Submission to the AER for an exemption under rule 34 of the National Gas Rules

February 2024

PowerWater

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Introduction

Power and Water Corporation (**Power and Water**) is a government owned, essential services provider in the Northern Territory (**NT**). It connects thousands of homes and businesses with electricity, gas, water and sewerage. Territorians rely on Power and Water's networks and services to be made available at a price that is affordable.

Power and Water is established under the *Power and Water Corporation Act 2002* (NT) and the *Government Owned Corporations Act 2001* (NT) (**GOC Act**). Under the GOC Act 'the objectives of a government owned corporation are:

(a) to operate at least as efficiently as any comparable business; and

(b) to maximise the sustainable return to the Territory on its investment in the corporation.'

These legislative objectives balance community service obligations, public sector policies and government directions made in the public interest. Ultimately, the unique operating conditions that Power and Water is subject to results in it being distinct from its competitors.

From 2 March 2024, the ring-fencing obligations set out in Chapter 4 of the National Gas Law (**NGL**) will require Power and Water to separate its McArthur River Mining Pipeline (**MRM Pipeline**) from all related businesses. Power and Water has assessed the impact of complying with the ring-fencing obligations and submits that the cost of separating out its pipeline assets would significantly outweigh any perceived or actual public benefit. Furthermore, of the 4 pipelines that Power and Water owns, only the MRM Pipeline will be subject to the NGL's ring-fencing obligations from 2 March 2024.

For the reasons set out in this application, Power and Water requests an exemption under rules 34(3) and 34(4) of the National Gas Rules (**NGR**).

Power and Water's Gas Services business

Power and Water manages a large wholesale gas supply and transportation portfolio that includes supplying to power stations, several large commercial and industrial customers in the NT and various commercial and industrial customers interstate.

In addition to owning the MRM Pipeline, it also owns gas pipeline assets that are used to transport gas from remote locations to the central gas transportation network in the Northern Territory. These pipelines are not subject to ring-fencing obligations under the NGL as Power and Water is the only user of the pipelines (there is no third party access to these pipelines).

Power and Water's Gas Services business unit sells wholesale gas from its portfolio of supply, and on limited occasions, it offers transportation services to existing customers on third party owned pipelines. However, typically Power and Water prefers to present a delivered gas price to the market (rather than offer gas and transport separately).

Importantly, Power and Water does not have any capacity rights on the MRM Pipeline. As such, it does not market any gas transportation capacity on that pipeline.

Power and Water has demonstrated its ongoing commitment to driving economic growth in the Territory by supplying affordable natural gas into the market while also investing in infrastructure to support the development of the Territory's energy market, as outlined in the *Our North, Our Future: 2021-2026 Targeted Growth* publication.

McArthur River Pipeline background

The MRM Pipeline (also known as the Daly Waters Pipeline) is a transmission pipeline located in the north region of the Northern Territory. The pipeline is owned and operated by Power and Water (with operation and maintenance services provided by a contractor).

The MRM Pipeline is 330 km in length and 168 mm in width and has a maximum capacity of 15 TJ per day. Its connection points are:

a) Receipt point – Daly Waters Scraper Station on the Amadeus Gas Pipeline (operated by the APA Group); and

b) Delivery Point – McArthur River Mine.

A map showing the location of the MRM Pipeline is set out below.

As noted above, while Power and Water owns the MRM Pipeline it does not currently have any transport capacity rights on the MRM Pipeline.

Map 1. Location of McArthur River Pipeline

Ring-fencing requirements

The NGL imposes a number of ring-fencing obligations on "service providers" who own, operate or control a pipeline (and their associates). Previously, ring-fencing obligations were restricted to apply only to "covered pipelines", but from 2 March 2024 the obligations have been extended to apply to all non-exempt pipelines, including "non-scheme pipelines" such as the MRM Pipeline.

The key obligations applicable to Power and Water's Gas Services business unit, as a "service provider" of the MRM Pipeline, are:

- Section 139 of the NGL - a prohibition on being a service provider and carrying on a related business of purchasing and selling natural gas.
- Section 140 of the NGL – a prohibition on the cross employment of marketing staff between the service provider and an associate that takes part in a related business.
- Section 141 of the NGL – the requirement for a service provider to maintain separate accounts in respect of pipeline services provided by means of every pipeline owned, operated or controlled by the service provider.
- Sections 142-146 of the NGL – compliance with any additional ring-fencing obligations that the
- Australian Energy Regulator (**AER**) decides to impose.

The purpose of ring-fencing obligations has been published on the AER's website as being[1], "*provisions [to] ensure that related businesses do not gain a competitive advantage... by virtue of their common ownership or operation . .. In these types of situation, the pipelines are considered to have market power. Ring-fencing stops the leveraging of this market power into related markets*".

Thus, the ring-fencing provisions look to maintain a balance of market power by ensuring that a business cannot leverage its common interests to gain an unfair advantage. Accordingly, when determining whether ring-fencing is appropriate in the relevant context, it is important to consider whether or not imposing ring-fencing obligations on a given business achieves the desired outcome i.e. do the obligations prevent the business from leveraging a competitive advantage that arises from the owning or operating of a pipeline into related markets?

Power and Water does not consider that ring-fencing its pipeline assets from its gas marketing business achieves the desired outcome. This is largely because:

1. 3 of the 4 pipelines that it owns are exempt from ring-fencing obligations; and
2. it does not currently have rights to any available capacity on the MRM Pipeline.

Accordingly, Power and Water makes the following application for exemptions to ss139 and 140 of the NGL.

1 [Ring-fencing | Australian Energy Regulator (AER)]

Exemptions to ring-fencing

Rule 34(3) of the NGR provides that an exemption from section 139 is to be granted if the AER is satisfied as to all of the following:

(a) either:

  i. the relevant pipeline is not a significant part of the pipeline system for any participating jurisdiction; or

  ii. the service provider does not have a significant interest in the relevant pipeline and does not actively participate in the management or operation of the pipeline; and

(b) the cost of compliance with the relevant requirement for the service provider and its associates would outweigh the public benefit resulting from compliance; and

(c) the service provider has, by arrangement with the AER, established internal controls that substantially replicate the controls that would apply to associate contracts if the related business was carried on by an associate of the service provider and sections 147 and 148 of the NGL applied.

Further, rule 34(4) of the NGR provides that:

> "An exemption is to be granted from section 140 or section 141 of the NGL if the AER is satisfied that the cost of compliance with the relevant requirement for the service provider and its associates would outweigh the public benefit resulting from compliance."

Power and Water seeks an exemption from the ring-fencing obligations set out sections 139 and 140 of the NGL on the basis that:

1. the MRM Pipeline is not a significant part of the pipeline system;
2. the cost of complying with the requisite ring-fencing obligations significantly outweighs any public benefit and in certain circumstances may result in erosion of economic development in the NT; and
3. by arrangement with the AER, Power and Water will establish internal controls that substantially replicate the controls that would apply to associate contracts if sections 147 and 148 of the NGL and rules 32, 32A and 33 of the NGR applied.

Each criteria is addressed in more detail in the next section.

Criteria for exemption

With respect to the commercial arrangements in place concerning capacity rights on the MRM Pipeline, despite Power and Water owning the asset it has no capacity rights on the pipeline. Accordingly, it is not able to market any of the capacity on the MRM Pipeline under the current arrangement. Therefore, Power and Water submits that no unfair market advantage exists that would result in Power and Water benefiting from a competitive advantage and therefore needing to ring-fence its pipeline ownership from its gas marketing activities.

Not a significant part of the pipeline system

The MRM Pipeline has a nameplate capacity of 15 TJ per day that is fully contracted to one user. Power and Water submits that, in terms of capacity, the pipeline is not a significant part of the NT pipeline system. To illustrate this point, the capacity of the MRM Pipeline is 15 TJ per day, compared to the AGP and NGP's aggregate capacity of 255 TJ per day.

Power and Water recognises that there is potential for the MRM Pipeline to become a significant part of the NT's pipeline network as a result of the exploration currently underway in surrounding areas. However, any increase in significance of the MRM Pipeline is dependent on both the success of proposed production facilities and a number of upgrades to the MRM pipeline to allow transportation of gas from those production facilities into the Amadeus Gas Pipeline (**AGP**), likely requiring an increase in capacity, additional connection points and metering, and bidirectional flow in sections.

Cost of compliance vs public benefit

Public benefit

It is not clear that requiring implementation of the ring fencing requirements would deliver a public benefit in circumstances where:

- there is no current demand for access to the MRM Pipeline; and
- existing long-term commercial arrangements utilise all capacity on the MRM Pipeline.

Currently, the MRM Pipeline is a single user pipeline and there is no competing demand for access to capacity on the pipeline. As noted above, there may be future demand for access to the MRM Pipeline; however, any future demand is likely to be triggered by gas producers rather than gas users. As such this demand will require significant upgrades to the infrastructure, rather than result in direct competition for access to gas delivery.

In addition to the lack of demand for access, under the current, long-term commercial arrangements for access to the MRM Pipeline, if there is any increase in capacity, [redacted], it would be difficult for a related business to derive any competitive advantage from Power and Water's ownership of the MRM Pipeline.

On this basis, implementing ring fencing requirements for the MRM Pipeline would not lead to increased competition or address a competitive advantage.

The AER has previously considered the lack of demand for transportation capacity on a pipeline is relevant when making a determination in respect of an application for exemption from ring-fencing obligations.[2] Power and Water considers that the rationale behind that decision applies equally to this application for exemption.

Current operating costs

Gas Services business unit's pipeline assets

The MRM Pipeline is Power and Water's only asset subject to the ring-fencing obligations under the NGL, and Power and Water's only revenue earning pipeline.

Gas Services business unit organisation structure

The Gas Services team (also referred to as the Gas Services business unit) currently consists of 11 FTEs. The team is structured according to function, rather than line of business.

Under the current structure, 3 senior managers report into the Executive General Manager Gas Services. The senior managers have functional responsibility for business development (1 FTE), infrastructure and projects (3 FTE); and commercial operations (6 FTE) respectively. The Gas Services team is supported by a dedicated risk and compliance resource (1 FTE).

The senior manager commercial operations (**Commercial Manager**) handles commercial issues relating to the MRM Pipeline, including all commercial dealings with the existing user of the MRM Pipeline and negotiating access for prospective users (as required). In Power and Water's experience, these duties are irregular and low volume, on average accounting for approximately 5% of the Commercial Manager's time.

The Gas Services team also supports the MRM Pipeline in the following areas:

- Infrastructure and projects. This function consists of 3 FTEs and oversees all pipeline assets, including Power and Water's maintenance and operation obligations under the capacity sales agreement – it is estimated that the equivalent of 2 FTEs from this team are dedicated to the MRM Pipeline.
- Regulatory reporting.
- Risk and compliance.
- Budgeting and forecasting.
- Administration, reporting and governance.

[2] APTNT - Ring-fencing waiver 2011 | Australian Energy Regulator (AER)

Pipeline business economics

The MRM Pipeline and exempt pipelines are contained in the Gas Services business unit, along with related gas businesses.

In 1992 the NTG and Mount Isa Mines Ltd (MIML) entered into an agreement for the purpose of granting mineral leases, and facilitating the development, construction and operation of the McArthur River Project, The agreement was ratified in the *McArthur River Project Agreement Ratification Act 1992* (NT).[3]

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

[redacted]

[redacted]

[3] Legislation Database (nt.gov.au) .

[redacted]

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Given that the ring-fencing provisions are designed to prevent leveraging market power associated with owning or operating a pipeline, into creating a competitive advantage in related businesses, it is relevant to consider the economics of the MRM Pipeline in the context of the Gas Services business unit's overall business, and its net contribution to Power and Water (expressed as EBITDA), see below:

[redacted]

[redacted]

[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]

[redacted]	
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]

[redacted]

Cost of separation

Power and Water proposes that the relevant costs to take into consideration should be the net costs of separating the MRM Pipeline's marketing services from Power and Water's related gas businesses (ACCC Final Decision, Application to waive ring fencing obligations by NT Gas Pty Ltd Date: 13 March 2002). In that decision, the net costs under consideration were the costs associated with the applicant obtaining services from an external source, less the cost of obtaining these services internally.

Accordingly, the most efficient way for Power and Water to meet the ring-fencing obligations would be to separate out its entire infrastructure and projects team that is responsible for pipeline operations and maintenance and engage additional resources to manage the commercial issues relating to the MRM Pipeline. Based on Power and Water's experience, this would require it to recruit senior level advisors akin to its Commercial Manager. The size and structure of the team, small pool of available talent in the NT, and the ad hoc nature of marketing support required for the MRM Pipeline mean that there would be a significant cost to Power and Water.

Other internal changes would be required in order to separate pipeline services from the Gas Services business unit's related businesses – this would include reporting lines, business strategy support, finance support, and governance structures. This necessary corporate support would place a significant, albeit intangible, burden on Power and Water. An estimate of the annual net costs of complying with sections 139 and 140 of the NGL are included in Attachment 1.

These additional costs to Power and Water, the NT Government and ultimately NT and federal taxpayers cannot be argued to be reasonable in the financial context of owning and operating the MRM Pipeline, and any potential public benefit that might be derived.

Proposed controls

Following engagement with the AER, Power and Water proposes the following internal controls, which it submits substantially replicate sections 147 and 148 of the NGL and rules 32, 32A and 33 of the NGR applied.

Obligation	Proposed Control
Change in circumstances	Inform the AER if circumstances relating to demand for access to the MRM Pipeline materially change; or of any change in circumstances that give Power and Water capacity rights to the MRM Pipeline.
Procedure	Adopt a Gas Pipeline Services Associated Dealings Procedure to govern any potential associated dealing relating to pipeline capacity on the MRM Pipeline. In the event services on the MRM Pipeline are provided internally, a SLA will be mandatory, and the NGR's notification and approval framework (Rules 32, 32A and 33) will be applied to the SLA, as if it were an associate contract.
Training	The Gas Services team to be provided with targeted in person training on competition risks and internal controls related to the sharing of commercially sensitive information.

Conclusion

Power and Water has a long history of contributing to the Northern Territory Government's economic objectives by investing in infrastructure [redacted] Power and Water's investment in this infrastructure is critical to the Territory's ability to attract major business and new industries, in turn driving economic development and employment opportunities, particularly in remote parts of the Territory.

Power and Water has a complex role in the gas industry as a purchaser, seller, transporter and pipeline owner operating across the NT and into the east coast gas system.

It undertakes this complex role for the benefit of Territorians, with the primary objective being the supply affordable gas for electricity generation. These functions are performed by a small team within Power and Water that is able to deliver the breadth of services by operating along functional, rather than business, lines. Whist Power and Water is a "service provider" in respect of the pipeline assets that it owns, it does not actively engage in the marketing of gas pipeline transportation services. Power and Water holds Category 1 exemptions under Part 10 of the NGR for 3 of the 4 pipelines it owns, making those pipelines exempt from the ring-fencing obligations under the NGL and it has no capacity rights on its remaining pipeline – the MRM Pipeline.

For the reasons set out in this application, Power and Water requests an exemption from sections 139 and 140 of the NGL under rules 34(3) and 34(4) of the NGR for the MRM Pipeline.

Attachment 1

The following is an estimate of the annual net costs of moving the infrastructure and projects team into a new entity in order to comply with NGL ss139 and 140.

Items	Basisof calculation	Estimated net annual cost
Corporate cost under SLA	Additional cost associated under a commercial arrangement at 3%margin	43,051
CEO/COO/Exec Director/Commercial Manager	Based on average EC01salary	230,060
Bookkeeping services	Estimated one day per week @$800	41,600
2 Non-Executive directors	Based on the average Director fee paid to a medium-sized private/unlisted company	91,200
Annual Audit fee	Based on CPA market research2019-2022	35,624
Total		**441,535**