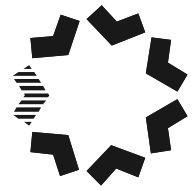


NATIONAL  
COMPETITION  
COUNCIL



## Jemena Pipeline Reclassification

National Gas Law: Application by  
Jemena Gas Networks (NSW) Limited  
for reclassification of the Northern  
Trunk and Southern Trunk pipelines



**Draft Decision and  
Statement of Reasons**

**1 June 2009**

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## 1 Draft decision

- 1.1 This draft decision is issued as part of the Council's process for determining an application by Jemena Gas Networks (NSW) Limited ('Jemena') for reclassification of the Northern Trunk (Wilton to Newcastle) and Southern Trunk (Wilton to Wollongong) pipelines as distribution pipelines for the purposes of the National Gas Law and Rules.
- 1.2 Pursuant to s129 of the National Gas Law ('NGL') and in accordance with the National Gas Rules ('NGR'), based on the information available at the time this draft decision was prepared, the Council proposes to reclassify the Northern Trunk and Southern Trunk pipelines as distribution pipelines as requested by Jemena.
- 1.3 The Council also proposes to determine that these pipelines are not cross boundary pipelines for the purposes of s129(4) of the NGL.
- 1.4 The Council's draft reasons for decision are set out in the following sections of this report.
- 1.5 The Council now seeks further submissions from interested parties in response to this draft decision and reasons. In accordance with the NGL and NGR this application is being considered under the expedited consultative procedure. **Submissions on this draft decision must be provided to the Council no later than 5pm on Tuesday, 23 June 2009.** The Council then has 20 business days to make a final decision on the application. The Council's final decision can be expected on or before 21 July 2009.
- 1.6 Submissions along with a completed submission cover sheet (available on the Council's website), should be emailed to [gas@ncc.gov.au](mailto:gas@ncc.gov.au), with a hard copy sent to John Feil, Executive Director, National Competition Council, GPO Box 250, Melbourne, VIC 3001.

National Competition Council

1 June 2009

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## 2 Background

### The application

- 2.1 Under the NGL and NGR natural gas pipelines are classified as either transmission pipelines or distribution pipelines. Section 128 of the NGL permits a service provider to apply to the Council for a pipeline to be reclassified.
- 2.2 On 22 April 2009 Jemena applied for reclassification of the Northern Trunk pipeline (Wilton to Newcastle) and the Southern Trunk pipeline (Wilton to Wollongong) as distribution pipelines. A more detailed description of the pipelines that make up the Northern Trunk and Southern Trunk pipelines is contained in Appendix A.
- 2.3 These pipelines are currently classified as transmission pipelines in Schedule 3 of the NGL. The pipelines were also classified as transmission pipelines in Schedule 1 of the National Third Party Access Code for Natural Gas Pipeline Systems ('Gas Code'), however a derogation from the Gas Code by the NSW Government provided for the pipelines to be treated as distribution pipelines for regulatory purposes. In effect Jemena seeks to maintain the regulatory treatment of the Northern Trunk and Southern Trunk pipelines as distribution pipelines.
- 2.4 Jemena's application is available on the Council's website ([www.ncc.gov.au](http://www.ncc.gov.au)).
- 2.5 Jemena states that the proposed reclassification would:
- reduce the administrative burdens associated with the implementation of the planned short term trading market for gas ('STTM') (see paragraph 3.7)
  - avoid unnecessary operational costs
  - provide equivalent treatment for the Northern Trunk and Southern Trunk pipelines with respect to other similar pipelines which are also classified as distribution pipelines, and
  - remove an unintended risk that would otherwise arise if parts of its Sydney network were subject to different forms of economic regulation.
- 2.6 Jemena also states that the Northern and Southern Trunk pipelines meet the criterion for reclassification as distribution pipelines in the NGL and that the proposed reclassification is consistent with the National Gas Objective.

### Decision criterion

- 2.7 When making a classification decision under the NGL the Council must have regard to:
- the National Gas Objective, and

- 
- the pipeline classification criterion.

2.8 The National Gas Objective is set out in s26 of the NGL, which provides:

The objective of this Law 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, quality, safety, reliability and security of supply of natural gas.

2.9 The pipeline classification criterion is in s13 of the NGL (see Box 2.1). The criterion requires that pipelines be classified according to whether their primary function is to:

- reticulate gas within a market—in which case the pipeline is a distribution pipeline, or
- convey gas to a market—in which case it is a transmission pipeline.

2.10 In determining the primary function of a pipeline regard must be had to the factors set out in s13(2)(a)-(h) of the NGL (together ‘the s13(2) factors’) (see Box 2.1). These factors do not however limit the Council’s consideration of the primary function of a pipeline and hence its classification.

**Box 2.1: Pipeline classification criterion (NGL, s13)**

- (1) The pipeline classification criterion is whether the primary function of the pipeline is to—
  - (a) reticulate gas within a market (which is the primary function of a distribution pipeline); or
  - (b) convey gas to a market (which is the primary function of a transmission pipeline).
- (2) Without limiting subsection (1), in determining the primary function of the pipeline, regard must also be had to whether the characteristics of the pipeline are those of a transmission pipeline or distribution pipeline having regard to—
  - (a) the characteristics and classification of, as the case requires, an old scheme transmission pipeline or an old scheme distribution pipeline;
  - (b) the characteristics of, as the case requires, a transmission pipeline or a distribution pipeline classified under this Law;
  - (c) the characteristics and classification of pipelines specified in the Rules (if any);
  - (d) the diameter of the pipeline;
  - (e) the pressure at which the pipeline is or will be designed to operate;
  - (f) the number of points at which gas can or will be injected into the pipeline;
  - (g) the extent of the area served or to be served by the pipeline;
  - (h) the pipeline's linear or dendritic configuration.

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- 2.11 As part of the reclassification decision, if it reclassifies a pipeline, the Council must also determine whether the pipeline is a cross boundary transmission or distribution pipeline as the case may be (refer s129(4) of the NGL).

### **The Council's process**

- 2.12 The NGL provides for the Council to make a reclassification decision within four months of receiving an application and to apply the expedited consultative procedure set out in r9 of the NGR.
- 2.13 The expedited consultative procedure requires that a draft decision be circulated for public submissions and comment, and prescribes a submission period of up to 15 business days followed by a final decision being made by the Council within 20 business days of submissions closing.
- 2.14 In addition to consulting on a draft decision it is the Council's practice to publicise applications under the NGL and to call for submissions on such applications to assist it in preparing its draft decision. In the Council's view this facilitates decision making and is consistent with meeting the overall timeframes for determination of these matters so long as a relatively short submission period is set and adhered to.
- 2.15 In practice the Council's consideration process includes two opportunities for submissions from interested parties: firstly in response to the application and then in response to a draft decision prepared by the Council setting out its preliminary views and proposed decision.
- 2.16 The Council gave notice of Jemena's application in 'The Australian' newspaper and published the application on its website on 24 April 2009. The Council invited submissions on the application. Submissions on the application closed on 18 May 2009.
- 2.17 The Council received one submission on the application within the submission period prescribed by the Council—from AGL Energy Limited ('AGL Energy'). A list of submissions received and other parties consulted at each stage of the Council's process is contained in Appendix B and a chronology of key dates and milestones is set out in Appendix C.

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## 3 Reasons for decision

### Pipeline classification

- 3.1 Under the NGL pipelines are classified according to their primary function. If the primary function of a pipeline is to transport gas to a market, then the pipeline is a transmission pipeline. If the primary function is to reticulate gas within a market, then it is a distribution pipeline.
- 3.2 Jemena submitted that the Northern and Southern trunks, as inseparable components of the interconnected gas network, reticulate gas within a market. They suggest that there are two interrelated elements that contribute to this conclusion:
- the market within which Jemena reticulates gas and
  - the physical operation of the network.
- 3.3 Jemena considered the function of these pipelines should be determined in the context of a single retail gas market covering Sydney, Newcastle, Central Coast and Wollongong. Jemena stated that it currently balances its network and the NSW retail market to end use customers across the whole of the Sydney, Central Coast, Newcastle and Wollongong networks. This, Jemena contended, establishes its network assets as a single balanced network for operational and fiscal purposes.
- 3.4 AGL Energy, the primary user of the Jemena network, supported the reclassification, and noted that the trunks have long operated as part of a single distribution/retail network. AGL Energy stated that while some of the physical characteristics of the Northern Trunk and Southern Trunk pipelines suggest they are transmission pipelines, the primary function of the pipelines is to convey gas that has already been delivered to the city gates.
- 3.5 In considering the primary function of the pipelines and hence their appropriate classification the Council must have regard to the criteria set out in s13(2) of the NGL. The Council's analysis in regard to these factors is summarised in Table 3.1.

**Table 3-1 Consideration of Section 13(2) factors**

Element	Views of applicant	Summary of Council's consideration
(a) the characteristics and classification of, as the case requires, an old scheme transmission pipeline or an old scheme distribution pipeline	The effective characteristics and classification of the pipelines under the Gas Code indicate that the pipelines should continue to be treated as distribution pipelines under the NGL. In practice, and for the purposes of its access arrangements, the trunk	Both pipelines were classified as transmission pipelines under the Gas Code. However derogations from the application of the Gas Code in NSW allowed for the pipelines to be treated as distribution pipelines and regulated by IPART rather than the ACCC. These derogations were initially intended as transitional measures but in fact

	<p>pipelines have never been treated as transmission pipelines.</p>	<p>persisted for the life of the Code.</p> <p>In these circumstances it is not clear how the Council should view the status of these pipelines under the Gas Code in relation to this factor.</p>
<p>(b) the characteristics of, as the case requires, a transmission pipeline or a distribution pipeline classified under this Law [the NGL]</p>	<p>The characteristics of the pipelines under the NGL indicate that the pipelines should continue to be treated as distribution pipelines. The rationale for treating the Northern Trunk and Southern Trunk pipelines as transmission pipelines is not clear and leaves Jemena in the unique position of having different parts of its network treated under alternate classifications.</p>	<p>Despite the contradictory classification and practical treatment of these pipelines under the Gas Code, both pipelines are classified as transmission pipelines under the NGL.</p> <p>Apparently no particular consideration was given to the status of these pipelines in the development of the NGL. The Council does not consider the initial classification of these pipelines under the NGL is indicative of how they should be classified in terms of the pipeline classification criterion.</p>
<p>(c) the characteristics and classification of pipelines specified in the [NGR] Rules (if any)</p>	<p>Not applicable.</p>	<p>The NGR do not provide for such specifications.</p>
<p>(d) the diameter of the pipeline</p>	<p>The diameter of the trunk pipelines is consistent with a distribution classification when compared to similar distribution pipelines. While the Northern Trunk and Southern Trunk pipelines are generally wider than pipelines within the ActewAGL and Multinet distribution networks, the difference can be explained by the larger market serviced by the Jemena trunks.</p>	<p>Generally transmission pipelines could usually be expected to have larger diameters than distribution pipelines.</p> <p>The Northern Trunk and Southern Trunk pipelines are, on the whole, wider than comparable distribution networks and similar in diameter to the some of the largest diameter transmission pipelines.</p>
<p>(e) the pressure at which the pipeline is or will be designed to operate</p>	<p>The pressure at which the trunk pipelines operate is consistent with a distribution classification when compared to similar distribution pipelines. The Northern Trunk and Southern Trunk pipelines operate at the same pressure as the ActewAGL primary main (6.9MPa), but at a lower pressure than the Actew AGL HFP pipeline (14.9MPa).</p>	<p>The operating pressure of a pipeline is determined by a range of factors, some of which are unrelated to whether the pipeline has a transmission or distribution function.</p>

	The pressures of the Multinet licensed pipelines range from 2.8 MPa to 10.2 MPa.	
(f) the number of points at which gas can or will be injected into the pipeline	The number of receipt points is consistent with a distribution classification when compared to similar distribution pipelines.	In relation to this application, it is not clear how the number of receipt points is indicative of a pipeline's classification.
(g) the extent of the area served or to be served by the pipeline	The extent of the area served by the Jemena trunks is consistent with a distribution classification. The Northern Trunk and Southern Trunk pipelines have a combined length of around 270 kilometres. While longer than both the ActewAGL distribution network and Multinet distribution network, the difference is explained by the larger market served by the Jemena network.	Generally transmission pipelines will be long and 'thin' and serve a relatively small number of discrete points whereas a distribution pipeline will serve a broader distinct 'region'.
(h) the pipeline's linear or dendritic configuration	The pipeline's linear or dendritic configuration is consistent with a distribution classification.	<p>A pipeline has a dendritic configuration where it exhibits a tree-branch or similar structure.</p> <p>Distribution pipelines will tend to consist of a series of branches whereas transmission pipelines are usually longer and more linear.</p> <p>The Northern Trunk and Southern Trunk pipelines are of themselves relatively linear but do have some branch like characteristics due to integration with elements of other downstream pipelines.</p> <p>Of course if viewed as a part of a broader pipeline system these pipelines are branches in a larger tree, but that is not the perspective this factor requires.<sup>1</sup></p>

<sup>1</sup> The Council notes that Jemena suggested consideration of a 'dendritic ratio' it had devised in the absence of data to calculate industry recognised measures of dendritic configuration. While in this case the Council accepts that the inclusion of industry standard measures of dendritic nature of these pipelines was not necessary, the Council is unwilling to give significant weight to Jemena's dendritic ratio measure which Jemena accepts is not in common use in the pipeline industry.

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- 3.6 Looking at the function of these pipelines and the nature of the markets they serve: historically the function performed appears closer to that of a transmission pipeline, but looking forward to the period of regulation that would be impacted by any reclassification of these pipelines—with the development of the STTM—the role is more clearly akin to that of a distribution pipeline.
- 3.7 The STTM is a market-based wholesale gas balancing mechanism to be established at defined gas hubs initially in Sydney and Adelaide. The STTM is expected to commence on 1 July 2010. It is envisaged that the market will set a single daily price for gas within each hub, which will be calculated on the basis of the bids, offers and forecasts received by market participants. The Sydney hub will encompass Sydney, Wollongong, Central Coast and Newcastle—the major centres serviced by the Northern Trunk and Southern Trunk pipelines. The Council understands that while some transitional arrangements may be put in place the aim is that all gas be traded on the STTM in such a manner that prospective buyers are agnostic as to the source of gas supply.
- 3.8 The Council notes the conclusion in the expert report prepared by Swier and submitted as part of Jemena’s application (Application, Appendix E) that “within the environment intended by the STTM the primary function of the Northern and Southern Trunk pipelines [is] to reticulate gas as part of an integrated distribution network”. Swier acknowledges that his conclusion is subject to three assumptions relating to: there being no material pipeline constraints; the design of the STTM ensuring all users can access the hub price; and there being no competition for trunk pipelines. While final decisions on the design of the STTM have yet to be taken, the Council anticipates Swier’s assumptions are likely to hold.
- 3.9 The s13(2) factors are of limited assistance in determining the appropriate classification for these pipelines. While some of the s13(2) factors suggest the current transmission pipeline classification is appropriate, other s13(2) factors support reclassification as distribution pipelines, and the conclusion to be drawn from still other of these factors is ambivalent.
- 3.10 With the emergence of the STTM in particular, the Council considers the primary function of the Northern Trunk and Southern Trunk pipelines is to reticulate gas within the geographic area served by that market and should therefore be classified as distribution pipelines.

### **National Gas Objective**

- 3.11 As well as considering the pipeline classification criterion, in deciding the classification of a pipeline the Council is required to have regard to the National Gas Objective (see paragraph 2.8).
- 3.12 As Jemena stated in its application, having parts of its Sydney network classified as distribution pipelines and other parts as transmission pipelines is likely to impose

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additional costs on it and in all likelihood other parties (see paragraph 2.5). Most notably these costs include upgrades to Jemena's custody transfer metering, estimated by Jemena to cost \$100 million. In its submission AGL Energy agreed that maintaining the current regulatory framework would require considerable outlays with no corresponding benefits.

- 3.13 In the Council's view such a mixture of classifications is likely to give rise to a range of inefficiencies, including imposition of unnecessary costs and complexity. Furthermore such a mixed treatment is inconsistent with the aims underpinning the STTM and could be expected to impede those aims or at least impose additional costs or compromises.
- 3.14 While the Council does not necessarily accept the magnitude of the costs and other consequences of mixed classification as suggested by Jemena, it accepts that such costs are likely to be real and significant.
- 3.15 In contrast, the differences in regulatory outcomes for the Northern Trunk and Southern Trunk pipelines whether these pipelines are classified as distribution or transmission pipelines do not appear to be significant.
- 3.16 Under the NGL and NGR operators of both covered transmission and distribution pipelines must submit access arrangements to the Australian Energy Regulator ('AER') for approval. Access arrangements for transmission pipelines must include a queuing policy and provide for maintenance of a capacity register. These elements are not mandatory for distribution pipeline access arrangements, however the AER may require that they be included by notifying the service provider of this requirement (see NGR r103).
- 3.17 While the NGR provide for different rules for determining the construction of reference tariffs for distribution and transmission pipelines (see NGR r94 and r95 respectively)—and the AER has yet to consider an access arrangement for a distribution pipeline—it is not apparent that regulatory outcomes will be better or worse for any party as a result of the classification given to these pipelines. No party has suggested to the Council that *a priori* Jemena will be permitted higher prices, revenues or other returns if these pipelines are reclassified.
- 3.18 The Council considers that reclassifying the Northern Trunk and Southern Trunk pipelines as distribution pipelines is consistent with the National Gas Objective.

### **Determination of cross boundary status**

- 3.19 As the Council proposes to reclassify these pipelines it is required to determine whether the pipelines are cross boundary transmission or distribution pipelines as the case may be. A cross boundary pipeline is one which is partly situated within the jurisdictional areas of one or more state or territory.

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3.20 Both the Northern Trunk and Southern Trunk pipelines are entirely within New South Wales and therefore the pipelines are not cross boundary pipelines for the purposes of s128(4) of the NGL.

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## Appendix A Pipelines subject of application

A.1 The **Northern Trunk** consists of four pipeline sections each of which are licensed under the *Pipelines Act 1967 (NSW)* between Wilton and Newcastle:

- Wilton to Horsley Park Natural Gas Pipeline (NSW:1)
- Horsley Park to Plumpton Natural Gas Pipeline (NSW:3)
- Plumpton to Killingworth Natural Gas Pipeline (NSW:7)
- Killingworth to Walsh Point Gas Pipeline (NSW:8)

A.2 The **Southern Trunk** consists of one licensed pipeline section between Wilton and Wollongong:

- Wilton to Wollongong Natural Gas Pipeline (NSW:2)

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## **Appendix B Submissions and other materials**

### **B.1 Submissions on application:**

- AGL Energy Limited

### **B.2 Parties consulted in the preparation of the draft decision:**

- Australian Government Department of Resources, Energy and Tourism
- NSW Department of Water and Energy
- Vencorp
- The Gas Market Leaders' Group
- Australian Energy Regulator

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## Appendix C Chronology

- Application received 22 April 2009
- Public notice/Call for submissions on application 24 April 2009
- Submissions on application close 18 May 2009
- Draft decision released 1 June 2009
- Submissions on draft decision close 23 June 2009
- Final decision released by 21 July 2009
- 4 month expedited consultative procedure  
timeframe ends 23 August 2009