OFFICE OF GAS ACCESS REGULATION

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DRAFT DECISION:

WAIVER OF RING FENCING OBLIGATIONS

PARMELIA PIPELINE

Application Submitted by:

CMS GAS TRANSMISSION AUSTRALIA

INDEPENDENT GAS PIPELINES ACCESS REGULATOR

WESTERN AUSTRALIA

22 May 2000

PREFACE

On the 31 March 2000, CMS Gas Transmission Australia (CMS) made application for waivers of certain ring fencing obligations under section 4.15 of the *National Gas Pipelines Access Code for Natural Gas Pipeline Systems* (the Code). The application was lodged in respect of the Parmelia Pipeline (Pipeline Licence Numbers WA: PL 1 – 3, 5 and 23).

The procedures for considering the waiver of ring fencing obligations require that a Draft Decision be issued within 14 days after the last day of submissions. The Regulator has no discretion to extend this time period. Submissions were called on 7 April and closed on 8 May 2000. This Draft Decision is therefore required to be issued by 22 May 2000.

There are, however, a number of issues requiring additional information from the applicant before these issues can be adequately addressed under the Code, both in terms of relevance and impact. The Code does not provide sufficient time for this information to be provided prior to issuing this Draft Decision. Accordingly, the required information is being obtained and will be made publicly available during the public consultation period that commences with the issuing of this Draft Decision.

On the basis of the available information, the Regulator assessed the application for waiver of ring fencing obligations against the requirements and principles of the *Gas Pipelines Access (WA) Law 1998* which includes the Code and the *National Gas Pipelines Access Agreement*. In addition, the Regulator has considered issues raised by two submissions lodged in respect of this pipeline.

Further submissions are now invited from interested parties in respect of this Draft Decision. Submissions must be delivered to the Office of Gas Access Regulation by 4 pm (WST) Thursday 31 August 2000, and should be addressed to:

Mr Michael Jansen
Office of Gas Access Regulation
6th Floor
197 St Georges Terrace
PERTH WA 6000

All submissions must be in writing and should be provided in both hard copy and in electronic format.

Copies of the Draft Decision are available from the Office of Gas Access Regulation by contacting Mr Mike Jansen on telephone +61 8 9213 1925 or facsimile +61 8 9213 1999, or through the Office's web site (www.offgar.wa.gov.au).

KEN MICHAEL
GAS ACCESS REGULATOR

DRAFT DECISION

In accordance with section 4.20 of the Code, this Draft Decision is that the Regulator does not intend issuing a notice under section 4.15 of the Code granting a waiver of the ring fencing obligations under sections 4.1(b), 4.1(h) or 4.1(i) of the Code in respect of the Parmelia Pipeline.

However, additional information is being sought from the applicant. The Code does not provide sufficient time for this information to be taken into consideration within the time available for issuing this Draft Decision. The information and advice being sought will be made public via the Regulator's web site (www.offgar.wa.gov.au) during the public consultation period that commences with the issuing of this Draft Decision. The additional information and advice will be taken into account in preparing the Final Decision.

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1 INTRODUCTION

CMS Gas Transmission Australia submitted an application for a waiver of certain ring fencing requirements for the Parmelia Pipeline on 31 March 2000. This application was made under *the National Third Party Access Code for Natural Gas Pipeline Systems* ("the Code") to the Independent Gas Pipelines Access Regulator (the Regulator).

2 PROCEDURES FOR A WAIVER OF RING FENCING OBLIGATIONS

The Code (sections 4.16 to 4.24) sets out the procedures to be followed by the Regulator in considering a request for a waiver. In this particular case the application was received on 31 March 2000, and the actions taken or to be taken are:

- A notice was issued to interested parties on Friday 7 April 2000 and advertisements were placed in the *West Australian* and the *Australian* newspapers on Wednesday 12 April 2000. Included in the advertisements was a call for public submissions.
- The closing date for public submissions was set at 4pm WST Monday 8 May 2000.
- An Issues Paper to assist with the submissions was placed on the Office of Gas Access Regulation web site on 20 April 2000.
- Two submissions were received in respect of this call for submissions.
- This Draft Decision was issued on 22 May 2000.
- A copy of the Draft Decision was forwarded to the Service Provider on 22 May 2000.
- Submissions are invited on this Draft Decision to be received by the Office of Gas Access Regulation (O*ff*GAR) no later than at 4pm WST Thursday 31 August 2000.
- A Final Decision will be issued by 21 September 2000.

3 THE OBJECTIVE OF RING FENCING REQUIREMENTS

A natural gas pipeline Service Provider that has an Access Arrangement under the Code transports natural gas on behalf of third parties such as gas producers, gas marketers, and gas consumers. If the pipeline Service Provider is also a participant in the gas production or the gas sales businesses, then the legislators believed that a potential for anti-competitive behaviour might exist.

The Report by the Independent Committee of Inquiry into National Competition Policy (1993), (The Hilmer Report), examined this problem and reported that (p241):

> …the preferred response to this concern is usually to ensure that natural monopoly elements are fully separated from potentially competitive elements through appropriate structural reforms. In this regard it is important to stress that mere "accounting separation" will not be sufficient to remove the incentives for misuse of control over access to an essential facility. Full separation of ownership or

control is required. In fact, failure to make such separation despite deregulation and privatisation is seen as a major reason why infrastructure reform in the UK has been disappointing.

Where such structural reforms have not occurred, the challenge from a Competition Policy perspective is to provide a mechanism that will support competitive market outcomes by protecting the interests of potential new entrants while ensuring the owner of the natural monopoly element is not unduly disadvantaged.

Ring fencing is part of that mechanism. With ring fencing particular emphasis is placed on the separation of business activities, marketing information, and accounting details and staff between the natural monopoly (gas transport) activity and the competitive activity (gas production or gas sales).

The concern of the legislators that gave rise to ring fencing was that if a third party approached a pipeline Service Provider who was also a competitor in the gas production/gas sales business, information supplied to the gas transport activity, as a condition of seeking access, may be provided to the gas production/gas sales activity and used to the detriment of the third party. The object of ring fencing is to prevent this happening.

4 CODE REQUIREMENTS

Section 4.1 of the Code sets out the minimum requirements for ring fencing.

4.1 A person who is a Service Provider in respect of a Covered Pipeline (regardless of whether they are also a Service Provider in respect of a Pipeline that is not Covered) must comply with the following (but in the case of paragraphs (a), (b), (h) and (i), as from the date that is 6 months after the relevant Pipeline became Covered):

(a) be a legal entity incorporated pursuant to the Corporations Law, a statutory corporation, a government or an entity established by royal charter;

(b) not carry on a Related Business;

(c) establish and maintain a separate set of accounts in respect of the Services provided by each Covered Pipeline in respect of which the person is a Service Provider;

(d) establish and maintain a separate consolidated set of accounts in respect of the entire business of the Service Provider;

(e) allocate any costs that are shared between an activity that is covered by a set of accounts described in section 4.1(c) and any other activity according to a methodology for allocating costs that is consistent with the principles in section 8.1 and is otherwise fair and reasonable;

(f) ensure that all Confidential Information provided by a User or Prospective User is used only for the purpose for which that information was provided and that such information is not disclosed to any other person without the approval of the User or Prospective User who provided it, except:

(i) if the Confidential Information comes into the public domain otherwise than by disclosure by the Service Provider; or

(ii) to comply with any law, any legally binding order of a court, government, government or semi-government authority or administrative body or the listing rules of any relevant recognised Stock Exchange;

(g) ensure that all Confidential Information obtained by the Service Provider or by its servants, consultants, independent contractors or agents in the course of conducting its business and which might reasonably be expected to affect materially the commercial interests of a User or Prospective User is not disclosed to any other person without the approval of the User or Prospective User to whom that information pertains, except:

(i) if the Confidential Information comes into the public domain otherwise than by disclosure by the Service Provider; or

(ii) to comply with any law, any legally binding order of a court, government, government or semi-government authority or administrative body or the listing rules of any relevant recognised Stock Exchange;

(h) ensure that its Marketing Staff are not also servants, consultants, independent contractors or agents of an Associate that takes part in a Related Business and, in the event that they become or are found to be involved in a Related Business contrary to this section, must procure their immediate removal from its Marketing Staff; and

(i) ensure that none of its servants, consultants, independent contractors or agents are Marketing Staff of an Associate that takes part in a Related Business and, in the event that any servants, consultants, independent contractors or agents are found to be the Marketing Staff of such an Associate contrary to this section, must procure their immediate removal from their position with the Service Provider.

5 PROVISIONS FOR THE WAIVER OF RING FENCING OBLIGATIONS

The legislators also recognised that the ring fencing obligations may not always be appropriate, either because of the particular circumstances for a given pipeline with respect to the potential for the misuse of information, or the cost of meeting the ring fencing obligations relative to the benefits. Provision was made by section 4.15 of the Code for the Regulator to waive certain of the ring fencing requirements as follows:

4.15 The Relevant Regulator may by notice to a Service Provider waive any of a Service Provider's obligations under:

(a) section 4.1(b) where the Relevant Regulator is satisfied that:

(i) either the Covered Pipeline is not a significant part of the Pipeline system in any State or Territory in which it is located or there is more than one Service Provider in relation to the Covered Pipeline and the Service Provider concerned does not have a significant interest in the Covered Pipeline and does not actively participate in the management or operation of the Covered Pipeline; and

(ii) the administrative costs to the Service Provider and its Associates of complying with that obligation outweighs any public benefit arising from the Service Provider meeting the obligation, taking into account arrangements put in place by the Service Provider (if any) to ensure that Confidential Information the subject of sections 4.1(f) and (g) is not disclosed to the Service Provider or is not disclosed to the servants, consultants, independent contractors or agents of the Service Provider who take part in a Related Business; and

(iii) an arrangement has been established between the Service Provider and the Relevant Regulator which the Relevant Regulator is satisfied replicates the manner in which section 7.1 would operate if the Service Provider complied with section 4.1(b); and

(b) sections 4.1(h) and (i) where the Relevant Regulator is satisfied that the administrative costs to the Service Provider and its Associates of complying with that obligation outweigh any public benefit arising from the Service Provider meeting the obligation.

In section 4.15(a)(iii) above, mention is made of Section 7.1 that reads:

7.1 A Service Provider must not enter into an Associate Contract without first obtaining the approval of the Relevant Regulator. The Relevant Regulator must not refuse to approve a proposed Associate Contract unless it considers that the contract would have the effect, or would be likely to have the effect, of substantially lessening, preventing or hindering competition in a market.

An "Associate Contract" is defined in Section 10.8 as:

(a) a contract, arrangement or understanding between the Service Provider and an Associate in connection with the provision of a Service; or

(b) a contract, arrangement or understanding between the Service Provider and any person in connection with the provision of a Service which provides a direct or indirect benefit to an Associate and which is not an arm's length transaction.

By only allowing a waiver to be considered with respect to the ring fencing requirements under sections 4.1(b), 4.1(h), and 4.1(i) the legislation clearly intends that the ring fencing requirements are not to be taken lightly. In particular, no waiver is possible with respect to:

- the requirements to be a legal entity (sections 4.1(a));
- the requirements for separate accounts (Sections 4.1(c), 4.1(d), and 4.1(e)); and
- the requirements for non-disclosure of confidential information (Sections 4.1(f) and 4.1(g)).

6 TESTS FOR CONSIDERING AN APPLICATION FOR A WAIVER

The waiver provisions set out above impose a series of tests for the Regulator to consider in assessing an application for a waiver of the ring fencing obligations.

For a waiver of section 4.1(b) ("not carry on a Related Business") there are three separate tests required by section 4.15(a) of the Code, all of which must be met before the Regulator can approve a waiver of this requirement.

The first test is:

> *Whether the Pipeline is not a significant part of the Pipeline System in the State in which it is located* <u>*or*</u> *whether the Service Provider seeking the waiver does not have a significant interest in the Pipeline, and does not actively participate in the management or operation of the Pipeline.*

The second test is:

> *Whether the administrative costs to the Service Provider and its Associates of complying with the obligation not to carry on a Related Business outweighs any public benefit arising from the Service Provider meeting the obligation. In making this judgement the Regulator is required to take into account any arrangements put in place by the Service Provider to ensure that confidential information is not disclosed to those in the Related Business.*

The third test is:

> *Whether an arrangement has been established between the Service Provider and the Regulator that satisfies the Regulator that it replicates the manner in which section 7.1 would operate if the Service Provider complied with section 4.1(b).*

For a waiver of the separated staff requirement (sections 4.1(h) and 4.1(i)) there is only one test required by section 4.15 of the Code for the Regulator to consider:

> *Whether the administrative costs outweigh any public benefit from the obligation to maintain separated staff.*

For the purposes of the above tests, the Code has not defined 'significant' or 'public benefit', leaving these to the judgement of the Regulator.

7 CONSIDERATION OF THE TESTS FOR THE PARMELIA PIPELINE

This section gives consideration to each of the tests set out in section 4.15 of the Code in the light of the claims made in the application by the applicant.

Two public submissions were received in respect of this application. One of the submissions was from AlintaGas Trading and the other from Origin Energy Retail Ltd.

7.1 THE "NOT CARRY ON A RELATED BUSINESS" REQUIREMENT

The "not carry on a Related Business" requirement is a provision of section 4.1(b).

7.1.1 The First Test

The first test is a provision of section 4.15(a)(i):

> *The Pipeline is not a significant part of the Pipeline System in the State.*

CMS in its application claims that the Parmelia Pipeline represents only a minority (five per cent) share of the gas transmission market in which it competes and a minority (0.4 per cent) share of the gas distribution market in which it competes. CMS has indicated that, relative to the Dampier to Bunbury Natural Gas Pipeline (DBNGP), the Parmelia Pipeline is insignificant in terms of the pipeline system of the State. Similarly, relative to the AlintaGas distribution system, and based on present sales through the Parmelia Pipeline into the AlintaGas distribution system, the claim is made that the Parmelia Pipeline is insignificant.

A further claim of insignificance is based on the fact that the effective capacity of the Parmelia Pipeline has been reduced from 120 TJ/day to 65 TJ/day by the removal of compressor stations. In addition, of the present 65 TJ/day capacity, 26 per cent of that is said to be unused.

CMS also rejects the argument that the Parmelia Pipeline is the only pipeline capable of taking gas whose gas quality specifications are outside those of the DBNGP. The reality, they argued, is that out of specification gas can be delivered to the DBNGP. However, the question of any penalty that may be imposed on gas that does not meet the LPG specification of the DBNGP needs to be considered.

CMS also claims that the Parmelia Pipeline is only capable of direct connection to a tiny fraction of AlintaGas customers. The connection between the DBNGP and the Parmelia Pipeline in the Dongara region, as well as a proposed connection directly into the AlintaGas distribution system may also be relevant in considering this matter.

CMS claims that even if capacity rather than current throughput is taken as the indicator of significance, its capacity is small relative to the DBNGP. CMS also claims the Parmelia Pipeline has a limited geographical reach with respect to distribution customers. That claim is, however, contested in the submission from AlintaGas Trading because of the connection to be made to the distribution system from the Parmelia Pipeline (see below).

On the basis of the above arguments, it is claimed by CMS that the Parmelia Pipeline is not a significant pipeline in Western Australia.

Submissions from Interested Parties

AlintaGas Trading

AlintaGas submits that the Regulator should measure the significance of the Parmelia pipeline by considering the potential market that can be supplied by the Parmelia pipeline. The Parmelia pipeline has the capacity to supply all demand in the metropolitan distribution system together with some major customers in the South-West. This will provide users of the Parmelia pipeline with access to at least 80% of the South-West gas market by volume and 95% of the market by customer numbers that is not committed to long term supply contracts. This is clearly a significant portion of the market

Consideration should be given to likely future outcomes that will increase the competitive position of the Parmelia pipeline. Two such outcomes are the complete deregulation of the gas market by mid 2002 and connection of the Parmelia pipeline to the metropolitan distribution system. These changes will give users of the Parmelia pipeline access to about 395,000 tariff and 250 contract customers. AlintaGas submits that this puts the Parmelia pipeline in a significant market position.

Gas producers in the Perth Basin are at a competitive advantage when compared to producers in the North-West because of the geographic proximity of Perth Basin gas fields to the South-West gas market. Users that are able to negotiate appropriate access to the Parmelia pipeline will be in a strong position to benefit from this geographic proximity. If CMS is not ring fenced there will be no realistic opportunity for marketers such as AlintaGas, which compete with CMS's marketing business, to utilise the Parmelia pipeline. The potential for marketers other than CMS and CMS's associates to access gas supplies from the Perth Basin will, effectively, be unavailable.

Whilst connection of the Parmelia pipeline to the metropolitan distribution system will increase CMS's competitiveness, AlintaGas submits that CMS is already a significant player in the State's gas industry. When the Parmelia pipeline was constructed in 1971 it was designed to pass through the major industrial areas in Perth's southern suburbs. Thus, the Parmelia pipeline passes through Canning Vale, Kewdale, Kwinana, O'Connor and Welshpool. These are significant areas of gas demand. CMS is in the unique position of being able to choose not to use the metropolitan distribution system in delivering gas to these areas, allowing CMS to circumvent the government's gas deregulation timetable.

> AlintaGas contends that to say CMS and the Parmelia pipeline are not significant players in the State's gas industry is incorrect. As far as AlintaGas is aware, CMS has gas transportation arrangements with two of the largest shippers on the DBNGP, in Western Power and Alcoa. In its role as a gas marketer, CMS already supplies gas via the Parmelia pipeline to end users such as Alcoa, Jandakot Wool Scourers, Midland Brick and Western Mining.

The submission from AlintaGas Trading stated that the Parmelia Pipeline is a significant pipeline as it has the capacity to meet the current demand made by the whole of the gas distribution system as well as its existing sales. Thus, significance should be determined in terms of capacity to supply rather than current throughput.

AlintaGas also claimed that CMS gas marketing competes with AlintaGas marketing and as AlintaGas will be subject to ring fencing, the same obligation should apply to CMS. Ring fencing for AlintaGas, however, is not required by the Code until 1 July 2002, although the sale of AlintaGas will bring the requirement for ring fencing forward as provided for by the Gas Corporation (Business Disposal) Act 1999.

As the Parmelia Pipeline will have a direct connection to the gas distribution system this, according to AlintaGas, will enable CMS to compete directly for customers with AlintaGas on the distribution system, particularly when full deregulation takes effect from 2002. In addition, AlintaGas believes that it could see itself in a position of wanting to use the Parmelia Pipeline for gas transport. It would want to feel confident that any information supplied for the purposes of the transport of gas was not used in ways that would frustrate AlintaGas gas marketing operations.

AlintaGas also stresses that the Perth Basin gas producers already have a competitive edge over Carnarvon Basin producers because of the shorter transport distances involved.

Furthermore, the Parmelia Pipeline passes through key industrial areas where there is potential for competition with AlintaGas. The direct connection that the Parmelia Pipeline has through these industrial areas means it can avoid the AlintaGas distribution system and get ahead of the deregulation timetable imposed on the distribution system by the Government.

AlintaGas also raised the issue of the potential for cross-subsidy between the gas transport and gas marketing divisions of CMS.

Finally, AlintaGas argues that significance may be gauged from the fact that the Parmelia Pipeline supplies major customers in the form of Western Power and Alcoa.

> **Origin Energy Retail Ltd**
>
> CMS control one of two major shipping pipelines into the Perth major industrial markets being the Parmelia Pipeline. They have stated they are planning to extend this network by laterals and connections to the Alinta distribution network.
>
> CMS is the owner and operator of the processing plant at Dongara and has a Gas Marketing Alliance with ARC Energy, owner of the Dongara Gasfield. In addition, CMS has a gas storage business at Mondarra. Together with their gas purchase and transport arrangements on the DBNGP to Mondarra these businesses provide market information on all new customer contracts and requirements and how other potential gas suppliers are proposing to bid on these contracts.

> Origin Energy believes there should be a complete separation between gas transportation and gas marketing businesses. Without separation CMS has a significant advantage in gas marketing along the Parmelia Pipeline.

Origin Energy in its submission pointed out that the Parmelia Pipeline is one of two major shipping pipelines to industrial gas consumers in the south-west of the State, and that plans are in place to extend the reach of the Parmelia Pipeline through connection to the AlintaGas distribution network.

Origin also indicates that the significance of CMS in the gas market is indicated by its role as owner and operator of a gas processing plant, and its alliance with ARC Energy, the owner of the Dongara gas field. In addition, CMS has a gas storage business based on the previously depleted Mondarra gas field.

According to Origin, all of these activities, when combined with the transport arrangements, mean that there are significant ways in which CMS could acquire information on the activities of other potential gas marketers proposing to enter into gas supply contracts using the Parmelia Pipeline as the transport route.

Consideration of the Regulator

From the Regulator's perspective, the fact that the pipeline is currently under utilised is not a consideration that gives rise into insignificance. The natural gas market and its associated institutional structures and practices in this State are still at what could be termed an immature level. The gas market has yet to develop comprehensive depth in terms of the number of participants and breadth in terms of the types of activities carried out in the market to meet the needs of consumers. Of particular significance for the Parmelia Pipeline is the possibility that in the future that gas storage using the depleted gas fields in the Dongara area of the Perth basin could become a major industry.

The *Western Australian Oil and Gas Review 1998* prepared by the State Department of Resources Development commented that (p.10):

> …the potential benefits of using the Mondarra field for gas storage include:
>
> - emergency gas supplies in the event of a major disruption to gas supplies such as a cyclone;
> - an option for the management of supply and demand imbalances;
> - support for transportation services such as peaking;
> - optimisation of gas supply and transportation arrangements; and
> - added reliability for interruptible production such as associated gas.

There may also be further discoveries of natural gas in the Perth Basin.

In these circumstances, it is inappropriate to assume that the current under utilisation of Parmelia Pipeline will continue long into the future. For the gas industry in Western Australia to mature, the appropriate institutional structures need to be in place to give confidence to gas producers, marketers and consumers that they will have access to the gas transport networks on fair and competitive terms. An important component of those structures is the isolation of the gas transport business from any gas marketing interests that may be associated with the owner/operator of the pipeline. Otherwise, there may be a deterrent to these future developments in the natural gas industry in Western Australia.

A further element of this first test based on section 4.15(a)(i) is that:

> *The Service Provider concerned does not have a significant interest in the pipeline.*

As a component of this first test, the Code requires an assessment of whether the Service Provider seeking the waiver does not have a significant interest in the pipeline and does not actively participate in the management or operation of the pipeline. CMS does have a significant interest in the pipeline as the full owner and it actively participates in the management and operation of the pipeline. As a result, there is therefore no basis for a waiver on the basis of the role of the service provider that has made the application.

Regulator's Finding

Because of its potential capacity to transport gas, its association with the gas storage business, and because of its interconnections into the DBNGP, major industrial areas in the Perth area, and the AlintaGas distribution system, the Regulator finds that the Parmelia Pipeline is in fact a significant pipeline in Western Australia.

7.1.2 The Second Test

The second test is a provision of section 4.15(a)(ii):

> *Whether the administrative costs to the Service Provider and its Associates of complying with the obligation not to carry on a Related Business outweighs any public benefit arising from the Service Provider meeting the obligation. In making this judgement the Regulator is required to take into account any arrangements put in place by the Service Provider to ensure that confidential information is not disclosed to those in the Related Business.*

CMS has argued that the cost of meeting the "not carry on a Related Business" requirement would force it to incur substantial losses as it would be involved in a forced sale because of the need to dispose of its existing integrated gas supply and gas transport contracts. It also argues that to restructure to separate gas transport and gas trading functions, there would be substantial costs, estimated at eight per cent of annual regulated revenue.

CMS claims that by preventing it from providing an integrated gas supply and transport service, little, if any, tangible public benefit would result. This is because the additional costs imposed on CMS would reduce its ability to participate in a competitive gas market. This outcome, CMS argues, would not be in the public interest.

CMS has made no specific offer of an arrangement to provide a general structure for the appropriate treatment of confidential information. What is offered is a procedure, based on a Code of Conduct, for dealing with situations in which there is a conflict of interest. In this offered arrangement, whenever a conflict of interest occurs between a possible gas transport contract with the Parmelia Pipeline and the gas marketing business of CMS, separate staff will be brought in to deal with the gas transport contract on a confidential basis, on a case-by-case basis.

Submissions from Interested Parties

AlintaGas Trading

> AlintaGas considers CMS's proposed confidentiality arrangements to be unsuitable. AlintaGas submits that, for the reasons presented in this submission, CMS should be required to comply with the ring fencing requirements of the National Access Code.

The AlintaGas submission stressed that gas marketers require confidence that structures are in place to ensure that any information supplied by a gas marketer to a gas pipeline transport Service Provider that also operates a Related Business is guaranteed of strict confidentiality. AlintaGas found unacceptable the proposals made by CMS to deliver that confidentiality without the formal ring fencing requirements.

Consideration of the Regulator

The public benefits of the ring fencing requirements cannot be quantified in the same way that the costs of ring fencing may be quantified. The purpose of the ring fencing requirements is to put in place institutional structures that will deliver benefits through their potential to generate not only competition in the natural gas industry, but also the growth and development of that industry. As long as these outcomes are possible, the costs of ring fencing to a service provider would have to be demonstrated to be significant.

Costs indicated by CMS are with respect to the assumed need to dispose of existing integrated contracts. This concern with existing contracts implies that the legislation is retrospective. There does not appear to be anything in the legislation that explicitly requires such retrospectivity.

No evidence was provided by CMS as to why the separation of the gas transport and gas trading functions would incur costs equivalent to 8 per cent of regulated revenue. The appointment of a single stand alone gas transport marketer to operate out of a separate wholly owned entity responsible for the gas transport business would not appear to be excessively onerous, but, as indicated, no evidence was offered as to why it might be.

As part of this 4.15(a)(ii) test, the Regulator is required to take into account any arrangements offered by the Service Provider to ensure that confidential information is not disclosed to those in a related business. No general arrangement is offered by CMS to meet this requirement.

Regulator's Finding

As CMS has not demonstrated that costs outweigh the public benefit of the ring fencing requirement, and that the arrangements proposed by CMS for dealing with confidential information do not sufficiently address the requirements of Section 4.15(a)(ii), the Regulator considers that the grounds for a waiver under this test are not substantiated.

7.1.3 The Third Test

The third test is a provision of section 4.15(a)(iii):

> *Whether an arrangement has been established between the Service Provider and the Regulator that satisfies the Regulator that it replicates the manner in which section 7.1 would operate if the Service Provider complied with section 4.1(b).*

If the Service Provider complied with section 4.1(b) and did not carry on a related business then all of the gas transport arrangements would be in the form of distinct contracts between business entities. Section 7.1 is designed to cover the situation where those contracts are with a business entity that is an Associate, and hence may have the potential to lessen, prevent or hinder competition in the market by offering terms and conditions not offered to third party users. Section 7.1 requires that a contract with an Associate of the transport Service Provider has the approval of the Regulator.

If the "not carry on a Related Business" requirement were to be waived for a Service Provider, the legislation still seeks to ensure that the gas transport arrangements on behalf of the Related Business are carried on under terms and conditions that do not lessen, prevent or hinder competition in the market. In other words, an arrangement should be in place to provide for the Regulator's approval of the gas transport terms and conditions for the Related Business.

What is offered by CMS is a commitment to work co-operatively with the Regulator on the specific details of the processes for meeting the requirements of Section 7.1, following any consultation process.

Submissions from Interested Parties

AlintaGas Trading

> AlintaGas considers CMS's proposals to deal with associated contracts are not sufficiently detailed. Once CMS is ring fenced, the Regulator must satisfy himself that CMS's associated contracts are acceptable.

The AlintaGas submission claims that this offer is not sufficiently detailed. Section 7.1 demands that the whole of the terms and conditions under which gas is transported in the Related Business should be subject to the approval of the Regulator. Acceptance of that condition is necessary.

Regulator's Finding

The Regulator considers that CMS has not satisfactorily provided a process that addresses the requirement under Section 7.1 of the Code.

7.2 REQUIREMENTS RELATING TO MARKETING STAFF

The requirements that the Marketing staff of the Service Provider are not also in a Related Business and that the staff of the Service Provider are not marketing staff of the Related Business are provisions of sections (4.1(h)) and (4.1(i)) of the Code.

The only test in relation to section 4.15(b) is:

> *Whether the administrative costs outweigh any public benefit from the obligation to maintain separated staff.*

Currently a single marketer is responsible for all marketing activities on the Parmelia Pipeline including gas transport, the marketing of integrated gas and gas transport services, and the delivery of transport capacity associated with the DBNGP and the AlintaGas distribution system. To separate out the marketing of gas transport from the other marketing activities, it is claimed, would constitute a significant expense and lead to under-utilisation of the extra staff. Although these additional costs will be eligible for cost recovery through regulated tariffs, it is argued that in competition with a much larger pipeline, those costs are relatively large due to the absence of economies of scale.

Furthermore, as the Parmelia Pipeline is claimed to be a minority player in gas transport and as the proportion of gas transported under integrated gas supply and transport contracts is small (six per cent of capacity) it is argued that little is to be gained by enforcing the hiring of additional marketing staff.

CMS recognises that a single person dealing with both gas sales from its own sources, and gas transport on behalf of third parties, does offer a potential conflict of interest. In this situation, CMS offers a Code of Conduct, which will require CMS to inform prospective pipeline users of any potential conflict of interest. Where a conflict of interest occurs marketing activities related to the transport component will be handled by separate staff on a case-by-case basis.

CMS is also of the view that as it is involved in pipeline on pipeline competition, it cannot afford to compromise its reputation for fair and honest dealing.

The Code intends that the granting of a waiver of the ring fencing requirements should only occur where the circumstances meet the tests that are imposed. The Introduction to the Code sets out the public benefits that are expected to flow from the Code as follows:

> The objective of this Code is to establish a framework for third party access to gas pipelines that:
>
> (a) facilitates the development and operation of a national market for natural gas; and
>
> (b) prevents abuse of monopoly power; and

(c) promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders; and

(d) provides rights of access to natural gas pipelines on conditions that are fair and reasonable for both Service Providers and Users; and

(e) provides for resolution of disputes.

Consideration of the Regulator

The separation of marketing staff is an important requirement of the Code by assisting in the pursuit of objectives (b), (c), and (d) above. The costs of compliance are required to outweigh the public benefit that may flow from the requirement before a waiver may be given. It is not sufficient to indicate that this requirement does have a cost. It is also necessary to demonstrate that the costs outweigh the public benefit.

CMS has argued that the public benefit is small, because the Parmelia Pipeline is only a minority player in the gas transmission and distribution markets in which it competes, and that the proportion of gas transported under integrated gas supply and transport contracts for the Parmelia Pipeline is small.

By contrast AlintaGas contends that the potential for the Parmelia Pipeline to be a major supply line is substantial and that it would be inappropriate to grant CMS a waiver of the restrictions imposed by the ring fencing requirements of the Code.

Regulator's Finding

On the basis of the discussion above, the Regulator considers that the Parmelia Pipeline is a significant pipeline and that it has the potential to be associated with new gas market developments in Western Australia. In addition, the appointment of a single stand alone gas transport marketer is not considered to impose a burden that would outweigh the public benefit from having a separation of marketing staff. The ring fencing arrangements should engender confidence that confidential information will be used appropriately, and that concern is of significant public interest. The Regulator therefore considers that a waiver of these sections of the ring fencing requirements cannot be granted. What is required is a separate gas transport business to market capacity on the Parmelia Pipeline.

8 GLOSSARY

Terms used in the Draft Decision have the meanings ascribed to them under the *Gas Pipelines Access (WA) Act 1998* or as otherwise defined in the documents pertaining to the application by CMS for a waiver of ring fencing obligations. In order to assist understanding, summary definitions of several terms that may be relevant to this Draft Decision are provided below.

Access Arrangement	A statement of policies and the basic terms and conditions that apply to third party access to a covered pipeline.
Access Arrangement Information	Additional and/or supplemental information pertaining to the Access Arrangement.
Access Request	A request for access to a Service made in accordance with the Access Arrangement.
Associate	Has the meaning given in the Gas Pipelines Access Law.
Capacity	The potential of a pipeline, as currently configured and operated in a prudent manner consistent with good pipeline industry practice, to deliver a particular service between a Receipt Point and a Delivery Point at a point in time.
Code	The *National Third Party Access Code for Natural Gas Pipeline Systems.*
Confidential Information	Information that is by its nature confidential or is known by the other party to be confidential and includes: (a) any information relating to the financial position of the party and in particular includes information relating to the assets or liabilities of the party and any other matter that affects or may affect the financial position or reputation of the party; (b) information relating to the internal management and structure of the party or the personnel, policies and strategies of the party; (c) information of the party to which the other party has access, other than information referred to in paragraphs (a) and (b), that has any actual or potential commercial value to the first party or to the person or corporation which supplied that information; and (d) any information in the party's possession relating to the other party's clients or suppliers and like information.

Contracted Capacity	The nominal quantity of gas transportation to be undertaken under a service agreement between a User and the Service Provider.
Covered Pipeline	The whole or particular part of a pipeline which is regulated under the Code.
Grandfathered Contract	A contract for the provision of gas transportation services by CMS, whether or not in conjunction with other services, entered into before the date for complying with the ring fencing provisions of the Code.
National Gas Pipelines Access Agreement	A national agreement endorsed by CoAG and sighed by all Australian Heads of State on 7 November 1997 to introduce a national gas pipelines access regime.
Parmelia Pipeline	The pipeline system that is the subject of Pipeline Licenses PL1, PL2, PL3, PL5 and PL23 issued under the *Petroleum Pipeline Act 1969 (WA).*
Prospective User	A person who seeks or who is reasonably likely to seek to enter into a Service Agreement with a Service Provider and includes a User who seeks or may seek to enter into a Service Agreement for an additional Service.
Reference Services	A Service that is specified as a Reference Service in an Access Arrangement.
Reference Tariff	A tariff specified in an Access Arrangement as corresponding to a Reference Service.
Regulator	Independent Gas Pipelines Access Regulator in Western Australia established under the *Gas Pipelines Access (WA) Act 1998*.
Related Business	The business of producing, purchasing or selling Natural Gas, but does not include purchasing or selling of Natural Gas to the extent necessary: (a) for the safe and reliable operation of a Covered Pipeline; or (b) to enable a Service Provider to provide balancing services in connection with a Covered Pipeline.
Ring Fencing	A requirement on a Service Provider to establish arrangements to segregate or “ring fence” its business of providing Services using a covered pipeline from other business activities.
Service	A Reference Service or Non-Reference Service relating to the transportation of gas by a Service Provider, and in the case of a Service Agreement means the particular reference Service or Non-Reference Service the subject of that Service Agreement.

Service Agreement	An agreement between a Service Provider and a User for the provision of a Service.
Service Provider	In relation to a pipeline or proposed pipeline, means the person who is, or who is to be, the owner or operator of the whole or any part of the pipeline or proposed pipeline.
User	A person who has a current Service Agreement or an entitlement to a Service as a result of arbitration under Section 6 of the Code.

9 ABBREVIATIONS

AA	Access Arrangement
AAI	Access Arrangement Information
ACCC	Australian Competition and Consumer Commission
CoAG	Council of Australian Governments
CMS	CMS Gas Transmission Australia
DBNGP	Dampier to Bunbury Natural Gas Pipeline
GJ	Gigajoules (10^9 joules)
O*ff*GAR	Office of Gas Access Regulation
PJ	Petajoules (10^{15} joules)
TJ	Terajoules (10^{12} joules)