

**Moomba to Adelaide Pipeline
System - Application to revoke
coverage under the National
Gas Code**

Issues Paper

30 March 2005

National Competition Council

Abbreviations and glossary of terms

ACCC	Australian Competition and Consumer Commission
Council	National Competition Council
Covered Pipeline	A pipeline covered under the National Gas Access Code
CPA	Competition Principles Agreement
Epic Energy	Epic Energy South Australia Pty Ltd
Gas Pipeline Access Law	Schedule 1 to the Gas Pipelines Access (South Australia) Act 1997
MAPS	Moomba to Adelaide Pipeline System as described in paragraph 1.3 of Epic Energy's application for revocation (Pipeline Licence SA:PL1).
National Gas Access Code	National Third Party Access Code for Natural Pipeline Systems
PJ	PetaJoule (ie. 10^{15} Joules)
SSNIP test	Consideration of a small but significant non-transitory increase in price of one product to see the demand and supply reactions in respect of the other product.
TJ	TerraJoule (ie. 10^{12} Joules)
TPA	Trade Practices Act 1974
Tribunal	Australian Competition Tribunal

1 Background

- 1.1 On 15 March 2005, the National Competition Council (Council) received an application from Epic Energy South Australia Pty Ltd (Epic Energy) to revoke coverage of the Moomba to Adelaide Pipeline System (MAPS) pursuant to sections 1.24 and 1.25 of the National Third Party Access Code for Natural Gas Network Systems (National Gas Access Code). The National Gas Access Code has application in South Australia pursuant to the *Gas Pipelines Access (SA) Act 1997*.
- 1.2 MAPS is made up of the main Moomba to Adelaide trunk line and laterals, and is owned by Epic Energy. MAPS is operated by Epic Energy Corporate Shared Services Pty Ltd under a service agreement with Epic Energy.
- 1.3 MAPS is currently covered under the National Gas Access Code as it is identified in Schedule A of the code (pipeline licence SA:PL1). The National Gas Access Code enables parties to apply to the Council to revoke coverage of a pipeline. If revocation is granted, the pipeline owner is not required to submit an access arrangement to the Australian Competition and Consumer Commission (ACCC) and third parties are not able to seek access under the National Gas Access Code to transport gas through those pipelines.
- 1.4 A copy of the National Gas Access Code can be found on the Code Registrar website at <http://www.coderegistrar.sa.gov.au>.
- 1.5 The National Gas Access Code requires the Council to conduct a public consultation process and issue a draft recommendation followed by further public consultation, prior to making its final recommendation to the relevant decision maker, in this case, the South Australian Minister for Energy (ss. 1.24 to 1.39). The code sets out a timetable for completion of this process. In accordance with section 7.16 to 7.18 of the code, the Council decided to extend the date on which it will release its draft recommendation to 7 June 2005 and on which it will accept public submissions on the application. Notice of the extension of time was published in the Australian Financial Review on Tuesday, 29 March 2005.

2 Revocation criteria

- 2.1 Under section 1.31 of the National Gas Access Code, the Council cannot recommend revocation of coverage unless it considers the

pipeline in question does not meet one of the criteria set out in section 1.9 of the code.

- 2.2 The Council may recommend revocation either to the extent sought, or to a greater or lesser extent than sought in the application (s 1.29).
- 2.3 The criteria in section 1.9 are:
- (a) *that access (or increased access) to services provided by means of the pipeline in question would promote competition in at least one market (whether or not in Australia), other than the market for the services provided by means of the pipeline in question;*
 - (b) *that it would be uneconomic for anyone to develop another pipeline to provide the services provided by means of the pipeline in question;*
 - (c) *that access (or increased access) to the services provided by means of the pipeline in question can be provided without undue risk to human health or safety; and*
 - (d) *that access (or increased access) to the services provided by means of the pipeline in question would not be contrary to the public interest.*

3 Submissions

- 3.1 The Council must consider whether MAPS meets the coverage criteria in section 1.9 of the National Gas Access Code. The Council is seeking submissions from interested parties to assist with its considerations. To facilitate the preparation of submissions, the Council has prepared this issues paper.
- 3.2 Parties interested in making submissions may wish to consult the Council's previous work in revocation matters and the Council's publication, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*. Copies are available at www.ncc.gov.au or by contacting the Council directly.
- 3.3 Submissions should be sent to Mr John Feil, Executive Director, National Competition Council, GPO Box 250B, Melbourne VIC 3001, **and** emailed to info@ncc.gov.au. Queries may be directed to Ms Michelle Groves on (03) 9285 7476.
- 3.4 All submissions will be treated as public documents and made available to interested parties and the public (via the Council's web

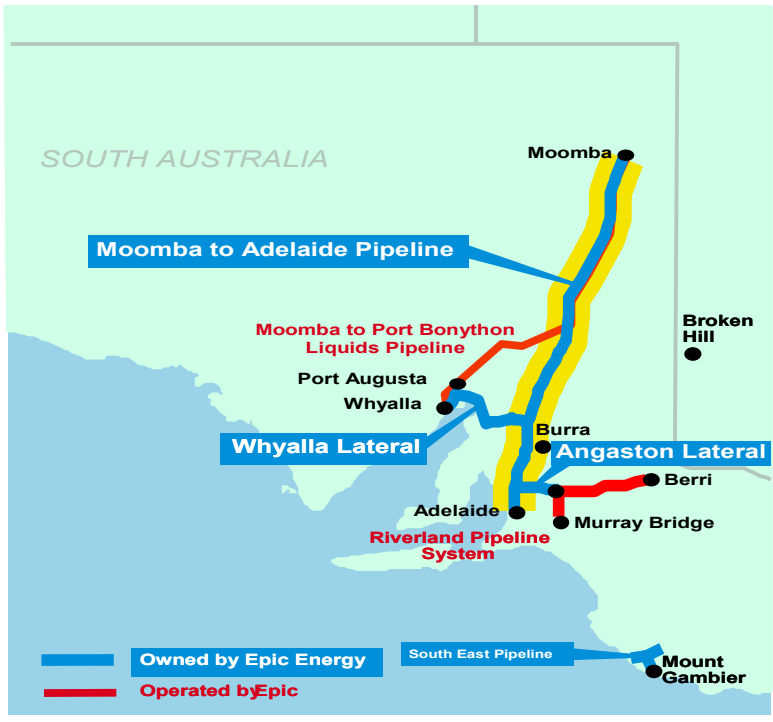
site); unless a specific and detailed claim as to the confidentiality of particular material due to commercial reasons or similar justification is made to, and accepted by, the Council. Any claim for confidentiality must be discussed with the Council prior to submission of the purportedly confidential material. Submitting parties should be aware that the Council's ability to test information that is subject to confidentiality is likely to be limited, and the Council may therefore give less weight to such material in its consideration.

- 3.5 The extended closing date for public submissions is **Tuesday, 3 May 2005**.

4 Moomba to Adelaide Pipeline System

- 4.1 The Moomba to Adelaide Pipeline System (MAPS) is a 1,185 kilometre system of pipelines which services Moomba, Adelaide and regional centres throughout South Australia. MAPS comprises of a 781 kilometre trunk line between Moomba and Adelaide, two main lateral pipelines (the Whyalla/Port Pirie lateral and the Angaston lateral) and a number of customer specific laterals.
- 4.2 Epic notes in its application that MAPS was originally constructed in 1969 by the South Australian Government and was operated by the Pipelines Authority of South Australia until 1995. Since then, its capacity has been enhanced in various stages to its current maximum capacity of 418 TJ per day. Part of this capacity expansion includes the Pelican Point Power Station uncovered expansion. The maximum capacity of the Covered Pipeline is 393 TJ per day (Epic 2005, para 2.7 and 2.23).
- 4.3 MAPS was the only transmission pipeline transporting gas to South Australia until the commissioning of the SEA Gas pipeline in January 2004. The SEA Gas pipeline links Victoria with South Australia. Epic Energy refers to MAPS “as providing a link within the integrated South East Australian energy market” (Epic 2005, para 2.21).

Diagram 1 – Moomba to Adelaide Pipeline System



5 Services provided by means of the Pipeline

5.1 The starting point in considering an application for revocation of coverage is to identify the “Services provided by means of the Pipeline”. This phrase is used in each of the section 1.9 coverage criteria.

5.2 Section 10.8 of the National Gas Access Code defines the term “Service” (for the purposes of section 1 of the code) to mean a service provided by a “Pipeline” including without limitation haulage services, the right to interconnect with the Covered Pipeline and services ancillary to the provisions of such services but does not include the production, sale or purchasing of natural gas.

5.3 The relevant definition of “Pipeline” is that contained in Schedule 1 of the *Gas Pipelines Access (South Australia) Act 1997* (Gas Pipeline Access Law) in which:

“pipeline” means a pipe, or system of pipes, or part of a pipe, or system of pipes, for transporting natural gas, and any tanks, reservoirs, machinery or equipment directly attached to the pipe, or system of pipes, but does not include-

- (a) *unless paragraph (b) applies, anything upstream of a prescribed exit flange on a pipeline conveying natural gas from a prescribed gas processing plant; or*
- (b) *if a connection point upstream of an exit flange on such a pipeline is prescribed, anything upstream of that point; or*
- (c) *a gathering system operated as part of an upstream producing operation; or*
- (d) *any tanks, reservoirs, machinery or equipment used to remove or add components to or change natural gas (other than odourisation facilities) such as a gas processing plant; or*
- (e) *anything downstream of the connection point to a consumer;*

5.4 Epic Energy refers to MAPS as comprising a number of separate pipeline systems, namely, the main Moomba to Adelaide pipeline,

and the Port Pirie/Whyalla and Angaston laterals. Under the definition of “pipeline” set out above, the relevant pipeline for the purposes of section 1.9 is the system of pipes used for transporting natural gas and any tanks, reservoirs, machinery or equipment directly attached to the pipe making up the system referred to as MAPS.

- 5.5 The principal “service” provided by a pipeline is the gas haulage service from one point to another serviced by the pipeline. This “point to point” approach to defining the relevant service was accepted by the Australian Competition Tribunal (Tribunal) in the Duke EGP decision. In that decision, the Tribunal concluded that the “service” provided by means of the Eastern Gas Pipeline was a haulage service for the transport of gas between one point on the pipeline and another. In so concluding, the Tribunal stated:

the pipeline operator sells a (haulage) service consisting of the transport of gas from point A to point B. That is what the customer buys. EGP’s standard contract describes the service to be provided as a firm forward haulage service involving the transport of natural gas in the pipeline between specified receipt points and delivery points. (para 68)

...

The question of what constitutes the services provided by the pipeline is fundamentally a mixed question of fact and the proper construction of criterion (b), rather than a matter of economic analysis. Every haulage service will of necessity be from one point to another. That is the commercial service actually provided by the pipeline operator to its customers. (para 69)

- 5.6 Applying the “point-to-point” approach, the principal service provided by MAPS is the haulage of natural gas from Moomba to Adelaide (in the case of the main line) and to the end points of the lateral lines making up MAPS, and all points in between. Other services provided by MAPS include the right of interconnection and ancillary services as set out in the National Gas Access Code.
- 5.7 In its application, Epic Energy recognised the Tribunal’s point-to-point construction of the relevant service but put an alternative approach. Epic Energy argued that the relevant services provided by MAPS fall into the following two categories (Epic 2005, para 5.4):
- (a) Transportation of gas within the integrated south eastern Australian gas market; and

(b) Transportation of gas to markets along the MAPS (north of the Angaston lateral) and along the Whyalla lateral.

- 5.8 Epic Energy argued that this broader approach “reflects the reality of the now fully integrated gas transmission network within south-east Australia” (Epic 2005, para 5.5). Epic Energy referred to concerns expressed by the Productivity Commission in its Review of the National Access Regime in respect of the Tribunal’s point-to-point approach to service definition.
- 5.9 Epic Energy also relied on the decision of the Minister of Industry, Tourism and Resources on the application for revocation of coverage of the Moomba to Sydney pipeline. In that matter, the Minister departed from the approach adopted by the Council in its recommendation, particularly in relation to the framework adopted for consideration of criterion (b). The Minister was of the view that it “would be unduly restrictive to conclude that a single transmission pipeline must provide the same point-to-point service as the MSP Mainline to be considered relevant to Criterion B” (Minister Industry, Tourism and Resources 2003, para 25). The Minister did not consider whether a broader interpretation of the relevant service was appropriate for the other coverage criteria.
- 5.10 Notwithstanding differing views it is the Council’s view that the services provided by a pipeline are confined to those provided by the pipeline and do not extend to some broad accumulation of services that may be provided by a broader network of pipelines, often owned by different parties. In this case, the MAPS alone cannot provide for the transportation of gas for an integrated south east Australian gas market even if such a market existed.
- 5.11 The question of whether, in the event that such an integrated market existed, MAPS would be constrained in its pricing and other relevant conduct due to substitutable combinations of gas supply and transportation to various markets is a separate issue and appropriately addressed under criterion (a).
- 5.12 In any event the Tribunal’s point-to-point approach on service definition remains binding authority on the Council. As such, the Council is required to apply this approach.

6 Criterion (b) - that it would be uneconomic for anyone to develop another pipeline to provide the services provided by means of the pipeline.

Background

6.1 Criterion (b) requires that it be uneconomic for anyone to develop another pipeline to provide the services provided by means of the pipeline. It is intended to limit coverage to pipelines that exhibit natural monopoly characteristics. The Tribunal in the Duke EGP decision referred to the Hilmer report in noting that while the term “natural monopoly” is difficult to define, major infrastructure such as electricity transmission grids and major pipelines are often given as examples (para 60).

6.2 The Tribunal did, however, formulate a more precise test in the Duke EGP decision in the following terms:

Thus we accept that if a single pipeline can meet market demand at less cost (after taking into account productive allocative and dynamic effects) than two or more pipelines, it would be “uneconomic”, in terms of criterion (b), to develop another pipeline to provide the same services. (para 64)

6.3 The Tribunal went on to state:

We agree with the submissions of NCC that the “test is whether for a likely range of reasonably foreseeable demand for the services provided by the means of the pipeline, it would be more efficient, in terms of costs and benefits to the community as a whole, for one pipeline to provide those services rather than more than one”. (para 137)

6.4 This test was applied by the Tribunal in the Sydney Airport decision in which it reiterated its view that “uneconomical” should be construed in a social cost benefit sense rather than in terms of private or commercial interests (paras 204-205).

6.5 In considering whether it is uneconomic to “develop” another pipeline, it is appropriate to have regard to pipelines that have

already been developed (Duke EGP, para 57). The term develop is sufficiently broad to encompass modifications or enhancements to existing pipelines. Criterion (b) will not be met if an existing pipeline (other than the pipeline the subject of the application) does not presently provide the services provided by the pipeline in question but could economically be modified or expanded to do so.

Issues for consideration

- 6.6 Applying the Tribunal's test of natural monopoly, the issue under criterion (b) is whether for the likely range of reasonably foreseeable demand for the services provided by MAPS, MAPS can satisfy that demand at less cost than multiple pipelines.

Moomba to Adelaide mainline

- 6.7 By applying the Tribunal's point-to-point service approach considered above, the principal service provided by MAPS is the transportation of natural gas from Moomba to Adelaide in the case of the main line, and to the end points of the lateral lines making up MAPS, and all points in between.
- 6.8 In applying the natural monopoly test to the relevant point-to-point service, the Council has always recognised the need to consider other pipelines able to provide the service. This is consistent with the Tribunal's approach in the Duke EGP decision where it concluded that "there is no logic in excluding existing pipelines from consideration in determining whether criterion (b) is satisfied" (para 57). Of issue is whether the single pipeline the subject of the application for coverage/revocation can meet the reasonably foreseeable level of demand for the point-to-point transportation service provided by it, at less cost than multiple pipelines. This assessment includes consideration of cost functions of alternate pipelines able to provide the service with or without some modification.
- 6.9 Epic Energy referred to the "now fully integrated gas transmission network within south-east Australia" (Epic 2005, para 5.5). The Council seeks further details as to whether gas can be physically transported from Moomba to Adelaide by pipelines other than the MAPS, and if so, whether the reasonably foreseeable demand for gas transportation from Moomba to Adelaide and all points between

could be satisfied more cheaply using the MAPS alone or by using MAPS together with the alternate pipelines.

6.10 In its application, Epic Energy noted that the maximum capacity of the MAPS is currently 418 TJ/day although the maximum capacity of the Covered Pipeline is 393 TJ/day. As at December 2004, the firm capacity of the Covered Pipeline was 323TJ/day and of the system including the uncovered portion was 348TJ/day (Epic 2005, para 2.3). Epic Energy stated that until the commissioning of the SEA Gas pipeline in January 2004, MAPS was the only gas transmission pipeline transporting gas to the South Australian market. At that time, MAPS was fully contracted. Epic energy argued that the entry of the SEA Gas pipeline has effectively doubled the gas transportation capacity into South Australia and the share of gas transportation contracts held by the MAPS is forecast to decline dramatically upon expiration of current contracts. Epic Energy noted that throughput on the MAPS has already declined since commissioning of the SEA Gas pipeline (Epic 2005, para 2.7).

6.11 Epic Energy further notes that the majority of the transportation contracts that supported the expansion of MAPS come to an end in 2005. It stated that while it believed it can secure contracts for the period following 2005, Epic Energy's own forecasts and those of independent experts conclude that there will be a significant period following 2005 when the MAPS capacity will be significantly under utilised (Epic 2005, para 2.9). On this basis, Epic Energy stated:

Clearly, if a point to point definition of service is applied to the Covered Pipeline, over the next 10 to 15 years, demand for gas transport services can be met by the existing asset (with appropriate enhancements). (Epic 2005, para 5.39)

MAPS laterals

6.12 In relation to the Port Pirie/Whyalla lateral, Epic Energy stated that the lateral's maximum firm capacity is 24 TJ/day and that the lateral is currently fully contracted and no spare capacity exists. The transportation contract for the principal customer (accounting for approximately 15 TJ/day) is due to expire in 2005. Negotiations for renewal of the contract are currently under way. Epic Energy stated that if the negotiations are successful, the only remaining capacity (and existing demand) will be for gas transport to Port Pirie and other, minor, Whyalla loads. It considers that commercial bypass to

satisfy any increase in demand may be feasible (Epic 2005, para 5.31).

- 6.13 Epic Energy concluded that the Port Pirie/Whyalla lateral can satisfy likely demand for services over the medium term and as such, is uneconomic to duplicate in a social cost sense. However, if the long term contract is successfully negotiated, there will be only limited additional capacity (Epic 2005, para 5.41-5.42). It is not clear to the Council whether this additional uncontracted capacity would be sufficient to satisfy foreseeable demand.
- 6.14 Epic Energy also concluded that the Angaston lateral can satisfy likely demand for services over the medium term. In the longer term, bypass via the Riverland and SEA Gas Pipelines may provide a feasible alternate source of gas (Epic 2005, para 5.43-5.44). The Council seeks information as to the maximum capacity and the foreseeable demand for the services of the Angaston lateral.

Broader service definition

- 6.15 As noted above, Epic Energy argued for a broader definition of the relevant service provided by MAPS (see paragraph 5.7) than that adopted by the Tribunal. In doing so, it relied on the reasoning of the Minister in the Moomba to Sydney revocation decision. In that decision, the Minister considered both the increasing physical interconnectivity of the gas pipeline network in south-east Australia as well as the increasing use of financial instruments such as swaps to facilitate competition. On this basis, the Minister applied criterion (b) to a broader network gas haulage service than the point to point service of a particular pipeline within the network (Minister Industry, Tourism and Resources 2003).
- 6.16 In addition to the fact that an such approach does not accord with that taken by the Tribunal in the Duke EGP decision, the Council sees a number of difficulties with applying the broader service definition in the context of criterion (b). First, the application of the Tribunal's natural monopoly test to the broadly defined service would require considerations of capacity and foreseeable demand of the integrated south eastern Australian gas market as a whole. This would reveal little if anything about whether a particular pipeline within that network satisfies the natural monopoly test — which is the focus of the coverage and revocation provisions under the National Gas Access Code.

- 6.17 A further difficulty is that criterion (b) is limited to considering whether it would be uneconomic to develop another *pipeline* to provide the relevant services. The term “pipeline” is the subject of specific definition under the Gas Pipeline Access Law (see para 5.3). It is unclear to what extent criterion (b) allows consideration of swaps and other financial arrangements in determining whether it is uneconomic to develop another pipeline given that they are but derivative financial instruments.
- 6.18 In its application, Epic Energy does not directly apply the Tribunal’s natural monopoly test to the MAPS on the basis of the broader service definition Epic Energy advanced. Rather, it argued that as it is possible to physically transport gas to Adelaide from Moomba via alternative pipelines to the MAPS, and that upstream and downstream markets have multiple alternative service options, criterion (b) is not satisfied for the Moomba to Adelaide main line (Epic 2005, para 5.40). The same conclusion does not appear to apply to the two laterals (Epic 2005, para 5.41 and 5.43).
- 6.19 The Council is of the view that the issues considered by the Minister under criterion (b) are pivotal to the consideration of an application for coverage/revocation as they go to the crucial question of whether the pipeline owner is constrained in the exercise of its presumed monopoly market power. The Tribunal has repeatedly considered such a question under criterion (a), having first established under criterion (b) whether the pipeline exhibits natural monopoly characteristics and as such whether there is a presumption of natural monopoly market power (See Duke EGP and Sydney Airport decisions).
- 6.20 The Council proposes to consider these issues fully under criterion (a).

The Council seeks comments on:

- *What is the capacity of MAPS and the reasonably foreseeable demand for the transportation services provided by the Moomba to Adelaide mainline, the Port Pirie/Whyalla lateral and the Angaston lateral?*
- *Could the reasonably foreseeable demand for gas transportation from Moomba to Adelaide (and points in between that are serviced by MAPS) be satisfied more cheaply using MAPS alone or by using MAPS together with the alternate route as it currently exists or as modified/expanded?*

- *Can gas be transported from Moomba to the end points of the Whyalla/Port Pirie lateral and the Angaston Lateral (and points in between) by pipelines other than MAPS? If not, what would be the cost of expansion/modification of existing pipelines to enable alternate service provision?*
- *Could the reasonably foreseeable demand for gas transportation from Moomba to the end points of the Whyalla/Port Pirie lateral and the Angaston Lateral (and points in between) be satisfied more cheaply using MAPS alone or by using MAPS together with the alternate route as they currently exist or if expanded/modified?*

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

Background

7.1 The purpose of criterion (a) is to limit coverage to circumstances where it is likely to enhance the opportunities and environment for competition in any dependent market(s). Whether competition will be enhanced depends critically on the extent to which the incumbent service provider can, in the absence of coverage, use market power to adversely affect competition in the dependent market(s). If the service provider has market power, as well as the ability and incentive to use that power to adversely affect competition in a dependent market, coverage would be likely to improve the opportunities and environment for competition, offering the prospect of tangible benefits to consumers (including reduced prices and better service provision).

7.2 In assessing whether criterion (a) is satisfied, the Council must:

- (a) define the relevant market(s) in which competition may be promoted and verify that this market or these markets are separate from the market for the service to which access is sought; and
- (b) determine whether access (or increased access) facilitated by coverage would promote a more competitive environment in the additional market(s), which requires assessing:
 - (i) whether the incumbent has the ability and incentive to exercise market power to adversely affect competition in the dependent market(s); and

- (ii) whether the structure of the dependent market(s) is such that coverage would, by constraining the exercise of market power by the service provider to adversely affect competition in the dependent market(s), promote competition.

Issues for consideration

Defining the relevant market

7.3 The first step in the application of criterion (a) is to define the market(s) in which competition may be promoted as a result of coverage. Such market(s) (referred to as the dependent market(s)) must be separate from the market for the services provided by the pipeline the subject of the application. Typically, the dependent market(s) will be either upstream or downstream from the market for the services provided by the pipeline which (if criterion (b) is satisfied) represents the bottleneck that declaration seeks to unlock.

7.4 The High Court has accepted the following definition of “market” (*Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Ltd and Another* (1989) 167 CLR 177):

A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them (if there is no close competition there is of course a monopolistic market). Within the bounds of a market there is substitution - substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive. ... Whether such substitution is feasible or likely depends [on a number of factors] ... in determining the outer boundaries of the market we ask a quite simple but fundamental question: If the firm were to 'give less and charge more' would there be, to put the matter colloquially, much of a reaction?" (Re Queensland Co-operative Milling Association Ltd (1976) 25 FLR 169 at 190).

7.5 Markets are normally defined by reference to four dimensions; namely, the product, functional, geographic and temporal dimensions. This requires the identification of:

- *product dimension* - the goods and/or services supplied and the sources or potential sources of substitute products;

- *functional dimension* – the different vertical stages of production and/or distribution that comprise the field of competition;
- *geographic dimension* – the areas that are supplied, or could be supplied, with the relevant product and to which consumers can practically turn; and
- *temporal dimension* – the period over which substitution possibilities need to be considered.

7.6 As noted at paragraph 7.4, markets are defined by reference to substitution possibilities. A test that is often used to determine whether products are sufficiently substitutable for them to fall within the same market is to consider a small but significant non-transitory increase in price of one product to assess the demand and supply reactions in respect of the other product (SSNIP test).

7.7 While multiple dependent markets may be identified, for criterion (a) to be satisfied, it is only necessary that access promote competition in at least one dependent market. If, however, the market in which competition is promoted is small such that the benefits to flow from increased competition are small compared with the overall costs of coverage, coverage may be revoked as it may be contrary to the public interest and hence not satisfy criterion (d).

7.8 In its application, Epic Energy identified the following relevant markets as being functionally distinct from the market for the services provided by MAPS (Epic 2005, para 6.9):

- (a) The upstream market for gas production and sales at the Moomba and Ballera hubs;
- (b) a downstream gas sales market along the MAPS and the Port Pirie/Whyalla lateral;
- (c) a downstream gas sales market in south-east Australia; and
- (d) a downstream electricity sales market in the Victorian and South Australian region of the NEM.

7.9 The Council seeks views as to whether the markets identified by Epic Energy have been appropriately defined and whether there are any other relevant dependent markets.

Would access promote competition?

- 7.10 The assessment of criterion (a) requires the Council to consider whether declaration will enhance the opportunities and environment for competition in a dependent market (Sydney Airport decision, para 107). This consideration involves a comparison of the future conditions and environment for competition *with* and *without* declaration.
- 7.11 As MAPS is currently covered under the National Gas Access Code, the current situation represents the situation with coverage. This must be compared against a situation absent coverage.
- 7.12 The Council must determine whether access (or increased access) facilitated by declaration would promote a more competitive environment in a dependent market. This requires an assessment of:
- (a) whether Epic Energy has the ability and incentive to exercise market power to adversely affect competition in a dependent market; and
 - (b) whether the structure of the dependent market is such that coverage would, by constraining the exercise of market power by Epic Energy to adversely affect competition in the dependent market, promote competition.

Market Power

- 7.13 It is only where the service provider has both the ability and incentive to use its presumed monopoly power to adversely affect competition in the dependent market(s) that coverage will be likely to improve the conditions for competition in the market(s). In essence, there are three means by which the service provider may seek to use its presumed monopoly power to adversely affect competition in a dependent market or markets:
- (a) the service provider may charge monopoly prices for the provision of the service;
 - (b) the service provider may engage in explicit or implicit price collusion; and/or

- (c) a vertically integrated service provider may engage in strategic behaviour designed to leverage its presumed monopoly power into the dependent market.

- 7.14 In relation to these tests of market power, Epic Energy contends that the prospect of collusion is limited given the multiple interconnections and spare capacity in the current interconnected south-east Australian pipeline network, and that the limited number of users and the extent of long term contracting increase the difficulty of successful collusion (Epic 2005, para 6.46). It considered that the principal area of concern is in relation to monopoly pricing (Epic 2005, para 6.47). It does not discuss whether there are any vertical integration issues that may be relevant.
- 7.15 The Council seeks views on these three market power issues. In respect of pricing conduct, the Council will consider the extent to which Epic Energy would have an ability and incentive to set prices above competitive levels in the absence of coverage, and the effects of such pricing on dependent markets.
- 7.16 In considering whether Epic Energy has the ability and incentive to exercise market power, the Council will consider all relevant constraints. The degree to which Epic Energy faces competition in the dependent markets through alternate pipelines and swap and other derivative arrangements will be a primary focus. In particular, the Council will consider the impact of the SEA Gas pipeline on competition in relevant dependent markets.
- 7.17 Other constraints on the ability and incentive to exercise market power will also be considered. Such constraints may include the threat of MAPS being re-covered under the National Gas Access Code if it is found to be exercising market power, and any countervailing power of the pipeline's customers. The Council seeks submissions on these matters.
- 7.18 The question of whether Epic Energy has market power and to what extent it may be constrained will likely differ in respect of different dependent markets. For example, the constraining effect of the south-east Australian gas pipeline network on the exercise of market power in respect of the market/s in which gas is traded on points on the MAPS mainline between Moomba and Adelaide or the Whyalla/Port Pirie and Angaston laterals, may be substantially different to the effect in respect of market/s in which gas is traded in Adelaide and for gas production in the Moomba/Ballera hub.

- 7.19 The Council can recommend revocation either to the extent sought or to a greater or lesser extent than sought in the application (s. 1.29, Code). Where the market power of a pipeline owner is constrained in respect of dependent markets serviced by part of the pipeline, revocation of coverage for that part of the pipeline may be warranted. Coverage of the remainder of the pipeline may continue if the market power of the pipeline owner is not constrained in respect of other dependent markets serviced by the remaining part of the pipeline.
- 7.20 In its application, Epic Energy stated that if coverage of MAPS is revoked, it will maintain prices for customers north of Adelaide and for users of the Port Pirie/Whyalla lateral, and provide transparent and open access in accordance with the Code of Conduct promulgated by the Australian Pipeline Industry Association (Epic 2005, para 6.45).
- 7.21 The coverage criteria are concerned with the structure of relevant markets and in particular, with whether a pipeline owner has the ability and incentive to exercise market power to adversely affect competition in a dependent market. This requires identification of factors which may constrain the exercise of market power and assessment of the degree of any such constraint. It is difficult to see how behavioural commitments or undertakings, which have no provision for later supervision or enforcement, can be considered as an effective constraint on the exercise of market power.

Promotion of competition

- 7.22 Epic Energy argued that coverage would not promote competition in the upstream gas production and sales market at the Moomba to Ballera hubs. It noted the close proximity of sources of supply to major demand centres, and that multiple transport options and the use of swaps mean substantial inter-basin competition. In addition, high barriers to entry in the gas production market suggest that coverage is unlikely to make a significant difference to competition in the upstream market (Epic 2005, paras 6.54-6.59).
- 7.23 In relation to the downstream markets, Epic Energy argued that coverage would not promote competition. In the downstream gas sales market/s along the MAPS and the Port Pirie/Whyalla lateral, Epic Energy noted that there is only 2 to 3 PJ/yr of uncontracted gas consumption in the downstream market north of the Angaston lateral that could potentially be impacted by an exercise of market power by Epic Energy. It further recognised that users along the Port

Pirie/Whyalla lateral do not have alternate sources of supply and as such, Epic Energy is prepared to make commitments as to post-revocation price levels (referred to above at paragraph 7.20) (Epic 2005, paras 6.60-6.67).

- 7.24 Epic Energy noted that current pipeline capacity into each of the main demand centres in south-east Australia significantly exceeds current demand and together with developable capacity, will continue to do so for at least the next ten to fifteen years. Given this capacity, both MAPS and the SEA Gas pipeline have strong commercial incentives to maintain high levels of throughput and to compete vigorously for market share (Epic 2005, para 6.75).
- 7.25 In relation to the downstream electricity sales market in the Victorian/South Australian region, Epic Energy argued that coverage will not enhance competition as the market is already effectively competitive and the National Electricity Market's gross pool spot market structure removes the ability of any participant in the upstream energy chain to sustainably increase prices. Epic Energy argued that electricity imports from Victoria serve to constrain the price achieved by South Australian generators and the price MAPS can charge (Epic 2005, paras 6.78-6.82).
- 7.26 The Council seeks views as to the effect on dependent markets of any exercise of market power by Epic Energy.

The Council seeks comments on:

- *Has Epic Energy appropriately defined the relevant dependent markets? Are there any other dependent markets in which competition may be promoted as a result of access through coverage?*
- *Can gas be physically transported from Moomba to Adelaide by pipelines other than MAPS? What (if any) constraints would limit this?*
- *What modifications or expansions would be needed for pipelines other than MAPS to be able to transport gas from Moomba to Adelaide? What would be the cost of such modifications or expansions?*
- *To what extent (if any) would swaps or other derivative instruments constrain the ability and incentive of Epic Energy to engage in monopoly pricing or otherwise exercise market power in respect of each dependent market? What is the nature of the market/s for such financial instruments within south east Australia? How do these markets operate?*

- *If coverage was revoked, what other factors would constrain Epic Energy from monopoly pricing or otherwise exercising monopoly power in respect of each dependent market?*
- *If Epic Energy has the ability and incentive to exercise market power if coverage was revoked, how would an exercise of such market power affect competition in dependent markets?*

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

Background and issues for consideration

- 8.1 The rationale for criterion (c) is that a pipeline should not be covered where access or increased access to the service provided by the pipeline may pose a legitimate risk to human health or safety.
- 8.2 Some pipelines and ancillary facilities require a degree of spare capacity to provide appropriate safety margins. Pipeline access may need to be governed by conduct codes, operational guidelines and relevant safety regulations. For a pipeline to be covered, access must be possible without compromising system and operational integrity and safe operability. Criterion (c) may be satisfied where it is possible to address any safety concerns raised by access to the service through the terms and conditions on which access is provided.
- 8.3 In its submission, Epic Energy stated that it does not consider that coverage under the National Gas Access Code would cause undue risk to human health or safety. As such, it considers that criterion (c) is satisfied (Epic 2005, 7.2).
- 8.4 MAPS is currently a covered pipeline and access to the service provided by MAPS is provided pursuant to the provisions of the National Gas Access Code and relevant access arrangements and transportation contracts. The Council is unaware of such access giving rise to human health or safety concerns.

The Council seeks comments on:

- *Has access to the services provided by MAPS given rise to a risk to human health or safety that has not been adequately addressed through the terms and conditions of access?*

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

Background

9.1 The Tribunal in the Duke EGP decision considered that:

criterion (d) does not impose an additional positive requirement which can be used to call into question the results obtained by the application of pars (a), (b) and (c). Criterion (d) accepts the results derived from the application of the other criteria, but enquires whether there are any other matters which lead to the conclusion that coverage would be contrary to the public interest. (para 145)

9.2 One matter of public interest is whether any benefits of coverage, such as cheaper prices and more efficient use of resources, are outweighed by regulatory or compliance costs. Other matters of public interest include environment considerations, regional development, and equity. Public interest matters might also include impending access regimes or arrangements, national developments and the desirability for consistency across access regimes, relevant historical matters and privacy.

Issues for consideration

9.3 The Council recognises that coverage involves direct and indirect costs. In its application, Epic Energy estimated that the cost of coverage following the establishment of the Australian Energy Regulator and the Australian Energy Market Commission could exceed \$1 million per annum (Epic 2005, para 8.7).

9.4 The indirect costs of regulation recognise that regulated outcomes are second best to competitive outcomes in terms of efficiency. The impact on dynamic efficiencies in particular, is seen as a cost of regulation.

- 9.5 As discussed at paragraph 7.7, if criterion (a) is satisfied only in respect of a small dependent market such that the competition benefits of continued coverage outweigh the costs of coverage for the pipeline (covered wholly or in part), coverage would be contrary to the public interest and criterion (d) would not be satisfied.
- 9.6 The Council seeks views on the relative costs and benefits of continued coverage and on any other public interest issues that may arise with continued coverage.

The Council seeks comments on:

- *What are the costs and benefits of continued coverage taking into account competition benefits in different dependent markets and the costs of coverage of MAPS (either wholly or in part)?*
- *What other matters may be of relevance in determining whether continued coverage would be contrary to the public interest?*

References

Epic (Epic Energy South Australia Pty Ltd) 2005, *Application under sections 1.24 and 1.25 of the National Third Party Access Code for Natural Gas Pipeline Systems for Revocation of Coverage*, March.

Duke Eastern Gas Pipelines Pty Ltd (2001) ATPR 41-821

Hilmer Review (Independent Committee of Inquiry into National Competition Policy) 1993, *National Competition Policy*, AGPS, Canberra.

Minister for Industry, Tourism and Resources (2003), *Applications for Revocation of Coverage on Certain Portions of the Moomba to Sydney Pipeline System, Statement of Reasons*, November.

NCC (National Competition Council) 2002, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*, December.

Queensland Wire Industries Pty Ltd v The Broken Hill Proprietary Ltd and Another (1989) 167 CLR 177

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