



NATIONAL COMPETITION COUNCIL

NCC DRAFT DECISION:

LIGHT REGULATION OF THE MOOBMA TO SYDNEY PIPELINE SYSTEM

Comments by Major Energy Users

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The views expressed in this document do not necessarily reflect the views of the Consumer Advocacy Panel or the Australian Energy Market Commission.

The content and conclusions reached in this submission are entirely the work of the MEU, and its consultant, Bob Lim & Co Pty Ltd.

I. Introduction

1. The Major Energy Users Inc (MEU) welcomes the opportunity to provide comments on the National Competition Council's (NCC) draft decision on the light handed regulation of the Moomba to Sydney Pipeline System (MSP).
2. The MEU's comments follow the structure of the NCC's draft decision.
3. The MEU notes that the Productivity Commission in its review of the gas access regime¹ makes the following observation (page 331):

“8.1 The case for light-handed regulation

The analysis in earlier chapters indicates that there can be substantial costs under the National Third Party Access Regime for Natural Gas Pipelines (the Gas Access Regime) as currently structured, that is, the current approach of prescribing reference tariffs and other matters in an access arrangement (box 8.1).

These costs arise from the intrusive cost-based price regulation applied under the Gas Access Regime. The regulation entails high compliance costs and inhibits commercial negotiations (chapters 3, 4 and 7). In chapter 7, the Commission concluded that it is possible to improve the cost-effectiveness of the current regulatory approach. Nevertheless, the costs of the current approach (access arrangements with reference tariffs) are likely to remain substantial and so might outweigh the benefits for some covered pipelines (chapter 4).”

4. The clear import of this observation is that a light regulatory regime **will reduce costs**. Thus the basic criterion for a decision to introduce light regulation is that lower costs will result.
5. Regulation is a surrogate for applying competition, and to prevent the acquisition of monopoly rents. It is a fundamental assumption of economics that competition will result in efficient outcomes, including reducing costs to consumers to the lowest sustainable level and not allow a service provider to acquire monopoly rents.
6. Thus if a regulatory change is implemented – i.e. from full regulation to light regulation - it is expected that the resulting cost reduction will flow to consumers and not retained by the service provider. In other words, if cost reductions are achieved as a result of moving to light regulation, then there is an expectation that the majority of the savings for allowing this light regulation

¹ Productivity Commission, Review of the Gas Access Regime, Inquiry Report No. 31, 11 June 2004

regime will be passed onto consumers. This is consistent with the objective of the National Gas law.

7. If savings are not passed onto to consumers, or if the change allows the service provider to retain the bulk of the savings, and adds more risk (and costs) to consumers, then the change has little (if any) justification. It will be akin to market failure.

I I. Effectiveness of Regulation Alternatives

8. The MEU notes that in the draft decision, the NCC stated it:

“...considers that the MSP will continue to have significant market power. In the Council’s view barriers to entry in relation to provision of pipeline services are likely to remain significant for the foreseeable future. While some users or potential users may have access to substitutable sources of pipeline services or for other reasons possess countervailing power in negotiations with EAPL, these situations are likely to be more limited than suggested by EAPL in its application. The EGP or other sources of pipeline services cannot replace the MSP and for many users gas transported through other pipelines is complementary to, rather than substitutable for, gas transported by the MSP”. (NCC, pg 16).

9. The NCC also states:

“While some users may be able to switch between gas sources and pipelines at the margin, substantial proportions of many users’ gas supply is dependent on access to the MSP”. (NCC, pg 16).

10. The MEU shares these views and indeed made similar points, as well as others, in its submission on the application.
11. As for the availability of information – i.e. transparency and disclosures of information that enable industrial users and/or prospective industrial users to verify that tariffs are fair and reasonable, and are economically efficient and not excessive – light regulation only requires service providers to disclose some information, but less than that required under an access arrangement. Further, over time, currently available and historical information become dated, and have diminishing utility. This same observation was made in other submissions to the NCC in response to the EAPL application.
12. The NCC expects that as a result of light regulation, EAPL will negotiate with access seekers. Having to negotiate without having access to current information (i.e. from the access seeker’s viewpoint)

is like boxing with one hand tied behind the back. Even under full regulation, accessing information to gain knowledge about the service provider's operations by the AER is difficult. Under light regulation, it will be made even more so.

13. Of course, there is recourse to arbitration by the AER in the event that users and/or prospective users believe that the prices or other terms offered in access negotiations are unreasonable. The key issue here is whether the AER has sufficient information (which is confidential and therefore not transparent to third parties and difficult to be properly verified) to undertake its role. At this stage, we only have the AER stating that it has adequate information.

14. MEU considers that the NCC could require, as a condition of its granting light regulatory status to EAPL for MSP, that in the event there is an arbitration, the AER is granted the same rights to acquire information as it has under full regulation and that EAPL must comply.

15. The current global financial crisis shows (rather belatedly) how valuable transparency and accountability are in ensuring markets perform more efficiently, and also raises significant questions about the utility of light regulation and the performance (and accountability) of regulatory institutions.

16. The MEU notes the NCC states:

"In the event of an arbitration the Council considers that the AER is in no less a position to determine an appropriate outcome than it would be if the pipeline were subject to full regulation". (NCC, pg 18).

We have less confidence than the NCC on this matter. Availability of the information required to be publicly disclosed, as prescribed in the former Gas Code and in the new Gas Rules, allows stakeholders (other than just the AER) to attest to the veracity of the information. Ineffective regulation can produce inappropriate outcomes.

17. In the MEU's view of the NCC's draft decision, the key requirements that need to be addressed, are transparency and accountability. Light regulation promises less information and transparency than that provided under an access arrangement developed under full regulation. Without the explicit requirement for adequate disclosure of information should arbitration be initiated, it will allow EAPL the potential to acquire monopoly rents. As stated in the MEU introduction, a move to light regulation should not allow the regulated business to excessively increase its profitability nor to acquire monopoly rents.

III Costs of Form of Regulation Alternatives

18. The MEU notes the NCC states:

“It is likely that the bulk of any potential savings will accrue to the service provider. Savings to other parties are less certain. The Council does not need to be satisfied that savings will be passed on to users and end-users in order to make a determination in favour of light regulation”. (NCC, pg 19)

and

“While the move to light regulation promises significant cost savings, the Council recognises that these savings would be very quickly reversed should negotiations fail. Indeed, it is possible that the cost of light regulation would be greater than the cost of full regulation should enough users seek arbitration by the AER. Nevertheless, the Council is of the view that these costs, as well as the threat of revocation of a light determination, will provide a substantial incentive for EAPL to commercially negotiate access terms and conditions for pipeline services to avoid access disputes”. (NCC, pg 19)

19. As previously pointed out by the MEU in its earlier submission, major industrial users are likely to incur additional costs in the light of a change to light regulation through the need to engage expert advice and additional internal processes. Moreover, accessing the arbitration process will also incur additional costs by users. However, the greatest potential costs would come by way of potentially inefficient outcomes arising from lesser transparency and accountability as a result of light regulation. The NCC recognises these risks:

“While light regulation may “inherently” lessen risk and uncertainty for EAPL, and may even lower its cost of capital, this is at best a partial analysis as light regulation may increase risk and uncertainty for users or other relevant parties.

20. When taken together, these observations by NCC raise some very basic and deep concerns. It is recognised that the change in regulatory management has been requested because EAPL states (as does the Productivity Commission) that this change will reduce costs. In essence, the NCC considers that it can change regulatory management:

- Without benefits accruing to consumers – this is highly questionable, as it effectively allows the regulated business to acquire monopoly rents, notwithstanding that the proposed change was primarily driven by reduced costs
- Increasing the risk and costs incurred by consumers.

21. The NCC then states that the risk to EAPL for not being reasonable in its use of the light regulatory environment could increase costs to both it **and consumers** and potential revocation of the light regime. Thus the clear conclusion of the NCC statements is that it considers its draft decision to allow light regulation for MSP could:

- Permit EAPL to acquire monopoly rents
- Increase costs to consumers in undertaking negotiations with EAPL
- Increase risks to consumers and others

22. Against this, the NCC considers the costs to EAPL in extended negotiations and/or arbitration with the potential for revocation of the light regulation will be sufficient to prevent EAPL from abusing this grant of light regulation. This may well prove to be a vain hope, and consumers are not convinced that there is the necessary incentive on retailers (the largest shippers) to act in the best interests of consumers as they probably consider that they do not gain any benefit from doing so.

IV National Gas Law Objective

23. The MEU considers that, all things being equal, it is possible that light regulation can be similarly effective to full regulation, and that it could involve a lesser cost to service providers. However, it is unlikely that the benefits will accrue to major users and or potential major users. It is questionable whether light regulation is appropriate given the clear assessment by the NCC that the MSP has significant market power and there is only an unproven AER arbitration process to provide pressure on EAPL.

24. The Objective of the Gas Law is to be interpreted in economic terms², but is clearly written so that its focus is on the long term interests of **consumers** in relation to price, quality, safety, reliability and security. It is not intended that the regulated business has a right to monopoly rents, and it does not require consumers to face higher risks and more uncertainty than they would face in a competitive market. The draft decision by the NCC does not address these concerns, and in fact, as the argument is developed by the NCC, a move to light regulation will tend to provide a position where the risks and costs of the service provider are being reduced and profitability can be increased. But at the same time the risks and costs for consumers “may” be increased as a result of the change.

² See South Australian Ministerial second reading speech

V Form of Regulation Factors

25. The MEU notes that the NCC concludes that:

“It is the Council’s view that consideration of the form of regulation factors and the circumstances of the MSP, support the view that light regulation is likely to be similarly effective as full regulation.

As discussed in paragraphs 3.13 to 3.17 the Council considers that barriers to entry in relation to provision of pipeline services are significant and the levels of countervailing power possessed by users and potential users of the MSP is for many users limited.

However the small number of large users (some of which may be able to exercise choice and countervailing power), the lack of notable network externalities and the availability of historic pipeline costs coupled with many users’ own experience in operating pipelines support the conclusion that light regulation will not leave the relevant parties worse off than full regulation”. (NCC, pg 27).

26. The MEU reiterates its concern that the countervailing power of users, even for large users, is over-rated. Further, the availability of historic pipeline costs is of diminishing utility, and the view that many users have experience in negotiating with operating pipelines is also exaggerated. Even for shippers, there are important differences between operating transmission and distribution pipelines and between transmission pipelines.

27. The MEU is also concerned at the NCC view that a move to light regulation is unlikely to leave “relevant parties worse off” than under full regulation. This observation runs counter to other observations by the NCC, where it opines that there “may” be a greater risk for consumers, in that prices could rise as a result of EAPL pricing policies and the potential for higher costs from the need to negotiate/arbitrate. That EAPL is being granted the opportunity to reduce its risk profile and perhaps increase its profitability at the expense of greater risk to consumers, is not what would be expected from a change in regulatory regime.

28. The MEU considers that the only protection that consumers have to counter this increased risk, is that the NCC must mandate the right for consumers and the AER to have sufficient access to information disclosure similar to that provided under full regulation.

VI Conclusions

29. The draft decision of the NCC offers increased profitability for EAPL and reduced risk. At the same time, it increases risk to consumers and potentially higher costs. Unless consumers have sufficient access to robust information, it is likely that they will chose to access arbitration, in which case it is essential that the AER has access to sufficient information similar to that provided under full regulation.
30. The MEU considers that the greatest threat to achieving more efficient outcomes under light regulation is that access to information is likely to be restricted, and that historic and current available information will be of diminishing utility. This lack of transparency, in the face of a pipeline service provider possessing significant market power (and with high existing barriers to entry) represents the greatest threat to achieving the national gas objective.
31. Whilst access to arbitration by the AER is provided for under light regulation, it is not clear to the MEU whether the AER has sufficient (confidential) information to fulfil its role diligently. The preference for markets to operate efficiently, as always, is to have the greatest possible transparency and accountability. The current global financial crisis should be a reminder to policy and rule makers about the advocacy of light regulation.