation factors. However, the Council considers that the potential for demand customers to bypass the Allgas Network is likely to be more limited than Allgas suggests regarding form of regulation factors (d) and (e). The Council accepts that new customers may be able to choose a location which allows them to select how their gas is supplied.

3.41 In the Council's view, the form of regulation factors and the circumstances of the Allgas Network support the conclusion that light regulation is likely to be similarly effective as full regulation.

Other matters

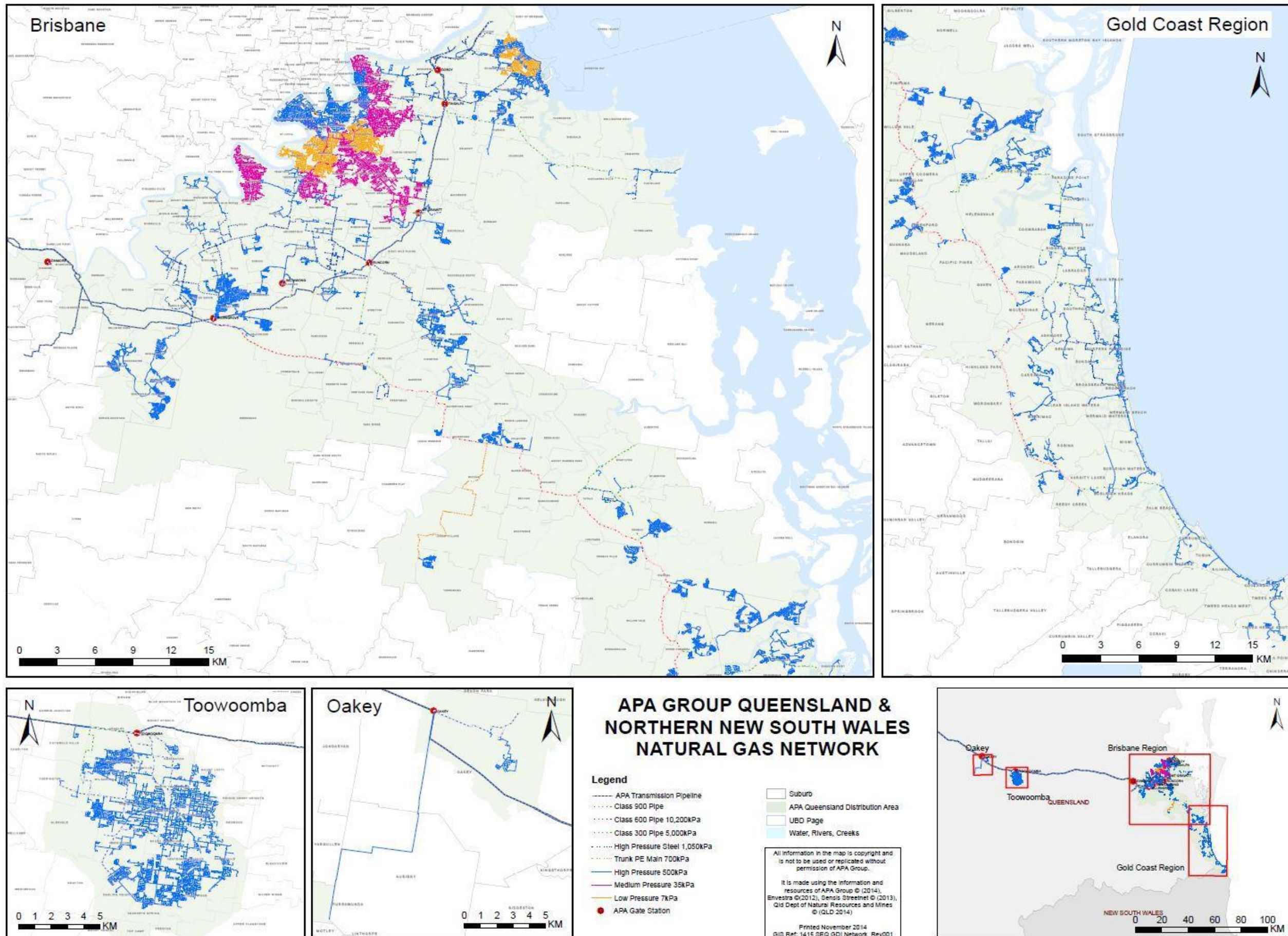
3.42 The Council does not consider that there are any further matters arising from this application that are not encompassed within the other elements of its consideration or require consideration under s 122(2)(c).

Council's conclusions

3.43 In summary, the Council concludes that it should make a light regulation determination in respect of the Allgas Network because:

- light regulation is likely to be similarly as effective as full regulation of the Allgas Network. Users and other interested parties may notify an access dispute if necessary, and in such an event the AER is no less able to address relevant issues than it would be in a full regulation context;
- light regulation is likely to involve significant cost savings, primarily for Allgas but also for other parties;
- light regulation of the Allgas Network is consistent with promoting the NGO; and
- consideration of the form of regulation factors supports these conclusions.

Appendix A – Maps of the Allgas Network



Appendix B - Key features of light vs full regulation

Full (access arrangement) regulation	Light regulation (additions or differences from full regulation)
<p>Service provider subject to general duties:</p> <ul style="list-style-type: none"> • Must be a specified legal entity (principally a corporation - s 131). • Must not engage in conduct to prevent or hinder access (s 133). • Obligated to disclose gas supply information in certain circumstances (r 138). 	No difference.
<p>Subject to 'ring-fencing' requirements</p> <ul style="list-style-type: none"> • Must not carry on a related business (s 139). • Must keep marketing staff separate from associate's related businesses (s 140). • Must keep consolidated and separate accounts (s 141). • Must comply with any AER regulatory information instrument about information reporting (s 48). • Must keep sensitive information confidential (r 137). • Any additional requirements ring-fencing imposed by the AER under s 143. 	No difference.
<p>Contracts with associates must not be entered into, varied or given effect to if they substantially lessen competition in a market for natural gas services or breach competitive parity rule unless approved by the AER under the rules (ss 147 and 148 and r 32). Entering into or varying an associate contract must be notified to the AER (r 33).</p>	No difference.
<p>Subject to rules relating to facilitating requests for access and information disclosure:</p> <ul style="list-style-type: none"> • Requirements to publish information and access arrangement (r 107). • Must provide certain information about tariffs (r 108). • Must not bundle services (r 109). • Must respond to request for access in structured manner (r 112). 	<p>Subject to same rules as for full regulation pipelines and additionally:</p> <ul style="list-style-type: none"> • Must report annually to the AER on access negotiations (r 37). • Must publish terms and conditions of access, including prices on offer, on website (r 36).

Full (access arrangement) regulation	Light regulation (additions or differences from full regulation)
<p>Requirement to submit and have in force a full access arrangement which sets out terms and conditions of access and reference tariffs for services likely to be sought by a significant part of the market (s 132). Importantly:</p> <ul style="list-style-type: none"> • Non-price conditions subject to AER approval, including capacity trading requirements, changes of receipt and delivery points, extension and expansion requirements and queuing requirements (rr 103 - 106). • Total revenue to be determined by the AER taking into account the revenue and pricing principles (s 24 and 28) and using the building blocks approach to economic regulation (r 76) which is highly dependent upon: <ul style="list-style-type: none"> • rules relating to the establishment and roll forward of a regulatory capital base; • determination of a rate of return on capital; • assessment of regulatory depreciation allowances and schedules; • estimates of corporate income tax (where post-tax model adopted); • maintenance and reporting of incentive arrangements; • determining allowances for operating expenditure; • creating a reference tariff variation mechanism based upon total revenue and appropriate cost allocation; and • complex arrangements relating to surcharges, capital contributions, speculative investment and capital redundancy (see generally Part 9 of the NGR). 	<p>No requirement to submit or have in force a full access arrangement. A limited access arrangement (governing only non-price terms and conditions) may be submitted for approval by the service provider if it chooses to do so (s 116).</p> <p>Note that only conforming capital expenditure is included in a capital base while a pipeline is on full regulation, however if a light regulation pipeline returns to full regulation actual capital expenditure in the intervening period is rolled into the capital base (r 77(3))</p>
<p>Requirement to submit detailed access arrangement information with an access arrangement and keep this information available (rr 42 - 43). This extends to detailed financial and operational information (r 72). The AER may also impose additional information requirements to allow them to assess an access arrangement as a regulatory information instrument (s 48).</p>	<p>No general requirement to submit or have approved access arrangement information. Minimal access arrangement information on capacity required if service provider chooses to submit a limited access arrangement (r 45(2)).</p>
<p>Requirements relating to compliance (usually annually)</p>	<p>No such requirements imposed.</p>

Full (access arrangement) regulation	Light regulation (additions or differences from full regulation)
with the reference tariff variation mechanism to increase reference tariffs by the control mechanism (including any pass through arrangements) (r 97).	
<p>A user or prospective user is able to notify to the dispute resolution body (the AER everywhere but Western Australia) an access dispute about any aspect of access to pipelines services provided by means of a covered pipeline (s 181) and the access determination may deal with any matter relating to the provision of a pipeline service to a user or prospective user (s 193). The dispute resolution body must take into account the national gas objective and revenue and pricing principles in resolving a dispute (s 28). Existing user rights and usage are protected (s 188) and the applicable access arrangement must be applied (s 189). Geographical extensions of a pipeline cannot be ordered (r 118(1)(b)).</p> <p>Note that pipeline services which are not likely to be sought by a significant part of the market (i.e. non-reference services) may still be subject of an access dispute even though no price is provided by the access arrangement (s 181).</p>	<p>Access dispute provisions apply, any approved limited access arrangement must be applied, but otherwise price and non-price terms and conditions determined by the dispute resolution body.</p> <p>In relation to capacity expansions, for a light regulation pipeline the access seeker needs to fund the expansion entirely (r 118(2)(a)), an extension or expansion requirement in an access arrangement governs the ability for a service provider to be required to fund the expansion of a full regulation pipeline (r 118(2)(b)).</p>
Price discrimination between users recognised in both prudent discount provisions (r 96) and pricing principles for distribution services (r 94). While service providers can offer other discounts, these would not be reflected in reference tariffs (r 96).	Prohibition on engaging in price discrimination unless that discrimination is conducive to efficient service provision (s 136).
Must comply with queuing requirements in an approved access arrangement (s 135).	Where a limited access arrangement is in force, the queuing policy must be complied with under s 135. Where no limited access arrangements are in place, issues about the priority of access could be resolved as part of an access dispute.
Other than for the queuing requirements, service providers and users are free to agree on alternative terms and conditions of access than set out in the access arrangement (s 322).	No difference.
Pre-existing contractual rights protected (ss 188 and 321).	No difference.
The extent to which an extension or expansion of a pipeline is taken to be part of the covered pipeline, and regulated by the regime, is governed by the extensions and expansion requirements in the access arrangement (s 18).	As for full regulation where a limited access arrangement applies, but otherwise all extensions and expansions are taken to be part of the covered pipeline (s 19).

Full (access arrangement) regulation	Light regulation (additions or differences from full regulation)
May apply to be uncovered if no longer satisfied coverage test (s 102).	No difference. Note also that any person can at any time apply to revoke the light regulation determination (s 118).
<p>Must, for interconnected transmission pipelines, disclose information to the Bulletin Board:</p> <ul style="list-style-type: none"> • nameplate rating (r 170). • 3-day capacity outlook (r 171). • linepack/capacity adequacy indicators (r 172). • nominated and forecast delivery nominations (r 173). • actual delivery information (r 174). 	No difference.
<i>Must, unless exempt distribution network, maintain a register of spare capacity on its website (r 111).</i>	<i>No difference.</i>

Source: NCC 2013, see Table 3 commencing on page 68

Appendix C – Materials the Council considered

C.1 Application

Allgas Energy (2015), *Application for Light Regulation Determination – Allgas Network*, 27 January 2015 (public and confidential versions)

C.2 Submissions

Origin Energy (2015), *Application for light regulation of the Allgas gas distribution network*, 23 February 2015

AGL Energy (2015) Re *Application for Light Regulation of the Allgas Gas Distribution Network*, 24 February 2015

Allgas (2015), *Application under s112 of the National Gas Law for a determination that the Services of Allgas Energy Pty Ltd be Light Regulation Services*, 13 March 2015

C.3 Other materials

AEMC (2009), *Perspectives on the building block approach - Review into the use of total factor productivity for the determination of prices and revenues*, 30 July 2009, Sydney

_____ (2014), *Retail Competition Review, Final Report*, 22 August 2014, Sydney

BREE (2014), *2014 Australian Energy Update*, July, Canberra

NCC (2013), *Gas Guide - A guide to the functions and powers of the National Competition Council under the National Gas Law*, October 2013, Melbourne

_____ (2014) *Light regulation of Envestra's Queensland Gas Distribution Network, Final determination and Statement of Reasons*, 5 November 2014, Melbourne