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Application to exempt APTNT from ring fencing obligations under section 140 of the NGL.

Submitted in confidence

1 Introduction

1.1 Waiver application

APT Pipelines NT Pty Ltd (**APTNT**) is a member of the APA Group.

APTNT is seeking an exemption from the Australian Energy Regulator (**AER**) under section 146 of the National Gas Law (**NGL**) from its obligations under section 140 of the NGL. Section 140 prohibits APTNT's marketing staff from being employees, or APTNT employees from being marketing staff, in the related business being conducted by NT Gas Distribution Pty Ltd.

On 17 June 2011, APTNT will acquire:

(a) the Amadeus to Darwin Basin Pipeline (**ABDP**) which is currently owned by a banking syndicate and leased to NT Gas Pty Limited (**NT Gas**) under a leveraged lease - the ABDP is a covered pipeline under the NGL;

(b) the shares in NT Gas Distribution Pty Ltd (**NTGD**) from NT Gas - NTGD owns the Darwin gas distribution network and carries on a 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 ABDP; and

(c) land tenure rights, buildings and other ancillary assets from NT Gas.

As NTGD is an associate of NT Gas, NT Gas currently has a ring fencing waiver in place enabling NT Gas' marketing staff to provide services to NTGD and to enable other staff of NT Gas to act as marketing staff of NTGD. Post-acquisition, APTNT wishes to keep the current staffing arrangements and is therefore formally seeking a new waiver under section 146 of the NGL from the obligations set out under section 140.

Further, under the previous waiver granted by the Australian Competition and Consumer Commission (**ACCC**) to NT Gas, the ACCC noted a review of the waiver would be warranted on the expiry of NT Gas' transmission contract on the ABDP with Power and Water Corporation (**PWC**) (previously the Northern Territory Power and Water Authority) or the introduction of gas to the region from the Timor Sea. The application also addresses these changes in circumstances.

1.2 Costs still outweigh benefits despite change in circumstances

The AER may grant an exemption if the costs of compliance outweigh the public benefits.

In this case, the costs of compliance (in the order of $236,000 per annum) are substantial given NTGD is currently making substantial losses. If the APTNT is required to incur any additional costs purely for compliance reasons, and without any associated revenue, it will be necessary to review the viability of the business.

There are limited public benefits from compliance (if any). The main purpose of ring fencing in this case would be to prevent information flows occurring by the sharing of staff between APTNT in relation to the ABDP and the related retail business of NTGD. The primary concern being addressed is the potential for that information to be used for the benefit of NTGD to prevent other retailers competing in Darwin and the sale of gas to customers connected to the ABDP. In fact, despite changes in upstream arrangements since 2002, the level of demand in the Darwin and surrounding regions is such that it will not, in the foreseeable future, support any retail entry by competitors and thus the need for ring fencing to facilitate such competition is unnecessary. The reasons for the ACCC granting the waiver in 2002 remain relevant today.

1.3 Timing

APTNT requires the AER's decision on the waiver application by 17 June 2011 and therefore would like to discuss with the AER whether an expedited consultation and decision making process is possible.

1.4 APA contact

If you have any queries regarding this application, please contact:

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2 Background

2.1 The 2002 waiver

On 13 March 2002, the ACCC issued its final decision stating it would issue a notice under section 4.15 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the **Code**) waiving the requirement for NT Gas to meet the obligations set out under sections 4.1(h) and (i) of the Code.

Under 4.1(h) and (i) of the Code, a person who is a service provider in respect of a covered pipeline must ensure that:

- its marketing staff are not also servants, consultants, independent contractors or agents of an associate that takes part in a business involved in the producing, purchasing or selling of natural gas, and

- none of its servants, consultants, independent contractors or agents are marketing staff of an associate that takes part in a business involved in the producing, purchasing or selling of natural gas.

The Code has since been replaced by the NGL and National Gas Rules (**NGR**) but section 140 of the NGR is substantially the same as these sections of the Code other than the reference to servants having been replaced with references to officers and employees.

The 2002 waiver was granted in favour of NT Gas, the service provider of the ABDP. In practice, the waiver allowed NT Gas to carry out all the marketing functions for the ABDP as well as for NTGD and, therefore, for the transmission, distribution and retail arms of natural gas supply in Darwin.

In granting the 2002 waiver, 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 ABDP on a firm basis; or

- the introduction of gas to the region from the Timor Sea.

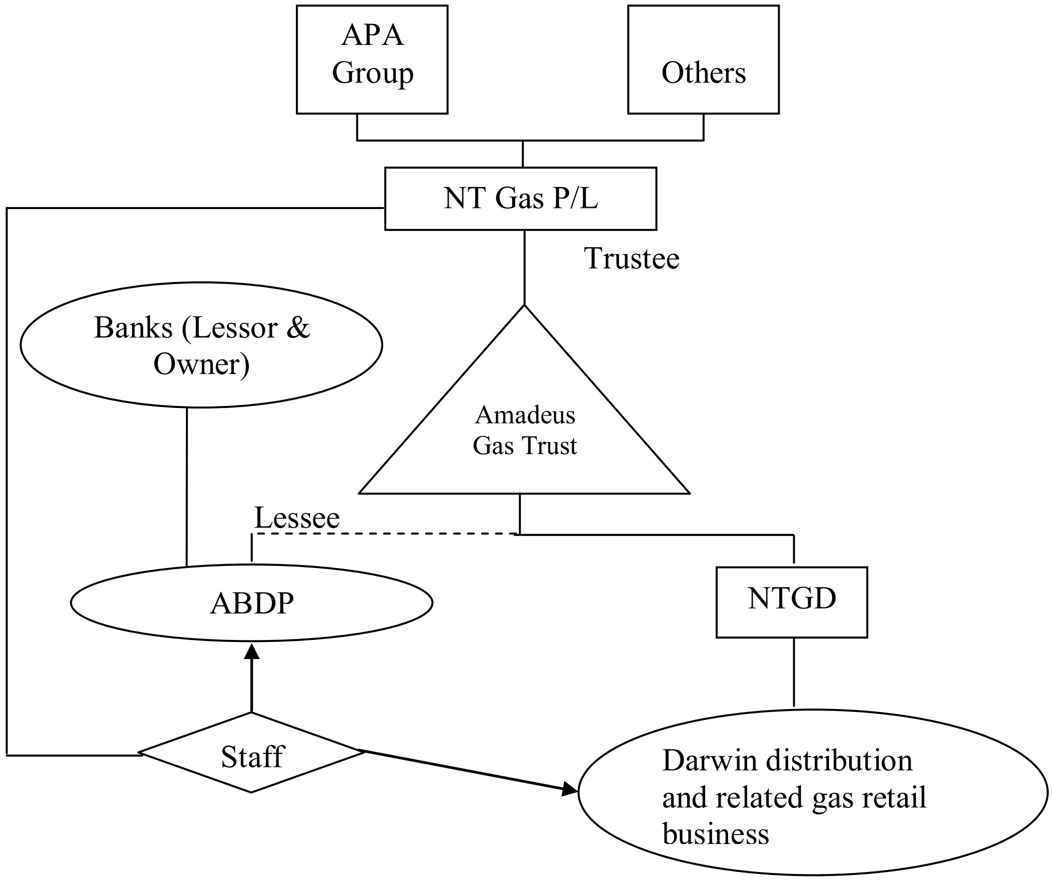
These changes have occurred or are about to occur.

2.2 Ownership arrangements

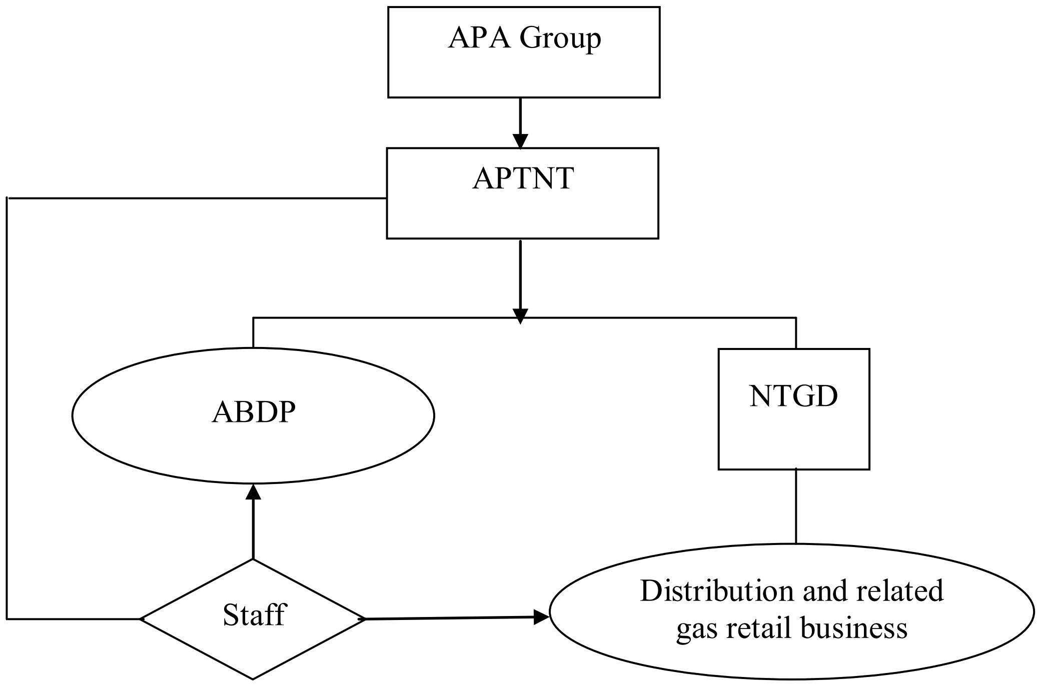
The following diagrams set out the current ownership arrangements.

NT Gas is currently the lessee of the ABDP under a leveraged lease with a number of banks. This lease ends on 17 June 2011 and, on its termination, APTNT will acquire the full title to the ABDP.

Current structure



Structure post acquisition



2.3 Assessment criteria

Section 146 of the NGL enables a covered service pipeline provider to apply to the AER for an exemption from section 140 in accordance with the NGR.

Section 31(4) of the NGR provides for the AER to grant an exemption from compliance with section 140 of the NGL if it is satisfied that the costs of compliance with the relevant requirement for the service provider and its associates would outweigh the public benefits resulting from compliance.

Where the AER is of the opinion that compliance would lead to increased competition in a market, the AER must, in carrying out the assessment, disregard costs associated with losses arising from increased competition in upstream or downstream markets (section 31(5)) of the NGR).

The remainder of this application considers the costs and public benefits of compliance.

3 Costs of compliance

3.1 Current staffing arrangements

NT Gas currently has a Darwin office with approximately 20 people (primarily employees seconded from APA) which provide services in relation to the ABDP and the Darwin distribution network and retail activities. The vast majority of these people do not have a commercial role and are not involved in marketing activities.

The primary issue for the purposes of section 140 is the role of the General Manager, NT Gas and Business Development Manager, NT Gas. Pursuant to the existing waiver, these persons undertake the marketing activities for the ABDP as well as undertaking marketing and other activities for NTGD. From time to time, other persons in the office may provide marketing services for NT Gas in relation to one or both of the ABDP and NTGD. NTGD does not itself directly employ any staff.

The General Manager role in fact encompasses all commercial and operational aspects of the Northern Territory business. All Northern Territory staff report to the General Manager.

No changes to the roles are proposed following APTNT's acquisition of the ABDP and NTGD. This means that a waiver is required for:

- marketing staff of APTNT (the covered pipeline service provider) to be officers, employees, consultants, independent contractors and/or agents of NTGD (an associate taking part in a related business); and

- officers, employees, consultants, independent contractors or agents of APTNT to be marketing staff of NTGD.

3.2 Direct costs of compliance

To meet the ring fencing obligations set out in section 140 of the NGL, NTGD would need to employ a dedicated employee in Darwin, solely to manage and conduct the commercial activities of the distribution and retail activities (which are not separable). It is anticipated that this would be at a total cost of approximately $236,000 per annum, [redacted] The administrative and on costs include, for example, payroll tax, long service leave and sick leave entitlements, the cost of a computer, dedicated printer, telephone, securing information separation protocols, firewalls and other information barriers.

APTNT has considered whether it would be possible to obtain the relevant services from a consultant on a contractual basis but considers this unworkable for the following reasons:

- The level of enquiries about gas connection are not infrequent, particularly from small loads such as bakeries, dry cleaners etc. While all enquiries need to be addressed, very few give rise to a connection due to the very small geographic scope of the network - the gas distribution network runs from the city gate to an industrial park and does not pass through the CBD or main commercial areas.

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

As an alternative, APTNT has considered whether it could use an APA employee not directly involved in the Northern Territory business or another covered pipeline of APA. As APA is not generally involved in the retailing of gas, there is no group of resources generally available from which to source this function. In any case, it is important that the resource be located in Darwin and a fly in, fly out approach is neither cost effective nor realistic.

Finally, all of these models are inconsistent with the current management structure under which the General Manager, Northern Territory has a holistic overview of, and responsibility for, the Northern Territory operations. While reporting and functions could be changed, this would come with attendant loss of efficiencies.

[redacted]

[redacted]

[redacted]

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

4 Minimal public benefit from compliance

4.1 Retail competition in the Northern Territory is theoretical

In its 2002 Final Decision, the ACCC stated the purpose of ring fencing was to assist in the introduction of effective competition into markets traditionally supplied by integrated monopolies by putting in place structures to prevent flow of information and personnel within an integrated utility and between related businesses.

In 2002, the ACCC agreed there was little prospect of retail competition in Darwin. Despite some changes in the upstream supply chain since that time, this is primarily still the case. The primary reason remains the one identified in 2002 - the level of gas demand in Darwin, and most parts of the Northern Territory, is not sufficient to sustain a competitive retail market, as explained further in section 4.2 below. Potential competitors in that market have little interest in undertaking the retail function.

Further, in 2003, the steel main forming the backbone of the Darwin distribution network had its coverage under the Code revoked. As it is not a covered pipeline service provider, there is no need for NTGD to separate or ring fence its distribution and retail functions in any way. Although NTGD is an integrated distribution and retail business, the real purpose of ring fencing in this case then is the separation of the marketing activities of the ABDP and the related retail business of NTGD. It is important to note that there is no ability to foreclose retail entry for gas supply in the Northern Territory by denying access on the ABDP as it is regulated under an access arrangement. The only potential benefit from ring fencing ABDP and NTGD marketing staff relates to possible information flows that NTGD could obtain about potential retail competitors through their activities on the ABDP. However, as discussed below, the ABDP is fully contracted on a firm basis.

4.2 Low level of demand for gas in the Northern Territory

As acknowledged in the ACCC's 2002 Final Decision, a number of factors particular to Darwin have resulted in there being a low demand for natural gas. These factors or natural market dynamics include:

- the small size of the city;
- the climate and the lack of need for space heating, which is a big driver of domestic sales in Southern states;
- the small industrial and commercial base, and the failure of the Trade Development Zone to achieve its anticipated growth; and
- the availability of alternative competing fuels, such as diesel and LPG and solar heating for hot water systems.

These factors remain applicable and, together, have resulted in a continually underutilised distribution network, with the consequent incurring of losses by NTGD as discussed above. In addition, the geographic coverage of the Darwin distribution network is very small so, while enquiries for gas connection are regular, most potential loads cannot be served by the existing network without laying additional pipelines, which is not economic to do.

The size of the Darwin market and the lack of growth is demonstrated by considering the customer loads in the last 10 years.

- In 2000-01, there were seven customers of the distribution network with a total volume of 14.7TJ per annum.
- As indicated in the table below, there are currently 5 customers, operating on month to month contracts, using approximately 10TJ per annum. [redacted]

[redacted]

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

4.3 Barriers to entry and changes since 2002

Since 2002, there have been some changes to the upstream supply arrangements, including those identified by the ACCC as warranting a review of the waiver. Practically, these changes have made little difference to the prospects of an effective retail market developing in Darwin.

(a) Introduction of new gas supplies

Traditionally, gas for Darwin was supplied by the Mereenie Producers from the Amadeus Basin in Central Australia via the ABDP. PWC had a long term gas supply with the Mereenie Producers and had fully contracted the ABDP for the purposes of transporting this gas for use in electricity generation.

Since 2002, additional gas fields have connected to the ABDP.

- Blacktip - As the Mereenie Producer's fields are depleting, PWC will now obtain the bulk of its gas from the Blacktip field in the Bonaparte Basin, an offshore basin situated south west of Darwin. The basin was connected to the ABDP by the Bonaparte pipeline in 2009.

- Bayu-Undan - In 2005, an underwater pipeline from the Bayu-Undan field to Wickham Point near Darwin, was completed for the purposes of supplying gas to an LNG Plant located in the Darwin Harbour. The gas is not used for domestic supply but is available to PWC for emergency use should PWC's supplies from Blacktip be disrupted.

(b) Expiry of the PWC ABDP contract

The ACCC identified that PWC's foundation contract in relation to the ABDP, under which PWC fully contracted the transport rights on that pipeline, was a barrier to new retail entry.

This contract ends on 17 June 2011. However, APTNT as the new owner of the ABDP has entered into a new contract with PWC commencing on 17 June 2011 under which PWC has contracted on a firm basis all of the capacity of the pipeline until 28 February 2034.

In theory, there is the potential for a new entrant to obtain gas supplies for the purposes of selling to end users and for some basin-on-basin competition for the supply of gas within the Northern Territory. However in practice, this does not address the very low demand levels or the need for transmission capacity on the ABDP for gas from the Amadeus or Bonaparte Basins.

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[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

5 Conclusion

APTNT believes it is clear that the costs of compliance outweigh the public benefits.

While there have been some changes in upstream supply arrangements since 2002, they do not alter the reality that the market for retailing gas in the Northern Territory, and Darwin in particular, is too small to be effectively or workably competitive and, accordingly, it is very difficult to see any potential public benefits from requiring compliance with section 140 that would outweigh the substantial costs of compliance.