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23 February 2001

The Executive Officer
National Gas Pipelines Advisory Committee
Level 13, Wakefield House
30 Wakefield Street
ADELAIDE SA 5000

By Facsimile: 8225 5866

Dear Sir

Proposed Amendments to the National Third Party Access Code for Natural Gas Pipeline Systems

Santos Limited ("Santos") refers to your Information Memorandum ("IM") on the above dated 1 February 2001, and welcomes the opportunity to comment upon some of the issues raised. Santos also refers to a document issued by Epic Energy on the Darwin to Moomba Natural Gas Pipeline Proposal dated 20 November 2000 ("Proposal").

Santos also notes that it apparently has conflicting interests to those of Epic as this pipeline will provide competition to gas produced in the Cooper Basin. On that basis Santos should be in favour of no Code coverage to lift tariffs on the pipeline and reduce competition. Santos is in favour of Code coverage unless the Code is scrapped and all gas transmission pipelines become unregulated. Santos could also become a shipper in this pipeline and would then require access rights and an equitable tariff.

Santos is particularly concerned that NGPAC has raised a number of complex interlocking issues but has only provided 21 days for these to be considered and a response submitted. This timeframe is inadequate for a proper response to be considered and provided.

Background to the IM

Epic in it's Proposal states that it wishes to build a pipeline from Darwin to the vicinity of Moomba and that it will be approximately 2,200 kilometres long and cost approximately \$1.5 billion. Epic believes that such a pipeline, regulated under the National Third Party Access Code for Natural Gas Pipeline Systems ("Code") (aside from what it sees as technical

difficulties in applying the Code to a pipeline not yet built) will not be attractive to it and its investors/financiers. Further Epic notes that it has a deadline which it needs to comply with to make investment decisions. This deadline Epic says, is imposed by an agreement between Phillips and Multiplex (Phillips is its partner in this undertaking) that includes advantageous terms and which expires on 30 June 2001. Epic wants to make its investment decision prior to that date. Epic also wants to be able to supply gas to customers by 2004 as the customers have apparently expressed a strong interest for gas in that time period.

Other essential points in Epic's Proposal are:

- pricing to be set by free bargaining in the gas market;
- that they require a fifteen to twenty year term for this non-regulated arrangement;
- during the term of non-regulation, that they receive legislative protection (to be achieved at their suggestion by a *Trade Practices Act* amendment) from the risk that a third party will apply to the National Competition Council for coverage of the pipeline.

Epic in its Proposal, at 1.5 and 1.7, say that they will not bear any risk of exposure to maximum tariffs determined by the application of the Code at a later time. Epic say that if such risks apply they will not develop the pipeline at all or, if they do develop it, it will not be efficiently sized. By this they appear to suggest that it will be sized to enable it to only carry the gas contracted to it with no spare capacity for other parties to use it. It is noted that pipeline capacities can easily be increased by compression or looping.

Epic talks of only being prepared to bear financial risk and not the risk that the Code will apply at a later stage. They also say that they will only make an investment decision if there are sufficient foundation customers signed up and secured. Mr Habelko of their office has been quoted as saying, in The Australian newspaper of 19 January 2001, "the MOU's are for more than enough gas to make the project succeed".

Epic appear to have put these arguments to the Australian Pipeline Industry Association ("APIA") and together they have put the issues to NGPAC. The IM has resulted.

The IM casts the net of possible responses much wider by listing a number of additional issues including the possibility of extensive amendment to the *Trade Practices Act* and Code. NGPAC raises the issue of whether the definitions of "Pipeline" and "prospective Pipeline" can apply to pipelines not yet built and if not can this be remedied by code changes to 2.3; similarly with the term "Service Provider" and "prospective Services Provider"; how will the Code be amended to take account of approving an access regime prior to construction and commissioning; how should access requests be dealt with when made prior to completion of the pipeline etc.

Hence Santos' concern that there has not been sufficient time for it and others to provide a proper response to all of these issues.

Response to Epic's Proposal to Accommodate the Darwin to Moomba Pipeline by Trade Practices Act Amendments

1. Epic – Investment only made if Sufficient Foundation Customers Secured.

As noted above, Epic is reported as saying that they already have sufficient MOU's signed with foundation customers to make the project succeed. They seem confident that the MOU's will be turned into firm contracts in due course. One must assume therefore that the foundation customers, at the prices quoted to them, are sufficient to

make the project viable. This immediately contradicts the statements concerning the very high risk, months before having to make the financial decision to invest and are in a position to secure even more foundation customers between now and then. Indeed Epic will not build the pipeline without sufficient foundation customers so there is no risk of not having sufficient foundation customers.

The danger for foundation customers of having higher tariffs can be overcome by most favoured nation clauses in contracts.

If sufficient foundation customers have already been secured; the risk of determining the Initial Capital Base for the purposes of the Code removed by the fact that it is a new pipeline and it will be the actual cost of the pipeline (Code clause 8.12); with the approximate rate of return already known by Epic as the maximum that might be approved by the ACCC; and with the prospect of many additional users of the pipeline in the future the risk to Epic in this investment seems low.

2. *Epic – Twenty Year Term for the Access Arrangement Required*

The Code provides for maximum of five year terms for access arrangements except in special circumstances. Twenty years of freedom from application of the Code seems excessive. A situation could arise where Epic secures its foundation customers on keen pricing for a portion of that twenty year period. It then adds customers as time goes on not constrained by having to have foundation customers to secure its investment. Its foundation customers contracts run out and have to be renegotiated and the result could be that the pricing in the second half of the term could be excessive, anti-competitive and threaten the usage of gas in south eastern Australia by forcing its price up. In addition new customers could be forced to pay high tariffs to either average up Epic's return (from what it might initially voluntarily accept) or to allow Epic to run excessive returns.

3. *Epic – Proposal for the Amendments to the TPA to Last for Four Years*

If this were to be agreed to for the Darwin to Moomba pipeline, the proposed pipeline from Victoria to South Australia, the proposed pipeline from Victoria to Tasmania, and any other pipeline proposed in that period could be regulated by the proposed special arrangements. This could create great inequity between regulated pipelines with controlled pricing and unregulated pipelines with market pricing. Market pricing in a market not yet mature enough in Australia could be irregular and uncompetitive. Severe market distortions could result with different gas usage patterns being driven by whether a pipeline is regulated or not.

It is noted that when the Hilmer amendments were made Hilmer made clear that no exceptions should be made responding to individual needs. Code changes should be generally applicable and made after consideration of all issues.

4. *Epic – Code Suitability for Greenfields Pipelines*

This appears to be an unfounded concern. The Eastern Gas Pipeline from Victoria to Sydney was built in the full knowledge that Code coverage was the most likely outcome of the effort. Duke has announced that it is committed to a pipeline from Victoria to Tasmania and it will be expecting that the Code will apply to such a pipeline. A new pipeline has been proposed from western Victoria to Adelaide again with the proposers operating under the Code. It therefore appears to be incorrect to say that new Greenfields Pipelines are being discouraged by having the Code apply to them. This is patently not the case.

Santos' position is that the proposed amendments to the *Trade Practices Act*, to provide Epic with the relief that they seek, are unnecessary and should not be made. As noted above, the financial risk to Epic in this new pipeline development is very low with the potential for much better returns to be earned by quickly improving throughput. Other pipeline investors have not found the Code to be an insurmountable obstacle to investment and there is no reason why Epic should.

In any event the volumes of gas being considered, approximately 250 PJ per annum, amount to about one third of the whole natural gas market in eastern Australia, and unregulated, would amount to a massive additional supply.

Creating two classes of pipeline owners defined by whether they are governed by the Code or not is anti-competitive and will introduce market distortions, both foreseen and unforeseen, which will be counter to the objectives of the Code.

5. *Objectives of the Code*

The objectives of the Code are contained in the Code itself. They include the objectives to facilitate the development and operation of a **national** market for natural gas; to prevent the abuse of monopoly power; to provide the right of access to natural gas pipelines on conditions that are **fair and reasonable for both Service Providers and Users**. Santos submits that these objectives are not being attained by creating regulated and unregulated pipelines in the same market. As noted, having market related pricing and having a twenty year term for the alternative arrangements, means, inter alia, that all consumers are exposed to the abuse of monopoly power, all consumers are exposed to unfair and unreasonable terms of supply and a **national** market for natural gas cannot be established.

The IM and the Proposal seem uncertain about the real motive for the proposed amendments to the Code. "Regulatory overlap", "regulatory uncertainty", "financial certainty", "**Epic Energy has determined that it** is not able to bear any risk associated with regulatory uncertainty" are all put forward as reasons why the Code change is required. Santos has demonstrated in this submission that none of these arguments appear to be valid and in any event are contrary to the objectives of the Code.

Santos notes the review by the Productivity Commission of Part IIIA of the TPA and clause 6 of the CPA will be interesting fora in which all stakeholders can express their view points on amendments that may affect the Code. A Code review itself, considering the initial gestation period of the Code, needs a measured approach over an appropriate period of time. The urgency is introduced by a contract which Epic and Phillips have entered into with Multiplex. This can be replaced if it lapses. Failing Epic building the pipeline an opportunity will open for other parties to do so.

Conclusion

In summary Santos believes that all gas transmission lines should either be under the Code or the Code should be scrapped. Unless the Code is abolished, Santos suggests that Epic should make its investment decisions in the atmosphere of risk and reward established by the Code, just as other commercial organisations have recently made such decisions. There is no evidence that the Code has been the cause of any cessation of investment in gas pipelines.

Santos also suggests that the APIA, and to some extent, NGPAC, responses to the Epic initiative could possibly lead to highly uncompetitive results with gas consumers in Australia potentially suffering great harm.

The Darwin to Moomba pipeline will be a natural monopoly as are the other regulated pipelines in Australia, and should therefore be regulated. The approach of APIA and NGPAC should be to respond to the proposal in a measured way in which all stakeholders, including the users of gas, have an opportunity to put their points of view and have them considered carefully in an appropriate amount of time.

Yours faithfully

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