

**CMS GAS TRANSMISSION AUSTRALIA**

**PARMELIA PIPELINE**

**APPLICATION FOR WAIVER**

**of**

**RING FENCING REQUIREMENTS**

**under Sections 4.1(b), 4.1(h), and 4.1(i)**

**of the**

**National Third Party Access Code**

**for**

**Natural Gas Pipeline Systems**

## **PARMELIA PIPELINE: APPLICATION FOR WAIVER OF RING FENCING REQUIREMENTS**

### **PURPOSE OF DOCUMENT**

This document makes application to the Independent Gas Access Regulator for:

- (1) waiver of the requirements of section 4.1(b) of the National Third Party Access Code for Natural Gas Pipeline Systems (i.e. not carry on a Related Business);
- (2) waiver of the requirements of section 4.1(h) of the National Third Party Access Code for Natural Gas Pipeline Systems (i.e. Marketing Staff are not employed by an Associate);
- (3) waiver of the requirements of section 4.1(i) of the National Third Party Access Code for Natural Gas Pipeline Systems (i.e. employees are not Marketing Staff of an Associate)

for the Parmelia Pipeline.

These waiver applications are made under the provisions of section 4.16 of the National Third Party Access Code for Natural Gas Pipeline Systems.

### **BASIS OF APPLICATION**

#### **Background**

Under the National Third Party Access Code for Natural Gas Pipeline Systems (the Code), the Parmelia Pipeline was required to comply with sections 4.1(b), 4.1(h), and 4.1(i) by 7 August 1999. The Independent Gas Access Regulator (the Regulator) has granted CMS Gas Transmission Australia (CMSGTA), the Service Provider for the Parmelia Pipeline, extensions of time for compliance with these sections of the Code until 31 March 2000.

Section 4.15 of the Code provides for waiver of sections 4.1(b), 4.1(h) and 4.1(i) of the Code by the Regulator.

In these waiver applications, CMSGTA seeks an enduring resolution of Ring Fencing issues pertinent to the Parmelia Pipeline.

**Waiver: section 4.1(b)**

CMSGTA provides 'integrated' supply and transport services (i.e. CMSGTA sources gas and provides transport for that gas) to several end users. This business accounts for a small portion of the gas transported by the Parmelia Pipeline. Figure 1 below provides a graphical representation of the current utilisation of capacity of the Parmelia Pipeline.

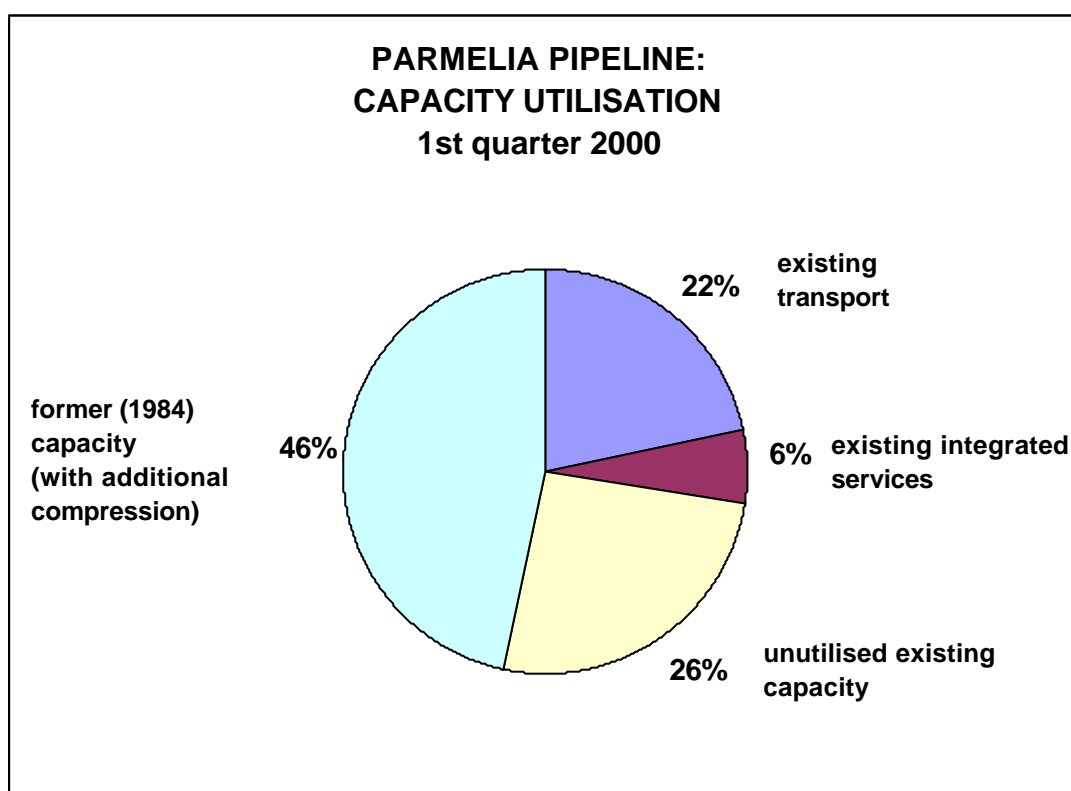


Figure 1.

The Parmelia Pipeline was originally constructed, operated, and owned by the West Australian Petroleum Pty. Limited joint venture participants (WAPET JVPs). In 1997, the WAPET JVPs sold both the Parmelia (formerly WANG) Pipeline and the Dongara oil and gas field to CMSGTA. CMSGTA subsequently sold the Dongara field to Arc Energy NL.

As part of the sale processes, transport contracts and integrated gas supply and transport contracts were assigned to CMSGTA, and back to back gas sales and purchase contracts were established in order that CMSGTA and the WAPET JVPs might continue to honour their pre-existing obligations.

CMSGTA holds a minority (5 percent) share of the gas transmission market in which it competes. It also holds a minority (0.4 percent) share of the gas distribution market in which it competes.

Figures 2 and 3 below provide graphical representation of the gas transport market shares currently held by CMSGTA.

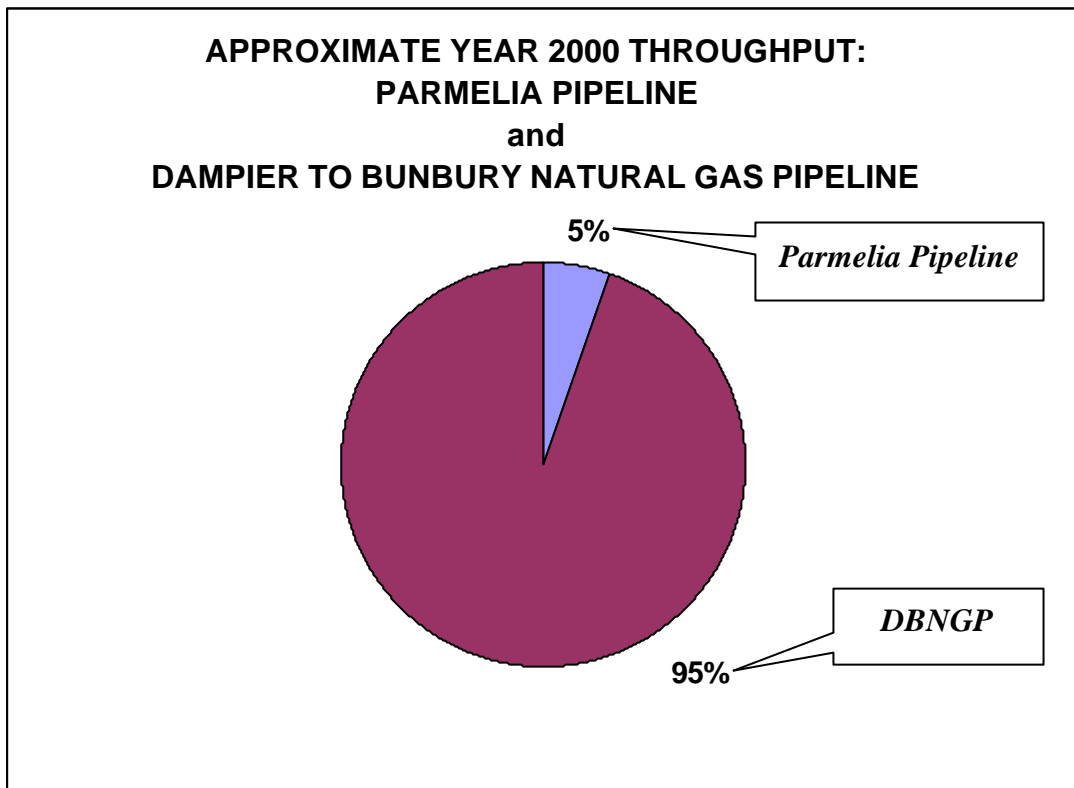


Figure 2.

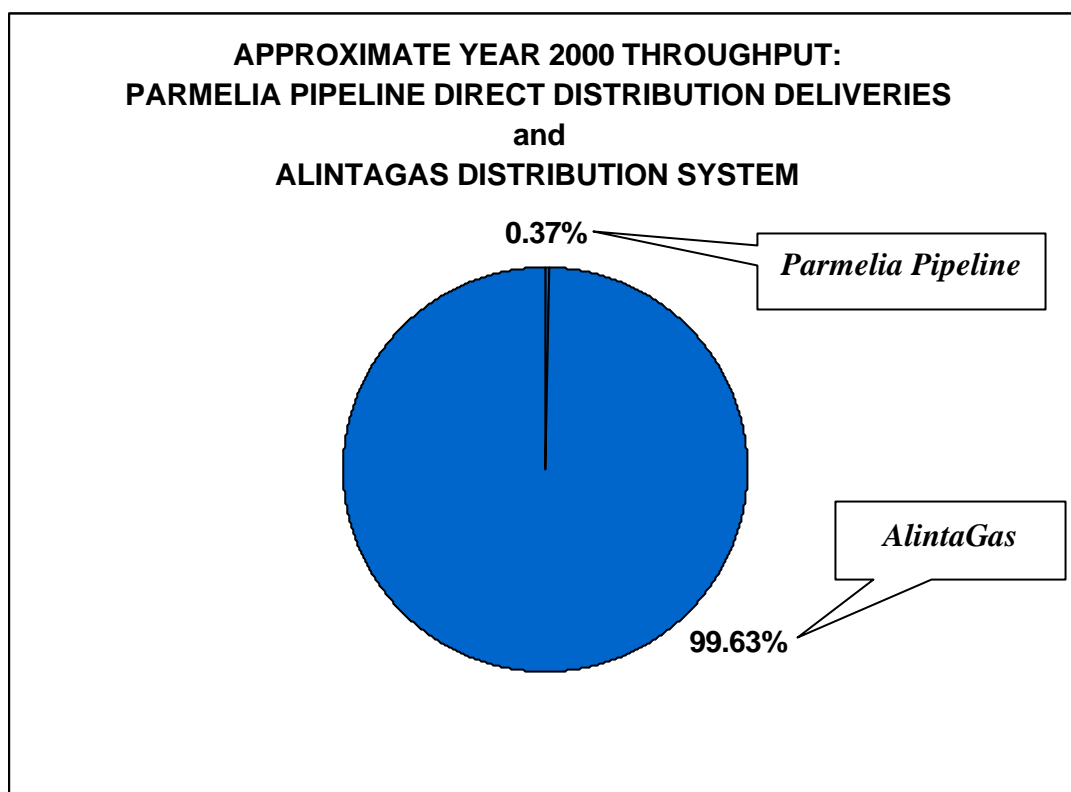


Figure 3.

CMSGTA faces determined and potentially overwhelming direct competition from the Dampier to Bunbury Natural Gas Pipeline (DBNGP) and AlintaGas in the transmission and distribution markets respectively. Events which have been the subject of recent press reports bear testimony to the nature and intensity of this competition.

The continued presence of the Parmelia Pipeline is necessary to sustain pipeline on pipeline competition.

Section 4.15(a) of the Code states that in order for the Regulator to waive a Service Provider's obligations under section 4.1(b), he must be satisfied that:

- (i) the Parmelia Pipeline is not a significant part of the Pipeline system in Western Australia;
- (ii) the cost of compliance with section 4.1(b) outweighs the public benefit; and
- (iii) an arrangement which replicates the operation of section 7.1 of the Code has been established between CMSGTA and the Regulator.

Addressing each point in turn:

(1) *Parmelia is not a significant Pipeline.*

The Parmelia Pipeline is currently a minor player in both the gas transmission (5% share) and distribution (0.4% share) markets in which it operates. Figures 2 and 3 above depicting the Parmelia Pipeline's market shares in the transmission and distribution segments bear testimony to this.

The Parmelia Pipeline has not always occupied such a minor position in the state's gas transport infrastructure. Between 1971 and 1984, the Parmelia Pipeline provided the sole means of transporting natural gas from fields in the Perth Basin to end user markets in the Perth metropolitan area, Kwinana and Pinjarra.

However, by 1984 the Dongara field, which provided the bulk of the natural gas consumed in Western Australia during this period, was no longer able to meet the (increasing) future demand. In order to maintain continuity of supply to domestic, commercial, and industrial customers, the State Government, through its utility SECWA (the State Energy Commission of Western Australia), purchased large volumes of gas from the North West Shelf consortium, and constructed the Dampier to Bunbury Natural Gas Pipeline to transport this gas to the major end user market in the South West of the state. The subsequent growth of this market during the late 1980s and throughout the 1990s necessitated several expansions of the DBNGP's capacity.

At the same time, the Parmelia Pipeline's proportionate contribution to the total gas supply to the South West market declined. Compressor stations were decommissioned and physically removed as they were no longer required. Other pipeline related assets were sold. As a consequence, the Parmelia Pipeline declined from a position of prominence to one of an insignificant competitor to the DBNGP.

Today, all three Perth Basin producers continue to utilise the Parmelia Pipeline. Choices were made at times when the selection of pipeline was at the producers' discretion.

There is a distressingly common misconception that the Parmelia Pipeline holds some kind of monopoly position over the Perth Basin producers because of differences in gas quality specifications between the Parmelia Pipeline and the DBNGP. In reality, the operator of the DBNGP currently offers (and previous operators have offered in the past) a gas blending service to smaller producers which has allowed 'off specification' gas to be diluted by the majority 'on specification' gas in the pipeline. This 'off specification' flow rate can be in excess of 20 terajoules per day.

In this way, smaller producers have avoided the cost of gas processing facilities required to achieve the DBNGP gas specification, and still

gained access to the DBNGP. There is no reason why Perth Basin producers could not avail themselves of this blending service, given that Arbitration of disputes regarding third party access to pipelines is a fundamental right of shippers under the Code.

The limited geographic extent of the Parmelia Pipeline means that it is commercially viable to directly connect to a tiny fraction only of AlintaGas' customers.

The Parmelia Pipeline is a single section of pipe to which four laterals are connected. In turn, these laterals supply typically one, or at the most two, end users. In total, the length of the main line and laterals servicing the Perth Metropolitan area is less than 100 kilometres.

In contrast, the AlintaGas distribution system is a complex network which covers the bulk of the Perth metropolitan area and country areas including the towns and localities of Geraldton, Eneabba, Muchea, Pinjarra, Harvey, Kemerton, Bunbury, Capel, and Busselton. The total length of the piping which comprises the AlintaGas distribution system is over 10,000 kilometres, or considerably more than 100 times the comparable length of the competing Parmelia Pipeline.

Thus, the ability of the Parmelia Pipeline to exert market power in the distribution market is practically zero.

It is not possible for the Parmelia Pipeline to gain a significant share of either the transmission or the distribution markets in the future. Its physical size (NPS 14 inch or DN 350 mm) compared to the DBNGP (NPS 26 inch or DN 650 mm) means that it simply does not have the physical throughput capacity to achieve an oligopolistic (let alone monopolistic) position in the transmission market. Its extremely limited geographical extent means that it simply can not directly reach the vast majority of distribution customers.

It is therefore apparent that the Parmelia Pipeline is not a significant pipeline in Western Australia.

(2) *Cost outweighs public benefit.*

If CMSGTA was forced to dispose of its existing integrated gas supply and transport contracts, it would almost certainly incur substantial losses, as it would be party to a forced sale.

If CMSGTA was to restructure to separate its gas transport and gas trading functions, it would incur substantial costs. These costs are likely to be approximately 8 percent of annual regulated revenue.

The Parmelia Pipeline is constrained in its ability to gain significant shares of either the transmission or distribution markets because of

limitations in capacity and geographic extent, as discussed above. Because of this limitation on possible market shares, the economic impact of CMSGTA's competition at state or regional level with either the DBNGP or the AlintaGas distribution system is, and can only ever be, small. Further, CMSGTA is subjected to the ongoing and demanding discipline of a vigorously competitive market.

Viability of the Parmelia Pipeline is necessary to sustain the pipeline on pipeline and trader on trader competition which currently exists in both transmission and distribution markets in the South West.

Thus, preventing CMSGTA from providing integrated gas supply and transport services offers little if any tangible public benefit.

It is therefore apparent that the cost of compliance with section 4.1(b) of the Code is considerable. Further, any public benefit gained from compliance with section 4.1(b) is small.

Consequently, the cost of compliance with section 4.1(b) of the Code far outweighs any public benefit.

(3) *Section 7.1 requirements can be replicated.*

In order to comply with the requirements of section 4.15(a)(iii) of the Code, CMSGTA and the Regulator must establish a mechanism by which the Regulator gives approval to integrated contracts for the supply and transport of gas.

CMSGTA proposes that the specific details of this process be established by CMSGTA continuing to work cooperatively with the Regulator following any consultation processes the Regulator may wish to implement. CMSGTA envisages that the mechanism established will have due regard for the protection of information which is commercially sensitive and if released would compromise CMSGTA's ability to compete against its potentially overwhelming rivals.

**Waiver: sections 4.1(h) and (i)**

Sections 4.1(h) and 4.1(i) of the Code are effectively reciprocals of each other. They require that the Marketing Staffs of a Service Provider and an Associate engaged in a Related Business (i.e. producing, buying or selling gas) can not be shared.

The Parmelia Pipeline has a Marketing Staff of one person.

The single Parmelia Pipeline Marketer is responsible for all marketing activities related to that pipeline. These activities include:



- the marketing of gas transport services,
- the development of new laterals,
- the marketing of integrated gas supply and transport services,
- the marketing of gas storage services,
- the utilisation of transport capacity on third party transmission pipelines such as the DBNGP which is related to deliveries to and from the Parmelia Pipeline,
- the utilisation of transport capacity on the AlintaGas Distribution System which is related to deliveries from the Parmelia Pipeline.

The workload of the single Parmelia Pipeline Marketer is such that if a second person were to be hired to perform the Parmelia Pipeline's gas transport marketing functions (only), then both the existing Marketer and the new hire would be substantially under-utilised.

The hire of suitably qualified and experienced Marketing Staff constitutes a significant expense to a small operator such as CMSGTA. Thus, the under-utilisation of such staff represents a significant financial drag. This burden is particularly onerous to CMSGTA because it faces strenuous competition from large and aggressive opponents in both the gas transmission and distribution markets.

The concept of 'user pays' through loadings on regulated tariffs may allow cost recovery of regulatory overhead imposed by the hire of additional Marketing Staff by a monopoly pipeline, but it certainly does not apply to a competing pipeline such as the Parmelia. The impact of regulatory loadings on prices charged by larger market players is comparatively small (compared to the Parmelia Pipeline) due to economies of scale, but the Parmelia must compete against the cost structures of its rivals.

The public benefit of separating the marketing of gas transport from other marketing activities for the Parmelia Pipeline is small for two reasons:

- the Parmelia Pipeline is a minority player in the gas transmission and distribution markets in which it competes, and
- the proportion of gas transported under integrated gas supply and transport contracts in the Parmelia Pipeline is small.

Thus, it is apparent that little is to be gained by enforcing the hire of additional CMSGTA marketing staff. Further, the cost would be significant. This cost would undermine the ability of the Parmelia Pipeline to compete in the transmission and distribution markets in which it is a minor player.

CMSGTA recognises that a potential conflict of interest situation could arise where both CMSGTA and competing gas trader(s) vie for the same business opportunity. To circumvent this problem, CMSGTA is most willing to make explicit its Code of Conduct regarding its separation of gas transport and gas trading activities to ensure that any potential conflicts of interest are transparently identified and do not disadvantage any third party. The Code of Conduct will require that CMSGTA explicitly inform prospective pipeline users of any potential conflicts of interest. As a matter of course, CMSGTA enters into confidentiality agreements with pipeline users as appropriate. These agreements provide bilateral protection. Thus, the interests of competing gas traders wishing to use the Parmelia Pipeline are protected. Further, in circumstances of a conflict of interest, marketing activities related to the transport component of integrated services offered by CMSGTA will be handled by separate CMSGTA staff members on a case by case basis.

The assessment of the Parmelia Pipeline Access Arrangement is expected to be concluded in the near future. The existence of a comprehensive suite of Reference Services, approved by the Regulator, ensures that third party users are ensured access.

However, the strongest protection for pipeline users comes from the discipline of a competitive market. In order that CMSGTA may continue to compete against its aggressive, larger rivals, it can not compromise in any way its reputation for fair and honest dealing, of which CMSGTA is justifiably proud.

## **DURATION OF WAIVER**

CMSGTA requests that under normal circumstances the duration of the waivers sought above be for the duration of the Parmelia Pipeline Access Arrangement currently being considered by the Independent Gas Access Regulator. If the circumstances of the Parmelia Pipeline change markedly within the Access Arrangement period (e.g. if the Parmelia Pipeline were to be integrated with a second major pipeline linking the Pilbara and South West regions), then an earlier review would be appropriate.