



Issues Paper

**To Assist with Submissions on the
Proposed Waiver of Ring Fencing
Arrangements**

**for the
Parmelia Pipeline**



1. INTRODUCTION

The purpose of this paper is to assist interested parties in making submissions on the application by CMS Gas Transmission Australia (CMS) to waive ring fencing obligations for the Parmelia Pipeline.

On 31 March 2000, CMS submitted an application for a waiver of ring fencing obligations for the Parmelia Pipeline (Licence Numbers WA: PL 1-3, 5 & 23). This application was made under section 4.16 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the Code).

A copy of this application for waiver is available at no cost from the Office of Gas Access Regulation (*OffGAR*) web site (www.offgar.wa.gov.au). Requests for the documents can be made to:

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A notice was issued to interested parties on Friday 7 April 2000 and advertisements were published in the *West Australian* and the *Australian* newspapers on Wednesday 12 April 2000, advising that the application for waiver of ring fencing obligations had been lodged.

The notice and advertisements invited public submissions to be lodged with *OffGAR* by 4pm Monday 8 May 2000 (WST).

Within 14 days after the last day for submissions specified in the notice published under section 4.17(b) of the Code, the Regulator must issue a Draft Decision stating whether or not a notice is intended to be issued to waive the ring fencing obligations (section 4.15).

At the time when the Draft Decision is issued, the Regulator is required (section 4.21b) to request submissions from persons who request a copy of the Draft Decision.

Within 21 days after the last day for submissions on the Draft Decision, the Regulator must (section 4.23) issue a Final Decision stating whether or not a notice, as provided for under section 4.15, will be issued to waive the ring fencing obligations.

2. BACKGROUND

2.1 The Pipeline System

The Parmelia Pipeline, constructed in 1971, consists of the gas pipeline licence numbers WA: PL1-3, 5 & 23. The Pipeline comprises 416 km of gas pipeline of 350mm diameter and extends from the Dongara gas field near Geraldton to Pinjarra just south of Perth.

2.2 Waiver of Ring Fencing Obligations

Section 4 of the Code details the requirements for the ring fencing of pipelines covered by the Code. The goal of these provisions is to sequester or segregate the natural monopoly transmission and distribution portions of the gas supply chain from upstream and downstream activities to prevent market inefficiencies in potentially competitive parts of the gas market. Minimum ring fencing requirements are specified in section 4.1 of the Code and require a pipeline service provider to:

- (a) be a legal entity;
- (b) not carry on a related business (essentially a business of producing, purchasing or selling natural gas);
- (c) establish and maintain separate accounts for the activity that is the subject of each Access Arrangement;
- (d) establish and maintain a consolidated set of accounts for all the activities undertaken by the Service Provider;
- (e) allocate costs shared between different accounts in a fair and reasonable manner;
- (f) ensure that confidential information provided by a User or a Prospective User is used only for the purposes for which it is provided and is not disclosed without the User or the Prospective User's consent;
- (g) ensure that confidential information obtained by a service provider which might reasonably be expected to materially affect the commercial interests of a User or Prospective User is not disclosed to any person without the permission of the User or Prospective User to whom the information pertains;
- (h) ensure that marketing staff of a Service Provider are not also working for an Associate that takes part in a related business; and
- (i) ensure that marketing staff of an Associate that takes part in a related business are not also working for the Service Provider.

The Regulator may also require a pipeline Service Provider to meet additional ring fencing obligations, but no such obligations are currently under consideration in respect of the Parmelia Pipeline.

Section 4.15 of the Code provides for certain ring fencing obligations that may be waived. These are:

- the requirement that the Service Provider does not carry out a related business (section 4.1 (b)); and
- The requirement that marketing staff of a Service Provider and Associate are separate (sections 4.1(h) and (i)).

CMS has applied for a waiver of all of these obligations for which a waiver is available.

3 ISSUES FOR CONSIDERATION

3.1 Related Businesses-

A waiver of the requirement that the Service Provider does not carry out a related business is subject to the Regulator being satisfied of three essential aspects. These are outlined in section 4.15(a) of the Code and discussed below. It should be noted that all three of the elements discussed in 3.1.1 to 3.1.3 below must be satisfied before a waiver is granted to avoid the need for a Service Provider to comply with the requirement not to carry out a related business.

3.1.1 Significance of the Pipeline or the Owners Stake in the Pipeline

Section 4.15(a)(i) states that a Service Provider may be granted a waiver of an obligation that it not carry out a related business if the Regulator is satisfied that either:

- the Covered Pipeline is not a significant part of the pipeline system in the State; or
- that the Service Provider does not have a significant interest in the Covered Pipeline and does not actively participate in its management and operation.

CMS has stated that the system is not significant. First, CMS state that the pipeline constitutes only 5 per cent of the transmission market and 0.4 per cent of the distribution market in the South West of the State. CMS suggests that these small market shares preclude the exercising of any current market dominance. Further, CMS state that both (a) the length of the Parmelia pipeline system, relative to the other major pipeline system servicing the Perth metropolitan area, the Dampier to Bunbury Natural Gas Pipeline (DBNGP), is small and (b) the physical size of the Parmelia Pipeline (NPS 14 inch or DN 350mm) relative to the DBNGP (NPS 26 inch or DN 650mm) also preclude the Parmelia Pipeline gaining a significant market share of either the transmission or distribution markets in the future.

Interested parties are invited to comment on the measure of significance proposed by CMS. In particular, comment would be helpful on whether the measure of significance should be based on actual throughput or capacity.

Interested parties are also invited to comment on how the market has been defined by the Service Provider, and whether in actuality, the Service Provider is able to influence competition in the market (including upstream or downstream markets), despite its seemingly small market share.

Comment on whether the DBNGP provides effective competition in the gas transmission market for Perth Basin gas producers would be of interest.

CMS has not addressed the second aspect raised by section 4.15 (a)(i) of whether the Service Provider has a significant interest in the pipeline. However, as CMS wholly owns and operates the Parmelia Pipeline, the second aspect raised by this section of the Code does not appear to be relevant in this case.

3.1.2 Administrative Costs vs Public Benefits

Section 4.15(a)(ii) states that a Service Provider may have the obligation that it not carry out a related business waived if the Regulator is satisfied that the administrative costs to the Service Provider outweigh any public benefit arising from the Service Provider meeting this obligation. This includes taking into account any arrangements put in place by the Service Provider to ensure that confidential information is not disclosed to the servants, consultants, independent contractors or agents of the Service Provider who take part in a related business.

CMS states that if it were to separate its gas transport and gas trading functions, it would incur substantial costs, likely to be approximately 8 per cent of annual regulated revenue. CMS has not provided details of the potential public benefits of a separate company structure, but believes these to be minimal.

In a previous Final Decision on ring fencing, IPART in NSW identified the following possible public benefits of not granting the waiver:

- stronger competition in the gas transmission marketplace through more market players having access to essential infrastructure; and
- a reduction in any actual or perceived market advantages for the incumbent in terms of its ability to offer a “one stop shop” of gas services.

Quantifying these and other benefits can be a very challenging exercise. Interested parties are invited to comment on potential public benefits in relation to the ring fencing obligations, which are the subject of this waiver application and to provide evidence in support of their comments where possible.

The relevant timeframe must be considered in calculating the net present value of benefits and costs. CMS postulates that the duration of the waiver sought should be for the duration of the Parmelia Pipeline Access Arrangement, which is approximately 4½ years. Interested parties are invited to comment on the appropriateness of this timeframe, both in terms of the costs and benefits involved and for the duration of the waiver itself.

In respect of confidential information, CMS states that as a matter of course it enters into confidentiality agreements with pipeline users.

Interested parties are invited to comment on the suitability of these arrangements for the confidential information provided by users or prospective users is only used for the purpose for which that information is given and is not disclosed to other persons without approval.

3.1.3 Associated Contracts

Section 4.15(a)(iii) states that a service provider may have the obligation that it not carry out related businesses waived if the Regulator is satisfied that an arrangement has been established between the Service Provider and the Regulator which replicates the manner in which Section 7.1 of the Code would operate if the Service Provider complied with the obligation not to carry out a related business.

Under Section 7.1 of the Code, a Service Provider may not enter into an Associate Contract without first obtaining the approval of the Regulator. This approval may not be granted on the grounds that the contract would have, or would be likely to have, the effect of substantially lessening, preventing or hindering competition in a market.

A Service Provider carrying out a related business by implication involves an Associate Contract, hence the requirement in Section 4.15 that the Regulator must be satisfied that the form of any such related business will not breach the conditions of Section 7.1 of the Code outlined above.

CMS does not provide information as to how Section 7.1 might be satisfied, but rather suggests that it work co-operatively with the Regulator to develop an appropriate solution.

Interested parties are invited to comment as to whether the proposals by CMS are sufficiently detailed, and/or of a form to satisfy section 4.15(a)(iii) of the Code.

3.2 Separation of Marketing Staff

Section 4.15(b) states that a service provider may have the obligation that it separate marketing staff (Section 4.1(h) and (i)) waived if the Regulator is satisfied that the administrative costs to the Service Provider and its Associates outweigh the public benefits of the Service Provider meeting the obligation.

CMS suggests that, due to its small size, additional marketing staff would be unnecessarily burdensome.

No specific estimate of the cost of compliance is provided. However, it is proposed that CMS' code of conduct regarding its separation of gas transport and trading activities, which is designed to ensure that any potential conflict of interest is transparently identified, be made explicit and that a cost effective method of separation would be the same as that suggested to ameliorate the issue of confidentiality as discussed under Section 3.1.2 above.

In a similar manner to Section 3.1.2 above, the essential issue relates to assessing CMS' estimates of the costs of compliance against the benefits to the public. Interested parties are invited to comment along the lines discussed in part 3.1.2 above.

4 MAKING A SUBMISSION

Submissions are invited from all interested parties on the proposed waiver of ring fencing obligations which must be received by 4pm Monday 8 May 2000, WST.

4.1 Confidentiality

In general, all submissions from interested parties will be treated as in the public domain and placed on the *OffGAR* web site. Where an interested party wishes to keep part or all of the contents of a submission confidential, it should indicate these parts clearly. However, where the Regulator considers that the release of this information would not be 'unduly harmful' to the legitimate business interests of any party, the Regulator will return the submission to the party making the submission and provide that party with the option of revising or withdrawing its submission.

4.2 Format for Submissions

Submissions with comments on the application for a waiver of ring fencing obligations should be in both written and electronic form and addressed to Mr Mike Jansen at the address given above.