Draft decision

APT Pipelines NT Pty Ltd
Ring fencing waiver application

July 2011

AUSTRALIAN
ENERGY
REGULATOR

Request for submissions

This document sets out the Australian Energy Regulator's (AER) draft decision in relation to the application by APT Pipelines NT Pty Ltd seeking exemption from its ring fencing obligations under section 140 of the National Gas Law.

The AER will publish this draft decision on its website and interested parties are invited to make written submissions on this draft decision to the AER by 25 July 2011.

Please forward submissions electronically to aerinquiry@aer.gov.au.

Submissions should be copied to:

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Australian Energy Regulator

Email: chris.pattas@aer.gov.au

To allow for an informed and consultative process, all submissions will be considered as public submissions and will be posted on the AER website. If interested parties wish to submit commercial-in-confidence material to the ACCC they should submit both a public and a commercial-in-confidence version of their submission. The public version of the submission should clearly identify the commercial-in-confidence material by replacing the confidential material with an appropriate symbol or '[c-i-c]'. All non-confidential submissions will be placed on the AER website.

The ACCC-AER information policy: the collection, use and disclosure of information sets out the general policy of the ACCC and the AER on the collection, use and disclosure of information. A copy of the guideline can be downloaded from the ACCC website: http://www.accc.gov.au.

Enquiries about the draft decision or about lodging submissions should be directed to the Network Operations and Development Branch on (03) 9290 1436.

Contents

Shortened forms

ACCC	Australian Competition and Consumer Commission
AER	Australian Energy Regulator
AGP	Amadeus Gas Pipeline
APTNT	APT Pipelines NT Pty Ltd
NGL	National Gas Law
NGR	National Gas Rules
NT Gas	NT Gas Pty Ltd
NT Gas Distribution	NT Gas Distribution Pty Ltd
PWC	Power and Water Corporation
the Code	the National Third Party Access Code for Natural Gas Pipeline Systems

Overview

On 27 May 2011, APT Pipelines NT Pty Ltd (APTNT) submitted an application to the Australian Energy Regulator (the AER) under s. 146(1)(b) of the National Gas Law (NGL), seeking exemption from its ring fencing obligations under s. 140 of the NGL. The application was made in anticipation of APTNT, a fully owned subsidiary of the APA Group, acquiring full ownership of the Amadeus Gas Pipeline (AGP) and shares in NT Gas Distribution Pty Ltd (NT Gas Distribution) on 17 June 2011.

Prior to 17 June 2011, NT Gas Pty Ltd (NT Gas), a company 96 percent owned by the APA Group, was the service provider for the Amadeus Gas Pipeline (AGP). In 2002, NT Gas was granted an exemption (the 2002 exemption) by the ACCC which allowed NT Gas to provide marketing services to NT Gas Distribution, an associate company of NT Gas, which carried on a related business of selling gas.

Given that APTNT is not covered by the 2002 exemption and wishes to keep current staffing arrangements in place following its acquisition of the AGP, APTNT has formally sought a new waiver from its obligations under s. 140 of the NGL.

Section 140 of the NGL prohibits a covered pipeline service provider from sharing marketing staff with an associate that takes part in a related business. The AER may exempt a service provider from the requirement if it is satisfied that the cost of compliance with the relevant requirement outweighs the associated public benefit resulting from compliance.[1]

NT Gas Distribution has estimated the costs it would incur to meet the obligations based on the prospect of hiring an additional resource or a contractor to provide marketing services. While the AER does not agree that the cost of compliance proposed by APTNT is reasonable, due to the size of the costs proposed, it does consider that the cost of complying with the ring fencing obligations may have a significant impact on the revenue of NT Gas Distribution.

The AER considers that, based on the current market environment for gas in the Northern Territory, including the low levels of demand and little prospect of a new entrant creating an effective retail market in Darwin, there would be little public benefit in requiring APTNT and NT Gas Distribution to separate their marketing staff. This position is consistent with the decision made by the ACCC in the 2002 exemption.

The AER's *Draft Decision,* in accordance with s. 146(2)(b) of the NGL, is that the AER will exempt APTNT from the ring fencing obligations set out in s. 140 of the NGL. The AER retains the power to repeal or vary the exemption at any time if the AER is no longer satisfied that the grounds for the exemption are met.

Additionally, given that NT Gas no longer requires the exemption provided by the 2002 waiver, the AER will revoke the previous exemption granted to NT Gas by the ACCC on 13 March 2002. That decision waived the requirement for NT Gas to meet

[1] Rule 31(4) of the NGR

the ring fencing requirements set out in ss. 4.1(h) and (i) of the National Third Party Access Code for Natural Gas Pipeline Systems.

1 Introduction

1.1 Background

Prior to 17 June 2011, NT Gas was the service provider for the AGP, which is also known as the Amadeus Basin to Darwin Gas Pipeline. On 16 June 2011, the APA Group announced that it would acquire the AGP.[2] The AGP is a transmission pipeline that transports gas from the Palm Valley and Mereenie gas fields in the Amadeus Basin and from the Blacktip gas field in the Bonaparte Basin to Darwin.

The 2002 exemption

On 10 December 2001 NT Gas submitted an application to the ACCC to have its obligations under ss. 4.1(h) and (i) of the National Third Party Access Code for Natural Gas Pipeline Systems (the Code) waived. These provisions prohibit a service provider from sharing marketing staff with an associate involved in a related business that buys or sells gas. The waiver would allow NT Gas staff to provide services, including marketing, to NT Gas Distribution Pty Ltd, an associate of NT Gas that carries on a related business of selling natural gas.

On 13 March 2002 the ACCC issued a final decision (the 2002 exemption) stating that it would issue a notice under s. 4.15 of the Code waiving the requirement for NT Gas to meet the ring fencing requirements set out in ss. 4.1(h) and (i). The Commission was satisfied that the costs of complying with the ring fencing obligations outweighed the associated public benefit. Most importantly, as the AGP capacity was fully contracted until 2011 and there was little prospect of significant demand growth in the short to medium term, there appeared to be limited scope for downstream competition in the Darwin area. Consequently, the Commission found that the public benefit from the two companies ceasing to share marketing staff was not likely to be significant in the circumstances.

In its decision, the Commission also stated that significant changes in prevailing conditions such as the expiry of the AGP foundation contract in 2011 or the introduction of gas to the region from the Timor Sea would warrant a review of the waiver.

1.2 Application for waiver

On 27 May 2011, APTNT lodged an in-confidence application under s. 146 of the NGL seeking exemption from its ring fencing obligations under s. 140. The application was made in anticipation of APTNT, a fully owned subsidiary of the APA Group, acquiring full ownership of the AGP on 17 June 2011.

On 17 June 2011 APTNT acquired:

1. The Amadeus Gas Pipeline
2. The shares in NT Gas Distribution from NT Gas Pty Ltd. NT Gas Distribution owns the Darwin gas distribution network and carries on a

[2] http://www.apa.com.au/investor-centre/news/asxmedia-releases/2011/amadeus-gas-pipeline-acquisition.aspx; APTNT, *Application to exempt APTNT from ring fencing obligations under section 140 of the NGL,* May 2011, p. 3-4

related retail business of buying and selling gas for the purposes of supplying customers on the Darwin distribution network and potentially customers taking supply from the AGP

3. Land tenure rights, buildings, and other assets from NT Gas

Following the acquisition, APTNT became the owner and operator of the AGP and the owner of NT Gas Distribution. Given that APTNT is not covered by the 2002 exemption and wishes to keep current staffing arrangements in place, APTNT has formally sought a new waiver under s. 146 of the NGL.

2 Legislative and rule requirements

2.1 Relevant legislative and rule requirements

2.1.1 Granting an exemption

The Code has been replaced by the NGL and the National Gas Rules (NGR). Section 146(1)(b) of the NGL enables a covered service pipeline provider to apply to the AER for an exemption from the ring fencing requirements in s 140. Section 140 of the NGL states that:

> *(1) On and after the compliance date, a covered pipeline service provider must ensure that none of its marketing staff are officers, employees, consultants, independent contractors or agents of an associate of the covered pipeline service provider that takes part in a related business.*
>
> *(2) On and after the compliance date, a covered pipeline service provider must ensure that none of its officers, employees, consultants, independent contractors or agents are marketing staff of an associate of the covered pipeline service provider that takes part in a related business.*

Rule 31(4) of the NGR outlines the factors that the AER must take into account when considering a request for exemption of the ring fencing obligations:

> *(4) An exemption is to be granted from section 140 of the NGL (segregation of marketing staff etc.) or section 141 (accounts) if the AER is satisfied, on the application of a service provider, that the cost of compliance with the relevant requirement for the service provider and its associates would outweigh the public benefit resulting from compliance.*

The AER must deal with a waiver application in accordance with the expedited consultation procedure.[3] Rule 9(2) of the NGR states that for an expedited consultation procedure the decision maker must proceed as follows:

> *(a) the decision maker must, after such consultation (if any) as the decision maker considers appropriate (and any revision of the proposal that results from that consultation), make a draft decision; and*
>
> *(b) the decision maker must give copies of the draft decision to the parties to the administrative process in which the decision is to be made; and*
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> *(c) the decision maker must publish, on its website and in any other way the decision maker considers appropriate, the draft decision together with a notice:*
>
> > *(i) stating why the decision is required; and*
> >
> > *(ii) giving reasonable details of the context in which the draft decision has been made, the issues involved and the possible effects of the decision; and*
> >
> > *(iii) inviting written submissions and comments on the draft decision within 15 business days from the date of the notice;*
>
> *(d) the decision maker must, within 20 business days after the end of the period allowed for making submissions and comments on the draft decision, consider all submissions and comments made within the time allowed and make its final decision.*

2.1.2 Repealing an exemption

Section 20 of Schedule 2 of the NGL provides for the amendment and/or repeal of a decision to grant an exemption and states that:

[3] Rule 31(2) of the NGR

If this Law authorises or requires the making of an instrument, decision or determination –

(a) the power includes power to amend or repeal the instrument, decision or determination; and

(b) the power to amend or repeal the instrument, decision or determination is exercisable in the same way, and subject to the same conditions, as the power to make the instrument, decision or determination.

2.2 Consultative process and key dates

The AER received APTNT's application on 27 May 2011 and will consider the application request in accordance with the expedited consultation procedure under r. 9(2) of the NGR. This procedure does not specify the time period within which the AER must make a draft decision.

However, once the AER has made its draft decision, it must publish that decision on the AER website along with a notice stating why the decision is required, and inviting written submissions and comments on the draft decision within 15 business days from the date of the notice.[4] The AER must then make a final decision within a further 20 business days after the end of the period allowed for making submissions.[5]

[4] Rule 9(2)(c) of the NGR
[5] Rule 9(2)(d) of the NGR

3 Assessment

3.1 Assessment criteria

Under s. 146 of the NGL and in accordance with the NGR, a covered service pipeline provider may apply to the AER for an exemption from s. 140 of the NGL.

Pursuant to r. 31(4) of the NGR, an exemption may be granted from the ring fencing obligations in s. 140(1) and (2) of the NGL if the AER is satisfied, on the application of a service provider, that the cost of compliance with the relevant requirement for the service provider and its associates would outweigh the public benefit resulting from compliance.

Under r. 31(5) of the NGR, if compliance with a relevant requirement would, in the AER's opinion, lead to increased competition in a market, the AER must, in carrying out an assessment under r. 31(4), disregard costs associated with losses arising from increased competition in upstream or downstream markets.

3.2 APTNT's submissions

APTNT submits that the primary issue for the purposes of s. 140 of the NGL is the role of the General Manager, NT Gas and Business Development Manager, NT Gas. Pursuant to the existing 2002 waiver, these persons undertake the marketing activities for the AGP as well as marketing and other activities for NT Gas Distribution. NT Gas Distribution itself does not itself directly employ any staff. APTNT does not propose any changes to these staffing arrangements following its acquisition of the AGP and NT Gas Distribution.

3.2.1 Cost of compliance

To meet the ring fencing obligations set out in s. 140 of the NGL, APTNT submits that NT Gas Distribution would need to employ a dedicated employee in Darwin, solely to manage and conduct the commercial activities of the distribution and retail activities, at an anticipated total cost of approximately $236,000 per annum.

In its application, APTNT states that it considered the possibility of hiring a consultant on a contractual basis, but considered this unworkable for the following reasons:

- The level of enquiries about gas connection are not infrequent, and while all enquiries need to be addresses, very few give rise to a connection due to the very small geographic scope of the network

- The consultant would need to be located in Darwin and be familiar with the network and APA's processes. This would in effect require a fully trained person on call at short notice, and the cost benefit of such an arrangement is unlikely to outweigh the benefit of direct employment.

APTNT also provided confidential information on other indirect costs of compliance to the AER to assist in its assessment of the compliance costs.

3.2.2 Public benefit of compliance

APTNT submits that in 2002, the ACCC agreed that there was little prospect of retail competition in Darwin, and despite some changes in the upstream supply chain since that time, the general position remains primarily the same. This is because the level of gas demand in Darwin, and most parts of the Northern Territory, is not sufficient to sustain a competitive market, and potential competitors have little interest in undertaking the retail function. This has resulted in a continually underutilised distribution network.

In 2003, the steel main forming the backbone of the Darwin distribution network had its coverage under the Code revoked. APTNT contends that as NT Gas Distribution is not a covered pipeline service provider, there is no need for it to separate or ring fence its distribution and retail functions in any way. As such, the real purpose of ring fencing in this case is the separation of the marketing activities of the AGP and the related retail business of NT Gas Distribution, and the only potential benefit from ring fencing AGP and NT Gas Distribution marketing staff relates to possible information flows that NT Gas Distribution could obtain about potential retail competition through their activities on the AGP.

However, APTNT, as the new owner of the AGP, has entered into a new contract with the sole customer of the pipeline, Power and Water Corporation (PWC), under which PWC has contracted on a firm basis all of the capacity of the pipeline until 28 February 2034.

APTNT submits that in theory, while there is the potential for a new entrant to obtain gas supplies for the purposes of selling to end users, in practice, the low demand and the need for transmission capacity means that this is unlikely.

3.3 AER's consideration

3.3.1 Current waiver application

Prior to the 17 June 2011, the service provider of the AGP, NT Gas, was 96 percent owned by the APA Group. The AGP itself was owned by a banking syndicate and leased to NT Gas as the service provider of the pipeline.

On 17 June 2011, APTNT acquired full ownership of the AGP. As a result, the service provider of the AGP is now 100 percent owned by the APA Group.

Given that the APA Group has remained in control of the AGP following APTNT's acquisition, the AER is of the view that the practical implications of the acquisition are minimal. Therefore, the circumstances in which the AER considers whether to grant a new exemption are similar to those previously considered by the ACCC in 2002.

3.3.1.1 Cost of compliance

In 2002, NT Gas provided the Commission with confidential estimates of the costs involved in obtaining marketing services from an external source. While the Commission did not consider that the estimate of compliance costs was reasonable, it concluded that the cost of complying with the ring fencing provisions would be substantial in relation to the revenue of NT Gas Distribution.

In its 2011 application, APTNT submits that in order to comply with the ring fencing obligations under the NGL, it would need to hire an addition resource to conduct the distribution and retail activities of NT Gas Distribution at a cost of $236,000 per annum. APTNT considers that the cost benefit of hiring a consultant would be unlikely to outweigh direct employment.

In NT Gas's 2011 Access Arrangement for the AGP, NT Gas accepted the AER's sales and marketing cost estimate of $172,000 per annum. The AER notes that while the Access Arrangement cost estimate relates to the AGP only, the estimates provided for NT Gas Distribution as part of APTNT's exemption application are considerably higher.

While the AER does not agree that the cost of compliance proposed by APTNT is reasonable, it does consider that the cost of complying with the ring fencing obligations may have a significant impact on the revenue of NT Gas Distribution.

3.3.1.2 Public benefit of compliance

In 2002, NT Gas submitted that neither it nor NT Gas Distribution faced any competitors or potential competitors in the sale of natural gas and, as a result, complying with ring fencing obligations would not produce any public benefit.

At that time, the AGP was fully contracted until 2011, such that the capacity of the pipeline was fully committed to users under pre-existing transportation contracts leaving little scope to grow the market. In the absence of additional supply capacity, there appeared to be little scope for active marketing at the transmission or distribution level.

Similarly, in its 2011 exemption application, APTNT states that PWC has contracted with APTNT on a firm basis all of the capacity of the AGP until 28 February 2034. The AER agrees with APTNT that, in theory, there is the potential for a new entrant to obtain gas supplies for the purpose of selling to end users. However, in practice, given the need for transmission capacity and low demand in the Darwin area, the AER is of the view that there is little potential for a new entrant to obtain gas supplies and compete in this market.

Furthermore, in 2002, NT Gas submitted that the potential market for gas in Darwin was limited due to the size of the city, its small industrial and commercial base, climatic conditions and the availability of alternative fuels. In 2000-01, there were seven customers of the distribution network with a total annual volume of 14.7 TJ. As a result of these factors, NT Gas submitted that there was no real prospect for the development of a competitive market for the supply of natural gas in Darwin.

In its 2011 exemption application, APTNT submitted that the market environment has not materially changed and the same four factors of city size, small industrial and commercial base, climate and availability of alternative competing fuels, continue to result in a low demand for natural gas and an underutilised distribution network. There are currently five customers of the AGP, using approximately 10TJ per annum.

Based on the market environment presented by APTNT, including the low levels of demand and little prospect of a new entrant creating an effective retail market in Darwin, the AER considers that, in line with the 2002 decision, there would be little public benefit in requiring APTNT and NT Gas Distribution to separate their marketing staff.

3.3.2 Repeal of the 2002 exemption

In granting the 2002 exemption, the ACCC retained the right to review the waiver subject to significant changes in the prevailing conditions, identifying in particular:

- the expiry of NT Gas' foundation contract with PWC under which PWC contracted all the capacity on the AGP on a firm basis; or
- the introduction of gas to the region from the Timor Sea.

As these changes have occurred – the PWC foundation contract has expired, and additional gas fields have connected to the AGP – the AER considers that a review of the 2002 waiver is warranted.

Given that NT Gas is no longer the service provider of the AGP and therefore no longer requires the exemption provided by the 2002 decision, the AER considers that repeal of the 2002 exemption is warranted and appropriate.

3.3.3 Conclusion

The AER considers that the practical implications of the acquisition by APTNT of the AGP and the shares in NT Gas are minimal. APTNT is an associate company of the APA Group and APTNT wishes to keep existing staff arrangements in place. Control of the AGP will not change and remains with APA.

The AER has considered APTNT's submissions regarding the cost of complying with the ring fencing requirements in s. 140 the NGL, and is of the view that the compliance costs would be substantial in relation to the revenue of NT Gas Distribution and might materially reduce its profitability.

In addition, the AER considers that the capacity and demand factors which prevented the development of effective competition in downstream markets in 2002 continue to be relevant, and hence the public benefit from APTNT ceasing to share marketing staff with NT Gas Distribution would not be significant unless market conditions changed substantially.

As a result, the AER has concluded that the cost of complying with the ring fencing obligations currently outweighs any associated public benefit and will waive the obligations. The granting of an exemption at this time will not preclude the AER from reviewing the exemption if market conditions change substantially at any time in the future.

4 Draft decision

In accordance with section 146(2)(b) of the NGL, the AER will exempt APTNT from the ring fencing obligations set out in section 140 of the NGL. The AER is satisfied that the cost APTNT would incur in complying with section 140 of the NGL would outweigh any public benefit from meeting these obligations. The exemption will allow staff of APTNT to undertake marketing and sales work for NT Gas Distribution, which is an associate company that carries on a related business.

The AER also repeals the exemption granted to NT Gas pursuant to the ACCC's 13 March 2002 final decision, which waived the requirement for NT Gas to meet the ring fencing requirements set out in sections 4.1(h) and (i) of the Code. The AER is satisfied that the change in market conditions justifies the repeal of this waiver.

The AER has the power to repeal or vary the exemption at any time if the AER is no longer satisfied that the grounds for the exemption are met.

Appendix 1: Media release from APA Group

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ASX RELEASE

16 June 2011

APA acquires the Amadeus Gas Pipeline in the Northern Territory

APA Group (ASX:APA), Australia's largest natural gas infrastructure business, announced today it will acquire the 1,630 km Amadeus Gas Pipeline in the Northern Territory for $63 million. The acquisition is supported by a long term gas transportation agreement.

Commissioned in 1986, the Amadeus Gas Pipeline transports gas to Darwin, Katherine and other locations principally to fuel power generation in the Northern Territory. Gas is delivered into the pipeline via the Bonaparte Gas Pipeline as well as from the Amadeus Basin in Central Australia.

Since 1986 the Amadeus Gas Trust has leased the pipeline from a consortium of financial institutions, and NT Gas as trustee for the Amadeus Gas Trust has managed and operated the pipeline. APA holds a 96% interest in NT Gas and the Amadeus Gas Trust. APA is acquiring the pipeline and associated assets at the end of that lease.

APA has entered into a long term gas transportation agreement with Power and Water Corporation, the Northern Territory's government owned electricity provider. The agreement provides for services on the pipeline to meet the growing energy needs of the Northern Territory and underpins the acquisition.

APA Managing Director, Mick McCormack said the acquisition ensures APA's continued presence in the Northern Territory. "I'm proud of our long history in the Territory. This acquisition, together with our gas transportation agreement, strengthens our strong relationship with Power and Water Corporation and our commitment to meeting the energy requirements of the Territory for the long term."

The acquisition of the pipeline complements APA's interest in the Bonaparte and Wickham Point pipelines and reinforces operational synergies between the three assets. The assets also provide APA with the ability to capture new growth opportunities in the Northern Territory when they arise.