



**The Australian Gas Association**

**Submission to the Queensland Competition Authority**

***Gas Distribution Access Arrangements***

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## ***1. Introduction***

The Australian Gas Association (AGA) welcomes the opportunity to comment on proposed access arrangements lodged by Allgas Energy Limited and Envestra Limited. The AGA encompasses all sectors of Australia's natural gas industry – including gas network owners/operators, gas retailers, pipeliners, manufacturers of gas appliances and equipment, gas producers and exporters of liquefied natural gas.

Of these sectors our core membership are the owners of the gas distribution networks and pipelines which reticulate and transport gas to the cities, towns and regional areas of Australia. The AGA estimates the capital value of this infrastructure at approximately \$24 billion, with potential investment of another \$6 billion over the next 5 years.

## ***2. Key Challenges for Gas Industry Regulation***

### **2.1 Promoting Market Development**

Gas industry third party access regulation in Australia has been consistently framed with two aims – first, to regulate monopoly assets in a way that is fair to asset owners and consumers, and secondly, to allow market development to bring the benefits of natural gas to a wider market. These twin aims, greater competition and creating a climate for market development were explicitly recognised by Heads of Government when the National Third Party Access Code for Natural Gas Pipeline Systems ('the Code') was agreed to in 1997.

The market development objectives of gas industry regulation are especially relevant given the limited size of the current Queensland gas market. Natural gas as a proportion of primary energy share in Queensland is the lowest of all mainland States and Territories, and Queensland natural gas consumption is less than six per cent of the national total.<sup>1</sup>

The key reason for the limited development of the Queensland gas market is the limited demand for space heating in its warmer climate. Cost-effective space heating is a key domestic application for natural gas, and low demand for this application has resulted in relatively low average consumption of natural gas in Queensland as compared to, for example, Victoria.

This feature of the gas market makes it important that the Queensland Competition Authority (QCA) recognise that the most sustainable and effective means of reducing natural gas prices in Queensland is to increase gas consumption throughout the State. Increasing the total load through the gas network will allow the average cost per customer of delivering gas to fall, resulting ultimately in lower end-user prices. It is important that regulators note that this market development focussed approach to lowering prices to end-users is preferable to heavy handed regulatory approaches which limit price movements and potentially constrict future gas market growth.

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<sup>1</sup> AGA *Gas Statistics Australia 2000*, p.51

Growing the gas market will require gas network owners and operators to promote the benefits of natural gas. As energy retailers will understandably seek to market products that return the highest profit margin (not necessarily natural gas), gas networks will have prime responsibility for marketing the benefits of natural gas and increasing natural gas consumption. Reference Tariffs approved by the QCA must include an appropriate allowance for network marketing activities.

Enhancing market development will also require appropriate outcomes from regulators which reward asset owners for risk and encourage network expansion. The rates of return approved by the QCA must provide an incentive for gas network businesses to continue to invest in Queensland. Without adequate incentives, State-wide investment in the gas industry will be reduced, with the full negative impacts of under-investment in energy infrastructure likely not to be felt for a number of years. One of the potential effects of under-investment in gas infrastructure is a denial of energy choice to potential new customers.

## **2.2 Reducing the Cost of Regulation**

The high cost of regulation is a key concern of AGA members who operate within the third party access regime. In the case of the Queensland gas market, it is especially important that regulators seek to minimise unnecessary costs of regulation. The comparatively undeveloped state of the gas market in Queensland means there is a greater risk of the costs of gas regulation outweighing the ultimate benefit to community.

The high costs related to the production of Access Arrangements by regulated businesses are of particular concern to the AGA. These costs include demands on in-house senior management resources and the provision of external specialist legal/economic advice. In addition to these resources, many gas industry network businesses employ a significant number of in-house specialists in the area of regulatory affairs. Estimates of the total costs of developing and negotiating Access Arrangements for small extensions to gas distribution networks range from \$200 000-\$250 000. In cases where a relatively small number of customers are involved, the cost per customer of a developing an Access Arrangement can be extremely high.

An accompanying concern that has greatly added to costs and uncertainty are the frequent and lengthy delays in the approval of Access Arrangements. The AGA views the delays and lengthy approval processes that have hitherto been experienced by network owners and operators in other jurisdictions as unacceptable from the viewpoint of both regulatory efficacy and the costs to the regulated businesses involved.

### **2.3 Encouraging Cleaner Energy**

Natural gas has a central role in cost-effective greenhouse gas abatement in Australia. The widely recognised environmental benefits mean that it is ideally placed to reduce the carbon emissions intensity of Australia's energy supply.

In May 2000 AGA released the results of its *Research Paper No 12: Assessment of Greenhouse Gas Emissions from Natural Gas* commissioned from Energetics Pty Ltd. The paper outlined the important lifecycle greenhouse benefits of natural gas when used for residential and commercial applications as well as power generation. The paper demonstrates clearly that natural gas is the most environmentally friendly of all the fossil fuels. For example, life cycle analysis shows that natural gas has significantly lower greenhouse gas emissions than either black or brown coal when used for power generation. For residential applications the greenhouse emissions reductions are even greater.

The Queensland Government has recognised the benefits of natural gas in its recently released energy policy *A Cleaner Energy Strategy*. It has highlighted that growing the gas supply industry can both lower greenhouse emissions and stimulate regional development.<sup>2</sup>

The AGA contends that the Queensland Competition Authority must ensure that its regulatory decisions encourage the expansion of gas networks and markets in order to maximise the environmental and cost benefits to Queensland of fuel-switching to natural gas.

### **2.4 Rewarding Prudent Asset Maintenance**

Long-term economic efficiency is best provided by a regulatory environment which provides incentives for the maintenance and replacement of capital at a level that maintains quality of supply while not leading to asset owners receiving abnormal benefits.

The inappropriate use of benchmarks to drive down allowed maintenance costs and replacement capital costs in some regulatory decisions made under the auspices of the Third Party Access Code has discouraged appropriate levels of maintenance and replacement.

Under-investment in asset replacement and maintenance should be avoided as it eventually leads to premature asset decay – and hence additional investment that may have been prudently avoided if maintenance and replacement investment had been rewarded appropriately.

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<sup>2</sup> Queensland Energy Policy *A Cleaner Energy Strategy*, May 2000, p.11

### ***3. Specific Issues for Queensland Gas Distribution Regulation***

#### **3.1 Removing Pricing Distortions**

A key objective of the Code, and third party access regimes more generally, is to attempt to replicate market outcomes for assets with natural monopoly characteristics.

Recognition of the efficiency benefits of appropriate pricing signals meant that an essential part of the process of gas industry reform involved the dismantling of vertically integrated state-owned utilities and an attempt to eliminate cross-subsidies within their pricing structures through ‘unbundling’ of prices.

In Queensland, bundled gas prices to the residential market have been constrained by the government. There have been only two price rises since 1992, the second occurring in 2000. Network owners and retailers have been absorbing the cost increases over the past decade that they have been unable to pass on. A result of the limited opportunity to adjust prices over the last ten years has been that natural gas businesses have been unable to move tariffs to a more cost reflective basis. Thus cross subsidies implicit in existing tariffs have not been removed.

The Code requires that Reference Tariffs be cost reflective. The AGA believes that a fair implementation of Code principles is likely to result in price increases for some gas customers in Queensland due to the factors outlined above. This is a necessary outcome of gas market reform and consistent with the underlying philosophy and aim of the Code. The AGA urges that the QCA acknowledge that prices to some customer classes may need to increase to address these historical factors.

It is important that the signals provided by the access determination encourage appropriate investment in developing all market segments and do not artificially constrain prices for any segment.

#### **3.2 Adopting Appropriate Benchmarks for the Queensland Gas Market**

The atypical nature of the Queensland gas market imposes a number of considerations on regulators seeking to apply regulatory benchmarks. AGA argues that the Queensland Competition Authority must exercise caution when seeking to apply benchmarks derived from other regulatory jurisdictions with gas markets that have different characteristics.

These differences between gas markets in diverse regulatory jurisdictions need to be accounted for in regulatory determinations. For example, the capital cost of installing a distribution network (i.e. cost per meter of pipeline laid) is essentially the same nationally. However, lower average gas consumption levels in Queensland means that average distribution tariffs per gigajoule are higher than gas networks jurisdictions that have high average household consumption, e.g. Victoria. The QCA will need to recognise this market reality in approving Reference Tariffs in Queensland.

Further, operating cost benchmarks derived by the QCA must take into account the operating environment of gas distribution networks in Queensland and analyse the

results with appropriate metrics. For example, comparing Victorian gas distribution operating and maintenance costs on a cost per gigajoule basis is not appropriate for Queensland due to low penetration rates and domestic consumption levels. The QCA must ensure that any benchmarks it uses to compare these costs are truly comparable with those calculated for the Queensland businesses.