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New light in gas reform tunnel

Richard Cottee has had a win with the latest gas market reforms. **Kirk Gilmour**

by **Matthew Stevens**

Having endured two months of upset that forced him to the brink of untimely retirement, Central Petroleum boss Richard Cottee has earned a welcome if unexpected fillip with the national gas market reforms triggered by South Australia's legislative response to the Vertigan Review.

Central owns onshore Australia's most isolated gas resources. And, ultimately, Cottee's plans to transform his latest adventure in gas into a thriving mid-tier producer swings on his ability to open an affordable pathway to market for his otherwise stranded gas.

To that end, he has been a booming voice and an often shaping voice in an enduring debate over national gas markets that last year, very briefly, became something of a political hot topic.

Cottee was one of the original shepherds to what became Jemena's Northern Gas Pipeline project and his admittedly self-interested narrative on the cost of accessing east coast gas markets helped lure the federal government interest that resulted in the ACCC market review which, in turn, inspired the review of the national pipeline grid by Mike Vertigan.
Vertigan's recommendations were as well received by the Council for Australian Governments as they were by Cottee and the rest of the nation's pipeline users.

But, as it turned out, there was devil in the detail. The draft National Gas Rules that were released to industry discussion in June by the newly constituted Gas Market Reform Group arrived a personal and commercial blow to Cottee.
The depressing impact of what he received as a deeply flawed reform platform was only amplified by the timing of the GMRG's draft. The proposals landed in deflating concert with a rising tide of shareholder discontent over Central's recommendation of a takeover offer by the driller's only banker, Macquarie Group.

That deal was subsequently rejected by enough shareholders to matter on June 29 and Cottee retreated to London for a week or so to consider whether he wanted to stay the distance with Central. He returned refreshed and has since stared down a board spill and opened a campaign aimed at recapitalising Central.

And, as it turns out, news on the pipeline regulation front has improved dramatically through Cottee's energising retreat.

As we discussed back in June, the big problem with the draft pipeline market rules was that the GMRG appeared to duck an issue central to the creation of a workable access regime.

The June advice effectively offered little or no guidance on the principles that would shape any future arbitration. Effectively, the starting point of each arbitration would have been a longwinded assessment of the best way to value the pipeline so that a market-based price for its use could be established.

Given the breadth of options left available, the owners and operators would be bonkers to argue anything but that replacement cost of their pipelines should be the starting point of the process.

But the customers disputing the cost of access for the mature pipelines that are most likely to be the subject of any dispute would be just as bonkers to argue anything but that the targeted infrastructure had long paid for itself so access should be priced on only the cost of service.

The real-world effects of that opening uncertainty would have been that no one would gamble on arbitration and the new regulatory regime would fail in its central purpose, which is to encourage negotiated outcomes by better arming users of monopoly infrastructure.

In June, Cottee argued, with passion and good sense, that if draft translated into final reality, then the whole ACCC and Vertigan process would have left pipeline customers little better off than they were. He was not alone in announcing anxiety.

The ACCC, among others, offered the GMRG advice that effective arbitration was built on certain and predictable guidelines and the most suitable valuation mechanic in this case was the depreciated construction cost model. That advice was apparently accepted alacrity and clarity.

The history of energy market reform leaves South Australia the legislative trigger for a domino effect that ends with national legislative alignment in gas and power markets.

Last week, South Australia confirmed amendments to the gas market rules that are materially different to the June GMRG draft. The most important and pleasing of the surprises is the binding guidance offered to any future gas access arbitrator.

The new rules have reduced the complex to something very simple indeed.

Except in situations accepted as exceptional, the valuation that is the building block to setting access pricing will start from a number that includes the cost of building pipelines and their supporting infrastructure and spending on the pipeline since its commissioning. From that total will be deducted "the return of capital recovered since commissioning" and the value of any pipeline assets sold since the original build.

In other words, we have a clearly stated version of the depreciated cost model proposed by the ACCC and others. And there is a lot more to like, if you are a future pipeline user.

The preamble attached to the GMRG's final offering on reform establishes a sensible mission statement for arbitration while broadening the range of disclosures that will be required of the pipeline operators, delivering some criticism of the illogic of the pricing of the parts of the network that are already regulated and warned pipeline operators against the risk of attempting to end access disputes by contracting the disputed capacity to third parties.

"The overarching objective of the information disclosure and arbitration framework is ... to facilitate access to services provided by non-scheme (unregulated) pipelines on reasonable terms, which is taken to mean at prices and on terms and conditions that so far as practical reflect the outcomes that would occur in a workably competitive market," the GMRG said.

And what might a competitive market look like?

"Perhaps the best shorthand description of workable competition is to envisage a market with a sufficient number of firms (at least four or more), where there is no significant concentration, where all firms are constrained by their rivals from exercising any market power, where pricing is flexible, where barriers to entry and expansion are low, where there is no collusion, and where profit rates reflect risk and efficiency," the GMRG reported.

"In the GMRG's view the workably competitive market principle should result in the prices charged for pipeline services better reflecting the cost of service provision.

This will, in turn, benefit upstream and downstream users of non-scheme pipelines and should also encourage more efficient investment in, and efficient operation and use of, natural gas services. The ultimate beneficiaries of these improvements will be consumers of natural gas."

The GMRG asserted that it had drawn up a "robust and commercially oriented arbitration mechanism that will provide a credible threat of intervention to constrain the exercise of market power during negotiations".

The way the ACCC sees its regulatory world, this ambition sits critical to better outcomes in the marketplace. The test of whether or not these new rules are effective is whether arbitration becomes a tool used often in settling the price of pipeline access. The paradox there is that, if the rules are well framed, then the weapon of arbitration will rarely if ever end up being called upon.

That didn't last long

Fair Work Commission commitments that mean Queensland coal union officials and 26 Glencore workers are unable to call strike breakers "scabs" have very apparently not contained the ugly aggression of others protesting near the gates of the Oaky Creek mine.
Overnight Monday an estimated seven new signs of protest appeared on poles and trees near the mine whose unionised workers have been locked out by management for a third successive week.

Those signs carried the names of staff and contract workers who have routinely expressed their right to work through union strikes and management lock-outs. Each sign carried a single-word headline. "Scabs".

We came across a very interesting Facebook conversation on Tuesday. It was between someone related to an Oaky North contractor and a Hunter Valley unionist employed by Glencore.

The conversation opened with a question. "I have family that work for contractors at Oaky North. Please tell me why it's OK for them to be threatened and abused by the striking miners?"

The response was: "The short answer is it's not OK. Unfortunately it comes down to the individual and if they're professional enough to work with the contractors properly. I myself have been going thru (sic) protected action in NSW for the last 2 months and at no stage has there been any bullying or unprofessional behaviour toward the contractors on site. It's our fight with the company, not theirs."

Hear hear.