Draft Decision

Executive Summary

Access Arrangement proposed by Epic Energy South Australia Pty Ltd for the Moomba to Adelaide Pipeline System

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Commissioners:
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Executive summary

Introduction

On 1 April 1999 Epic Energy South Australia Pty Ltd (Epic) applied for approval of its proposed access arrangement for the Moomba to Adelaide Pipeline System (MAPS). The application was made under section 2.2 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the code).

The Commission now releases its draft decision on the application and invites submissions from the applicant and interested parties by Thursday, 14 September 2000, to assist the Commission in reaching a final decision.

MAPS connects the Cooper Basin production and processing facilities, at Moomba, to markets for natural gas in Adelaide and in regional centres including Port Pirie, Whyalla and Berri, the regional centres being connected to the trunkline by laterals. Most of the demand for gas haulage services arises in the Adelaide area.

Epic's access arrangement describes the reference tariff, access policies and the terms and conditions on which the company proposes to make access to its pipeline system available to third parties. Epic's access arrangement information explains how the proposed reference tariff, access policies and the terms and conditions of access have been devised. The Commission has conducted its assessment of the proposed access arrangement and access arrangement information against the principles in the code, using information provided by Epic and interested parties and the results of its own research and analysis.

Epic has indicated that the firm (FT) and interruptible (IT) services described in the access arrangement can only be made available in limited circumstances in the initial access arrangement period. The pipeline system capacity is fully committed and the terms of the existing haulage agreements (notably shipper rights to renominate on the gas day and shipper control of available capacity at delivery points) limit the service provider's flexibility in the type of service it can provide while those agreements continue. As the pipeline system is fully contracted, unless existing firm capacity is released, applications for access to the pipeline system, at least for firm service, are likely to involve parties making a capital contribution for new facilities.

Since the access arrangement was lodged, Epic has proposed to redesign its IT service. However, Epic is still expected to earn its revenues primarily from existing haulage agreements. To a lesser degree, revenues will also flow from other arrangements entered into outside the terms of the access arrangement.

Therefore, most of the total revenue that will accrue to Epic over the initial access arrangement period cannot be varied by the Commission's decision on the access arrangement, since this revenue is derived from existing contractual rights or will fall outside the access arrangement for this period.

The Commission estimates that under the existing contracts, Epic Energy will continue to receive revenues yielding a nominal after-tax return on equity of 18 per cent per annum on the regulatory asset base assessed by the Commission. Under the code, these

agreements are preserved irrespective of the Commission's decision on the access arrangement.

In the future when new gas haulage contracts are negotiated, the terms of the access arrangement will form an important input to these negotiations. If the proposals made by the Commission in this draft decision are fully applied when new gas contracts are negotiated, Epic Energy would receive a return on equity of 13 per cent p.a.

The Commission is concerned that the agreements made in 1995 substantially foreclose the opportunities for new entry provided by a deregulating gas market. The Commission is also concerned that Epic proposes, in providing for the parties to give effect to the provisions of the existing haulage agreements in its access arrangement, to not entirely exclude exclusivity rights that arose on or after 30 March 1995. Furthermore, apart from the question of exclusivity rights, as will be explained later in relation to the queuing policy, the Commission has been concerned to address the possibility that the parties may seek to extend the existing agreements in substance beyond 2005.

At the time the agreements were made (30 June 1995), the COAG commitment to free and fair trade in gas had been in place for more than a year and steps were being taken towards its implementation. The parties were therefore in effect on notice that regulatory bodies and policy-makers were likely to view with concern new arrangements that ran counter to the COAG principles. The code's cut-off date for preservation of exclusivity rights (30 March 1995) reflects that logic. However, the constraints in the existing agreements (identified in the original access arrangement and in Epic's March 2000 revisions) that hinder the development of competition go beyond the exclusivity rights. The clauses that are not exclusivity rights are protected from regulatory intervention for purposes of applying the code to the access arrangement. (See discussion below under 'Relevance of existing haulage agreements'.)

A number of factors identified in the draft decision together mean that unless other developments (such as a new pipeline) occur, the difficulties facing new entrants will continue throughout the period of this arrangement and into the future. Relevant issues, in the light of the pipeline being at full capacity, are Epic's proposed queuing and extensions and expansions policy and contract renewal terms.

The Commission has proposed amendments to the access arrangement to address these issues.

The draft decision at a glance

The following table sets out the key parameters of the Commission's draft decision.

All figures are stated as at 30 June 2000 (except where specifically noted) and are stated to the nearest decimal point.

Parameter	Epic proposed	The Commission proposes
Optimised replacement cost (ORC) of pipeline system assets	$570m $December 1998 (Applying a CPI index, equates to $590m in June 2000.)	$527m $June 2000.
Initial capital base	$354m $June 2000 after depreciation of the ORC system and having regard to other valuations. $383m $June 2000 if assets were depreciated by asset class. (Valuation proposed by Epic in May 2000 correspondence with Commission.)	$310m $June 2000 after depreciation of the ORC system by asset class, deferred tax adjustment and having regard to valuations using other methodologies.
Stay-in-business capital	$2.5m calendar 2000 and thereafter as estimated in access arrangement information.	Accepted subject to review of expenditures before next period of access arrangement commences.
Working capital	$0.8m and similar levels in each following year.	Not accepted submissions invited from interested parties.
Escalation of initial capital base	CPI as fixed principle.	CPI fixed principle not approved.
Nominal rate of return on service provider's equity in initial capital base	13.1%-16.8% p.a. on initial capital base proposed by Epic.	13.0% p.a. on initial capital base proposed by Commission.
Gearing ratio assumed for purposes of calculating return on equity and other cost of capital parameters	60:40 debt:equity.	Accepted.
O&M expenditure	$14.9m calendar 2000 and thereafter as estimated in access arrangement information.	Accepted as reasonable having regard to industry yardsticks. To be reviewed before next period commences.
Forecast revenue (continued next page)	$56.1m initial calendar 2000 annual cost of service.	$45.7m (actually stated on half-yearly basis for 2000 as $22.9m, thereafter annually).

Parameter	Epic proposed	The Commission proposes
Forecast revenue (continued)	Application for approval limited to $51.2m calendar 2000 contract revenue, with forecast revenue thereafter to increase in line with contract revenues.	Forecast revenue thereafter calculated as forecast cost of service revenue, subject to a smoothing factor, CPI-X, where X = 1.6%. $44.2m ($22.1m on half-yearly basis for 2000, thereafter annually) if tariff escalator – see below – is approved in final decision. Forecast revenue to be reviewed before next access arrangement period commences.
Projected tariffs	Tariffs calculated from existing contract revenue divided by contract volumes.	Tariffs calculated from cost of service revenue divided by system capacity (since pipeline is fully contracted).
Tariff escalator	95% of CPI (for 12 months ending previous September).	Amount to be decided in final decision, subject to market submissions in the light of tariff escalator's relevance to revised extensions and expansions policy proposed by Epic in March 2000. At this stage the Commission proposes a CPI-X escalator where smoothing factor, X = 1.6%.
Incentive mechanism for shippers to release firm capacity for interruptible (IT) service.	Proposed by Epic March 2000.	Accepted.
Requirement for third parties to sign existing facilities agreement for access to infrastructure serving existing shipper's firm capacity reservations.	Proposed by Epic March 2000.	Accepted but rejected in respect of seeking consent to use the laterals.
Access arrangement period	From final approval until 31 December 2005.	Accepted.
Revisions submission date (commencement of review period)	1 July 2005.	Accepted.

Parameter	Epic proposed	The Commission proposes
Significant major event to be trigger for early review.	Concept rejected by Epic in response to submission and later discussions.	Proposed amendment by ACCC, submissions invited as to: ▪ whether to so amend; ▪ if so, definition of trigger event; and ▪ appropriate scope of regulatory review.

Reference tariff elements

Epic has proposed a cost of service methodology, where total revenue is set to recover costs. These costs are calculated using the building block approach, comprising a return on capital, a return of capital (depreciation) and operating and maintenance costs. The rate of return is set to provide a return commensurate with prevailing conditions in the market for funds and the risk involved in delivering the reference service.

The initial capital base

Evaluation of the capital base

In assessing the initial capital base, the Commission has had regard to Epic's depreciated optimised replacement cost (DORC) calculations based on both the weighted average life of the pipeline system as a whole and depreciation by asset class. In addition, the Commission has been guided by the results of a desk-top audit by Connell Wagner Pty Ltd (consulting engineers), the depreciated sale price, the adjusted book value, and the residual value resulting from economic depreciation of the sale price of the PASA pipeline assets. The code required the Commission to consider the depreciated actual cost (DAC) of the pipeline system assets. However, in the Commission's view the aggregation of depreciated capital expenditures made over a long period while the pipeline was in government ownership does not provide a useful indicator of the return on capital that a private sector operator could reasonably expect.

The Commission has adopted the least-cost option identified by its own analysis – generally comparable to Epic's Option D. The optimisation model differs from Epic's mainly in the treatment of the Port Pirie-Whyalla lateral and compression requirements and relies on a more detailed methodology than that employed by Epic in its submission. This issue is discussed further in section 2.2 and Annexure 2 of the draft decision.

For the purposes of evaluating DORC, Epic proposed to depreciate the pipeline system as a whole – assuming that the pipeline has a remaining life of 50 years, following 29 years' service at the time of valuation. The Commission considers that this approach does not provide the transparency necessary to track movements in assets over time and, in particular, makes it difficult to link capital expenditure to the expiry of assets. Therefore, in depreciating the ORC to arrive at a DORC valuation for a pipeline system, the Commission favours depreciation by asset class.

Adjustment of the capital base

In assessing revenues for services of infrastructure assets it is essential to take account of the tax depreciation provisions linked to those assets so as to adequately provide in the revenues for tax expenses. This is the objective of the Commission's preferred post-tax cost of capital methodology. Accelerated tax depreciation not only defers the timing of taxes but also means that the tax depreciation is exhausted in advance of economic or regulatory depreciation of the assets.

This raises the issue of how to account for the exhaustion of tax depreciation in establishing the regulatory asset base for established businesses at the commencement of an access arrangement period.

Taking first the taxation treatment, if the physical assets were transferred or sold, the Australian Tax Office (ATO) would permit the tax value to be re-established for tax depreciation purposes, based on the sale price. (This is what happens when government assets are privatised and is the basis for Epic's 1995 written-down tax valuations.) Where a company is not sold or is sold as a going concern, the ATO does not normally permit a re-establishment of the asset value for tax depreciation but relies on the earlier written-down tax value of the assets for future tax assessment.

There is a similar issue regarding the valuation of the regulatory asset (capital) base.

If ownership of the assets is transferred at the time the regulatory asset base is established, no adjustment needs to be made for what has happened in the past. Epic's situation at the commencement of this access arrangement period is that of an established, continuing business. The asset transfer is not taking place now; it occurred five years ago. Therefore, a substantial part of Epic's tax depreciation concessions may already have been utilised to defer tax.

As the tax liabilities deferred will have to be paid in the future, the value of future cash flows to the business is reduced. Accordingly, there is a reduction in the value of the physical assets to the continuing business.

The difference in value for the continuing business is closely approximated by the estimated value of cumulative deferred tax liabilities. This difference in value represents the savings in immediate tax expense that have already been realised by the business through accelerated depreciation.

The component of the firm's revenue requirement that these deferred taxes represent can be interpreted as compensation for the loss in value of future cash flows. That is, it is a return of capital, reflecting the reduction in the value of the physical assets to this business arising from its deferral of tax. It is therefore appropriate to reflect this return of capital in the regulatory asset base by reducing the valuation of the physical assets derived by other means, in this case, derived by a DORC estimation.

Where historic revenues have included a component to cover normal or prima facie taxes, users will already have compensated the business for the associated tax payments or loss of value of future cash flows by a corresponding amount. This issue is taken into account in modelling the post-tax revenue requirement.

To establish the initial MAPS capital base in accordance with the principles outlined above, the Commission proposes to adjust the valuation yielded by DORC for Epic's accumulated deferred income tax liability.

The amount of the adjustment is only a portion of the accumulated liability. This reflects the fact that investors receive the value of imputation credits associated with the payment of tax liabilities. The deferral of tax through accelerated depreciation gives imputation credits diminished value in the hands of shareholders. For the purposes of this access arrangement, the Commission has adopted a multiplier of 50 per cent to represent the rate of utilisation of imputation credits by shareholders, as discussed in section 2.5.4 of the draft decision.

In respect of Epic, the amount of the adjustment for deferred tax is $6 million. Unless this adjustment is made to the initial capital base, the quantum of capital that has been returned to date to the entity would be understated. Consequently its initial capital base would be overstated, with the result that two components of cost of service (return on capital and depreciation) would be overstated in each succeeding year.

Initial capital base

The Commission has taken into account the requirements of the code in assessing the information available to it and applying its previous practice, the *Draft Regulatory Principles*[1] and its developing principles.

The Commission has thereby determined an initial capital base for MAPS using its DORC methodology, adjusted for deferred tax liabilities, of $310 million.

The rate of return

Using the Capital Asset Pricing Model (CAPM) Epic proposed a nominal cost of equity of between 13.08 per cent and 16.84 per cent. Epic derived a real pre-tax weighted average cost of capital (WACC) range of 9 per cent to 10 per cent using a 'forward transformation' conversion process.

As outlined in its *Draft Regulatory Principles* and in recent decisions,[2] the Commission prefers to use a post-tax regulatory framework. The post-tax nominal return on equity is better understood by financial markets than the pre-tax real weighted average cost of capital (WACC), with shareholder returns typically being expressed in nominal, post-tax terms. Furthermore, the post-tax nominal return on equity determines whether investors are willing to advance equity to finance the capital infrastructure required to provide services.

Based on its own analysis and the parameters identified by the Commission as being appropriate to Epic within this access arrangement period, a nominal cost of equity of **13.0 per cent** per annum was derived. Based on cash flow modelling, the pre-tax real

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1 ACCC, *Draft Statement of Principles for the Regulation of Transmission Revenues,* 27 May 1999.

2 ACCC, 'NSW and ACT Transmission Network Revenue Caps 1999/00-2003/04', *Decision,* 25 January 2000 and ACCC, 'Access Arrangement by AGL Pipelines (NSW) Pty Ltd for the Central West Pipeline', *Final Decision,* 30 June 2000.

WACC that corresponds to a post-tax nominal return on equity of 13.0 per cent is 6.7 per cent.

In establishing the cost of service revenue requirement, the Commission has normalised Epic's tax payments over the life cycle of the assets to avoid discontinuity in the level of the revenue requirement and reference tariffs. The objective of normalisation is to ensure that in a later period customers do not pay a disproportionately high charge for services provided by the same portfolio of assets as the result of higher tax payments that will need to be made at that time. To normalise tax liabilities, the Commission has included in the post-tax revenue stream a normalisation factor that, in effect, represents additional depreciation (or return of capital).

The cost of service revenue stream proposed by the Commission has been smoothed using a CPI-X mechanism to prevent volatility in the reference tariff over the access arrangement period. Under this approach, revenues are increased annually by CPI-X where the 'X' factor is set such that the net present value (NPV) of the 'smoothed' revenue stream is equivalent to the NPV of the 'unsmoothed' revenue stream over the access arrangement period. The 'CPI-X' approach to revenue smoothing has been used by the Commission in its other regulatory decisions and has been widely used by other regulators in Australia and overseas.

The Commission has used the cost of equity and WACC it derived to determine the revenue requirement for Epic for each year during the regulatory period. The Commission has proposed an amendment to the access arrangement to link the reference tariff to the cost of service revenue requirement rather than, as proposed by Epic, to revenues under existing contracts (refer to section 2.8).

Operating and maintenance costs

A widely-accepted benchmark for operating and maintenance costs is cost per pipeline length. This indicator was not provided by Epic, but was derived by the Commission and compared with those for other pipelines. Generally, Epic's operating costs lie at the high end of the range, however, this is largely attributable to MAPS being a shorter and more highly compressed pipeline.

The Commission considers that the O&M costs proposed by Epic over the access arrangement period are reasonable. When the Commission reviews the access arrangement at the end of 2005, it will consider whether the level of costs continues to be appropriate in the light of corporate restructuring that occurred after the access arrangement was lodged.

Reference tariffs and reference tariff policy

Epic has argued that its existing capacity is fully committed and operational flexibility impacted through its existing haulage agreements and it therefore has limited scope to offer the reference service during the first access arrangement period without enhancement of the pipeline system. Epic proposes that services involving more than a threshold level of expansion would not, in any event, be reference services.

The Commission has largely accepted this view and has not pursued a broader range of reference tariffs in this access arrangement. The Commission intends to re-examine the relevant services and extensions and expansions policies in association with reference tariff policy before the commencement of the next access arrangement period.

Tariff path and incentive structure

The level of Epic's proposed tariff escalator would affect the level of capital contribution for prospective FT service users for whom new capital investment is undertaken, as well as the tariff they would pay.

The formula for the capital contribution is contained in Epic's proposed extensions and expansions policy for which Epic proposed substantial revisions in March 2000. The capital contribution is defined as the difference between the actual cost of the new facilities and the present value of capacity charge revenues for FT service over the term of the contract.

As third parties have not yet had the opportunity to comment on the proposed revisions, the Commission now invites interested parties to address this issue in their submissions.

In response to submissions, Epic put forward an amended incentive and risk-sharing mechanism in its proposed revisions to the access arrangement of 2 March 2000. Epic proposes a rebate mechanism to reward FT service users and existing shippers for releasing firm capacity for IT service. Based on submissions to date, the Commission is satisfied that the revised incentive mechanism meets the terms of section 8.46 of the code.

Access policies, terms and conditions and review of arrangement

Epic proposes to incorporate detailed terms and conditions in the access arrangement. The Commission has taken the view that a number of these terms and conditions are unnecessarily restrictive. Through proposed amendments, the Commission has sought to strike a reasonable balance between the needs of users, prospective users and the service provider.

The Commission has indicated that it intends to assess the operation of a number of these terms and conditions at the next revision. Without limiting the scope of the review, clauses that the Commission identifies for such assessment deal with:

- service provider discretion in assessing requests for FT service (clause 6);
- management of system-use gas (clause 17);
- imbalance and zone variation (clause 19);
- curtailment notices and operational flow orders (clauses 24 and 25); and
- rules for operation of the Electronic Bulletin Board (clause 27).

The Commission notes that Epic intends to consult parties on the formulation and revision of rules for the use of the proposed electronic bulletin board. The Commission encourages such consultation. As part of future reviews of the access arrangement, the Commission reserves the right to review whether those rules have operated to the satisfaction of the parties.

The Commission has identified certain clauses on which it would be particularly assisted by further submissions from interested parties. These are:

- Epic's proposals that non-specified services and extension of FT services contracts not be subject to queuing (clause 6.8);
- frequency of clearance of the queue (clause 10.4);
- Epic's proposed limits on expenditure on extensions and expansions (clause 10.5(a) as proposed by Epic in response to submissions 1 February 2000, reflected in part in clause 10.5(a)(ii) in 2 March 2000 lodgement);
- forecasting, nominating and scheduling of service (clause 18);
- allocation of delivery point quantities (clause 22);
- order of priority of service in respect of non-specified services (clause 23.2);
- curtailment notices and operational flow orders (clauses 24 and 25);
- requirements for equipment and for measurement at receipt and delivery points (clauses 28 and 29);
- liability and indemnity (clause 35);
- dispute resolution and independent experts (clause 37); and
- confidentiality (clause 39.1(d)(vi) as proposed by Epic 2 March 2000).

Relevance of existing haulage agreements

The parties to the existing haulage agreements provided copies of the agreements to the Commission on a confidential basis pursuant to sections 41 and 42 of the *Gas Pipelines Access (South Australia) Law*. This confidentiality condition potentially limits the specificity with which the Commission can discuss the agreements. It does not prevent the Commission from discussing information about the agreements that is already in the public domain. Nor does it prevent the Commission, pursuant to section 42 of the Law, from publicly releasing information about the agreements on public benefit grounds, provided no application for review of the Commission's decision to release the information has been lodged.

The Commission has taken the agreements into account in considering the access arrangement proposed by Epic and in preparing the Commission's proposed amendments. The Commission has prepared a confidential annexure, called 'Confidential Annexure 4', to set out its reasoning in respect of issues in which a confidentiality obligation arises, and to describe provisions of the existing agreements as far as relevant to that reasoning. This confidential annexure will be made available to the parties only. The Commission intends to follow the processes set out in section 42 of the Law (as far as required by the parties), with a view to making material in the confidential annexure publicly available.

Possible exclusivity rights

Section 2.25 of the code provides that the regulator must not approve an access arrangement any provision of which would, if applied, deprive any person of a contractual right in existence prior to the date the proposed access arrangement was submitted (or required to be submitted).

However, this code provision does not apply to any exclusivity right that arose on or after 30 March 1995. This means that the access arrangement need not recognise exclusivity rights. An 'exclusivity right' is defined in the code as a contractual right that by its terms either:

> (a) expressly prevents a Service Provider supplying Services to persons who are not parties to the contract; or
>
> (b) expressly places a limitation on the Service Provider's ability to supply Services to persons who are not parties to the contract,
>
> but does not include a User's right to obtain a certain volume of Services.

The Commission has identified two clauses that appear to the Commission to constitute or contain exclusivity rights.

Other contractual provisions that, in the Commission's opinion, are not exclusivity rights, give the shippers substantial control of capacity during the term of the agreements. These provisions are the size of the shippers' capacity reservations (totalling 100 per cent of the system's indicative capacity), the right to renominate capacity on the day and the shippers' reservation of capacity in the laterals and delivery points. In other words, the scope of services that Epic can offer is constrained even without the exclusivity rights.

The Commission has not been able to establish from the information provided to it that existing shippers have declined to resell unutilised capacity. However, the information that the Commission has indicates some dissatisfaction with terms that have been offered.

The Commission has proposed several amendments to the access arrangement to address exclusivity rights. These amendments are framed so that the service provider and existing shippers would not be permitted to give effect to exclusivity rights arising on or after 30 March 1995. Another amendment is designed to permit prospective users recourse to arbitration to the full extent permitted under the code in the event of an access dispute.

Non-specified services

The Commission accepts that the access arrangement make provision for non-specified services. However, for reasons set out in section 3.5.5 of the draft decision, the Commission is concerned that Epic's proposed queuing policy and order of priority of service together could facilitate an extension of the duration and/or terms and conditions of existing haulage agreements beyond 2005. In the Commission's view, such an outcome would be to the detriment of new entrants. The Commission invites submissions on this issue.

Reallocation of released or surrendered capacity

There is good sense in an access arrangement providing for relinquishment and reallocation of capacity. The pipeline owner, the existing shipper, the new user and the ultimate gas customer all have a stake in assuring continuity of service and certainty of process to that end. Epic's trading policy provides for the reallocation of capacity in cases where it is released by the shipper to another user or to Epic.

In a competitive transmission market any capacity released or surrendered by a shipper in consequence of a lost sale would be available for resale by the pipeline operator (if the shipper did not itself deal with it) to facilitate the changeover of retail suppliers, whoever they might be.

In the Commission's view the access arrangement should also make provision for the service provider to require that capacity not required by an existing user, in consequence of losing a customer to another supplier, be transferred to the other supplier, if that capacity is not released by the existing user. Any such provision should be subject to the provisions of the relevant existing haulage agreement other than any exclusivity rights that arose on or after 30 March 1995.

The Commission recognises that market evolution provides opportunities for existing shippers to make interstate trades in gas to make up for sales lost in the 'home' market. The development of interstate trade is a fundamental objective of the code. In those circumstances, the shippers would be likely to have concerns about the service provider intervening to make some part of their capacity rights available to another party entering the home market.

Nevertheless, in the Commission's view, the proposed provision would be an instrument for introducing contestability to a significant geographic area of the market that is likely to be subject to the constraint of a fully-contracted pipeline for some considerable time into the future. At this stage there is uncertainty as to whether the SAMAG/South Australian Government initiative to introduce new supply sources would resolve this capacity constraint, and the terms on which it would do so.

In the Commission's view, a provision for the transfer of capacity to shadow transfers in contestable load is entirely consistent with code objectives of fostering trade in gas within a competitive market. It also gives visible effect to fair terms of access for all users of haulage services, which is a code objective.

While the amendments proposed in the Commission's draft decision would benefit South Australian gas users, additional benefits could arise if more were done to bring about competition in supply at the wellhead.

Possible trigger for early review

The South Australian Government has recently invited submissions from industry to propose new sources of gas supply to South Australia. Such proposals may involve the construction of a new pipeline. If the magnesium refinery proposed by SAMAG Limited proceeds, it has the potential to significantly impact on the current gas supply and haulage arrangements in South Australia.

In the Commission's view, the development of a new pipeline as an alternative or complement to MAPS, if realised, may render the existing range of services, constraints on service delivery and tariff structure out of date. Such a development would potentially bring the proposed reference tariff and reference tariff policy into conflict with code provisions for tariff design.

If any developments were to adversely impact on Epic, it could exercise its rights to apply for an early review. The Commission has given consideration to requiring Epic to incorporate in the access arrangement, pursuant to section 8.17(ii) of the code, a trigger for early review in the event that a 'significant major event' occurs. This would give other interested parties the opportunity to make submissions for changes to the access arrangement, but only if that trigger were activated. An example of such a trigger might be the irrevocable commitment of a pipeline developer to construct a new pipeline to serve customers in South Australia.

The Commission will be assisted in reaching a final position by submissions on the matter from the applicant, users and prospective users. The submissions should address the following issues:

- whether to include a section 3.17 trigger in the access arrangement;
- if so, how to define a 'significant major event' for purposes of that trigger; and
- whether the regulator's scope for review of the access arrangement should be limited, for example, to reviews of the tariff structure only.

The Commission emphasises that while prospective developments in the market have a bearing on such submissions, a trigger can only be defined in terms of the actual occurrence (in the future) of a 'specific major event'.

In the event the Commission is persuaded by submissions that the access arrangement should incorporate one or more trigger events it would, as part of the further process of public consultation:

- make the terms of such events known to Epic prior to the final decision;
- make known its views as to the scope of any review that should be triggered by the occurrence of the specific major event.

Proposed amendments

The amendments to the access arrangement proposed by the Commission are drawn together below. The Commission's reasons for requiring these amendments are set out in the body of the draft decision, immediately preceding each proposed amendment.

The Commission is obliged to make its draft decision on the access arrangement as originally lodged. Accordingly, this document sets out the Commission's draft decision on the corrected version, of 16 April 1999, of Epic's proposed access arrangement. However, in drafting the amendments to the access arrangement that the Commission requires in order to approve it, the Commission has taken into consideration and discussed in this draft decision Epic's proposed revisions of 2 March 2000. In respect of those of Epic's proposed revisions not specifically discussed in this draft decision, the Commission proceeds on the assumption that Epic will make the

changes to the access arrangement proposed in its lodgement of 2 March 2000 and in supplementary correspondence with the Commission.

Proposed amendment A2.1

In order for Epic's access arrangement for MAPS to be approved, the value of the initial capital base must be adjusted to the value derived by the Commission, **$310** million.

Proposed amendment A2.2

In order for Epic's access arrangement for MAPS to be approved, for the purpose of calculating Epic's capital charge (return on capital assets) the working capital component must not be included in the value of the capital base.

Proposed amendment A2.3

In order for Epic's access arrangement for MAPS to be approved:

- the WACC estimates and associated parameters forming part of the access arrangement must be amended to reflect the current financial market settings, by adopting the parameters set out by the Commission in Tables 2.9 and 2.10 above; and
- the target revenues and forecast revenues must be based on these new parameters.

Proposed amendment A2.4

In order for the access arrangement for MAPS to be approved, Epic must:

- incorporate the new clauses 30.4 and 30.5 proposed by Epic in its letter of 15 June 2000 in place of clause 30.4 of the original access arrangement;
- incorporate the new definition of 'imposts' proposed by Epic in its letter of 15 June 2000 in place of the original definition in clause 43.1(b); and
- replace the words 'GST Recipient' and 'GST Supplier' in the new clause 30.4(b) with the words 'Recipient' and 'Supplier' respectively.

Further, in the CPI-X revenue adjustment that occurs in the year following the introduction of GST, Epic must incorporate the measure of CPI that is exclusive of GST impacts, as stated by the Commission at that time.

Proposed amendment A2.5

For the access arrangement to be approved, Epic must amend the reference tariff proposed in Schedule 4 of the access arrangement. The amendment must have the effect that the reference tariff is derived by applying, to the system primary capacity:

- to derive the initial tariff, the cost-of-service revenue resulting from the amendments proposed by the Commission in this draft decision;

- in each subsequent year, the smoothed cost-of-service revenue resulting from the amendments proposed by the Commission in this draft decision.

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Proposed amendment A2.6

In order for Epic's access arrangement to be approved, the Commission requires that Epic delete clause 30.2 of the access arrangement (that clause being entitled 'CPI Adjustment') and amend clause 5.2(a)(xii) of the access arrangement to read as follows:

> The initial Reference Tariff (including the Whyalla Lateral Surcharge) is set out in Schedule 4. The Total Revenue Requirement and the resulting Reference Tariff will thereafter vary on 1 January in each year of the initial Access Arrangement period in accordance with the formula CPI – 1.6%. Charges in respect of other services are also shown in Schedule 4. These charges will remain unchanged during the initial Access Arrangement period.

Proposed amendment A2.7

In order for Epic's access arrangement to be approved, the Commission requires that Epic incorporate in the access arrangement the incentive and risk-sharing mechanism proposed by Epic set out in clause 5.3 of the revised access arrangement of 2 March 2000.

Proposed amendment A2.8

In order for the access arrangement to be approved, the Commission requires that Epic amend clause 5.2(a)(vi) of the original lodgement (renumbered as '5.2(a)(v)' in the lodgement of 2 March 2000) so that it reads as follows:

> The Capital Base is to be adjusted annually on 1 January by the Capital Cost Revaluation, which will be equal to the CPI for the 12-month period ending on the previous 30 September.

Proposed amendment A3.1

For Epic's access arrangement for MAPS to be approved, the Commission requires:

- that the access arrangement be amended to provide for the FT, IT and non-specified services set out in Epic's lodgement of 2 March 2000, subject to the proposed amendments in the remainder of this draft decision; and

- that clause 43.1 be amended to make the definition of 'Available Capacity' and 'Spare Capacity' consistent with the definition of 'Spare Capacity' in section 10.8 of the code.

Proposed amendment A3.2

For the access arrangement to be approved, the Commission requires that Epic incorporate the proposed amendment providing for Epic to post on the EBB each day:

- forecast maximum capacity for each delivery point, based on the gas specification and the conditions prevailing on the previous day; and
- the forecast net available capacity, based on monthly forecasts that are provided by the FT users (under clause 18.1(c)).

as described in Epic's response to submissions of 1 February 2000 (section 2.2.7, page 24 of public response) and in section 3.1.4 in this draft decision.

Proposed amendment A3.3

For the access arrangement to be approved, the Commission requires that it be amended to provide that capacity that is released or surrendered by a user be dealt with as proposed by Epic in its letter dated 15 June 2000, as quoted in section 3.1.4, to the effect that:

> capacity that is released by a user:
>
> (a) otherwise than under the trading policy clause 26.2,
>
> (b) for reason that a consumer or aggregator has changed suppliers
>
> may be contracted by another user, or a prospective user:
>
> (i) who is (directly or indirectly) supplying that consumer (or aggregator); and
>
> (ii) without following the queuing process set out in clause 10.

Proposed amendment A3.4

For the access arrangement to be approved, the Commission requires that it be amended to make provision for the service provider to require that capacity be transferred in specified circumstances. The circumstances are where:

- in consequence of losing a customer to another supplier, an existing user no longer requires the volume of capacity attributable to that customer; and
- the capacity is not released by the existing user;

it must be transferred to the other supplier.

Any such provision should be subject to the provisions of the relevant existing haulage agreement other than any exclusivity rights that arose on or after 30 March 1995.

Proposed amendment A3.5

For the access arrangement to be approved, the Commission requires that it be amended to contain a provision in the following terms:

> This access arrangement takes effect subject to any contractual rights in existence prior to the date of lodgement of the proposed access arrangement, 1 April 1999, with the exception of Exclusivity Rights (within the meaning of the Code) that arose on or after 30 March 1995.

Proposed amendment A3.6

For the access arrangement to be approved, the Commission requires that clause 4.3, other than clause 4.3(g)(ii), as proposed in Epic's lodgement of 2 March 2000 be

incorporated in the access arrangement, subject to adding the following to clause 4.3(c):

> For the avoidance of doubt, nothing in the Agreement requires or permits the Service Provider or User to observe or give effect to the terms of any Exclusivity Rights (within the meaning of the Code) that arose on or after 30 March 1995.

Proposed amendment A3.7

For the access arrangement to be approved, the Commission requires that the definition, in clause 43.1, of 'Existing User Rights' proposed in Epic's lodgement of 2 March 2000 be incorporated in the access arrangement, subject to adding the following:

> The term 'Existing User Rights' does not include any Exclusivity Right (within the meaning of the Code) that arose on or after 30 March 1995.

Proposed amendment A3.8

For the access arrangement to be approved, the Commission requires that the definition, in clause 43.1, of 'Existing Delivery Facilities' proposed in Epic's lodgement of 2 March 2000 be incorporated in the access arrangement, subject to the deletion of references to laterals.

Proposed amendment A3.9

For the access arrangement to be approved, the Commission requires that clauses 9.1 and 9.2 be modified so that:

- they read as proposed by Epic in its letter dated 15 June 2000 to the Commission as follows:

  > 9.1 The Service Provider will not be required to commence the Specified Service for a Prospective User or to continue to provide the Specified Service to the User if the Prospective User/User is not able to satisfy the Service Provider of the ability of the Prospective User/User to fulfil its obligations under the Agreement.
  >
  > 9.2 If the Service Provider is not satisfied that the Prospective User/User will fulfil its obligations or continue to fulfil its obligations under the Agreement, the Service Provider may require, and the Prospective User/User will provide, security for those obligations to the Service Provider's reasonable satisfaction.

- they are cross-referenced to Schedule 2, Form 3, of the access arrangement so as to clearly indicate the credit and financial information that the service provider can reasonably request of the user or prospective user.

Proposed amendment A3.10

For the access arrangement to be approved, the Commission requires that clauses 6.3, 11.1 and 11.2 be amended in the manner proposed in the lodgement of 2 March 2000, subject to adding to clause 11.2 a provision to the following effect:

> The Service Provider will accept reasonable requests for a shorter Term of Agreement for IT service. `

The Commission also requires that clause 11.3 be amended to read as follows:

> 11.3(a) Providing the User is not in default at the date of notice, the User may extend the Term for FT service by minimum periods of 2 years at a time:
>
> (i) by giving written notice to the Service Provider not less than 3 months prior to the Termination Date; or
>
> (ii) by giving notice at a time and in a manner previously arranged with the Service Provider.
>
> (b) Where the Agreement is for IT Service, the Term will automatically extend on a year by year basis from the Termination Date unless:
>
> (i) the User has given written notice of termination to the Service Provider under clause 36.5;
>
> (ii) the User is in default under the Agreement at the Termination Date.

Proposed amendment A3.11

For the access arrangement to be approved, the Commission requires that Epic amend clause 12.4 by replacing the term '60°C' with the following:

> 71°C, or such lesser temperature as may be agreed at a future date with all users of the pipeline system at that time or as may be agreed as part of a future national gas code.

Proposed amendment A3.12

For the access arrangement to be approved, the Commission requires that clause 13.3 be amended as proposed by Epic in its lodgement of 2 March 2000 and as modified by its letter dated 15 June 2000.

Proposed amendment A3.13

For the access arrangement to be approved, the Commission requires that clause 15 be amended as proposed by Epic in its lodgement of 2 March 2000, subject to:

- Epic amending clause 15.3(b)(ii) by replacing the word 'may' with 'will' and by adding after the word 'System' in that clause words to the following effect:

  > … and for that purpose will communicate directly with the operator of the Moomba processing plant or other originator of the non-specification gas (if known) to bring about a termination of the supply of that gas as soon as it becomes aware of the problem;

- Epic describing the steps it will take to ensure that users are not adversely affected by the proposed change in gas specification.

Proposed amendment A3.14

For the access arrangement to be approved, the Commission requires that, in addition to making its other proposed revisions of 2 March 2000 to clause 17, Epic change its proposed revision to clause 17.1(c) to adopt the following standard:

> 17.1 (c) The Service Provider will use its best endeavours to minimise the quantity of System Use Gas that is required for the operation of the Pipeline System.

Proposed amendment A3.15

For the access arrangement to be approved, the Commission requires that clause 18 be amended in the manner proposed in the revised lodgement of 2 March 2000.

Proposed amendment A3.16

For the access arrangement to be approved, the Commission requires that, in addition to making its other proposed revisions of 2 March 2000 to clause 19, Epic amend its proposed revision to clause 19.2(c) to read as follows:

> 19.2(c) If, at the date of expiration or termination of the Agreement there is an Imbalance, then despite the expiration or termination of the Agreement, the User must:
>
> (i) if the Imbalance is negative, pay to the Service Provider (within 10 Days after receipt of an invoice) an amount equal to the number of GJs of the Imbalance multiplied by the Excess Imbalance Charge Rate; and
>
> (ii) if the Imbalance is positive, make arrangements to sell the amount of the Imbalance to another user. The Service Provider will assist the User (for instance, by providing access to the EBB) so that the user has the opportunity to realise from the sale the full market value that would be achieved in the normal course of trading.

Proposed amendment A3.17

For the access arrangement to be approved, clause 20.2(b) must be amended so that it is clear that the charge applies to the outstanding excess imbalance, i.e., to that imbalance outstanding after any and all exchanges or trades have been made.

Proposed amendment A3.18

For the access arrangement to be approved, the Commission requires that clause 21 be amended as proposed in the revisions to the access arrangement of 2 March 2000.

Proposed amendment A3.19

For the access arrangement to be approved, the Commission requires that Epic incorporate in it the revision to clause 22.3(a)(ii) proposed in Epic's letter to the Commission of 15 June 2000, that is, the words 'if any' be added after the words 'Metered Facilities' in the parentheses.

Proposed amendment A3.20

For the access arrangement to be approved, the Commission requires Epic to:

- adopt the revisions to clauses 24 and 25 set out in its lodgement of 2 March 2000 and in its letter dated 15 June 2000; and
- amend clause 41.1(c) by deleting after the words 'telephone and' the word '/or'.

Proposed amendment A3.21

For the Commission to approve the access arrangement, Epic must amend clause 27.4(d) to read as follows:

> The Service Provider will not be responsible for any losses, costs, damages and expenses suffered or incurred by any person in relation to the use of the EBB or any communications related to the EBB, unless such losses are due to the negligence of the Service Provider or default by the Service Provider in complying with its obligations under the Agreement.

Epic must amend clause 4.2 of the EBB System Agreement in Schedule 5 of the access arrangement to reflect the above amendment to clause 27.4(d) and Epic's proposed revisions of 2 March 2000 to clause 27.3(b) of the access arrangement.

Proposed amendment A3.22

For the access arrangement to be approved, the Commission requires Epic to amend clauses 28 and 29 and Schedules 8 and 9 to establish, in consultation with users and prospective users:

- threshold values at which, and circumstances in which, it is reasonable for the service provider to require the installation of measuring equipment and adherence to procedures set out in Schedules 8 and 9.

Proposed amendment A3.23

For the access arrangement to be approved the Commission requires that clause 32.1 be amended to read as follows:

> The User will pay each invoice by direct payment to a bank account nominated by the Service Provider by the later of the 14th day of the month or 10 business days after receipt of the invoice from the Service Provider.

The Commission also requires that Epic revise clause 32.2(a) as proposed in its lodgement of 2 March 2000.

Proposed amendment A3.24

For the access arrangement to be approved, Epic must amend clause 34.4(b) in accordance with the proposal in Epic's lodgement of 2 March 2000.

Proposed amendment A3.25

For the access arrangement to be approved, the Commission requires that Epic incorporate in clause 35 the revisions proposed in its lodgement of 2 March 2000, subject to changing the word 'lesser' in clause 35.3 to 'greater'.

Proposed amendment A3.26

For the access arrangement to be approved, the Commission requires that Epic:

- adopt the proposed revisions to clause 37.2(a)(i) set out in its letter dated 15 June 2000, that is, Epic is to add after the word 'practice' the following words:

and includes the grounds on which the Service Provider has issued a Curtailment Notice or an OFO

- add, after clause 37.1(d), the following sentence:

  The Service Provider is bound to take part in a Dispute resolution process initiated by another Party.

Proposed amendment A3.27

For the access arrangement to be approved, the Commission requires Epic to make the revisions to clause 38 proposed in Epic's lodgement of 2 March 2000, subject to clause 38(2)(c) being amended to read as follows:

38.2(c) An assignment by the User will be conditional upon, and will not be binding until, the assignee has:

(i) executed a deed of covenant in favour of the Service Provider agreeing to be bound by the Agreement. The Service Provider may prescribe a reasonable form of covenant but the User may make its own arrangements to draw up the deed and submit it to the Service Provider; and

(ii) reimbursed the Service Provider's costs, within the limits of the Application Fee, that have been reasonably incurred in assessing whether the assignee meets the Creditworthiness Criteria.

Proposed amendment A3.28

For the access arrangement to be approved, Epic must not incorporate in its proposed revisions of 2 March 2000 to clause 39 its proposed amendment to clause 39.1(d)(vi).

Proposed amendment A3.29

For the access arrangement to be approved, the Commission requires that Epic add the following to clause 43.6:

If there is any conflict or discrepancy between the clauses of the Access Arrangement and the Schedules to the Access Arrangement, then unless otherwise provided in a clause of the Access Arrangement, the clauses and Schedules will rank in order of interpretive precedence as follows:

(a) clauses of the Access Arrangement; and

(b) the Schedules.

Proposed amendment A3.30

For the access arrangement to be approved, Epic must amend clause 26 as proposed in its lodgement of 2 March 2000 and letter dated 26 March 2000.

Proposed amendment A3.31

For the access arrangement to be approved, the Commission requires that, except in the following respects, the arrangement incorporate Epic's proposed amendments of 2 March 2000 to clause 6.

- First, Epic is required to amend clause 6 so that it also applies to requests for non-specified services, in replacement or continuation of capacity reservations under the Existing Transportation Agreements or extensions thereof, by the Existing Users as defined in respect of those Agreements.
- Second, Epic is required to amend clauses 6.2(b) and (c) as proposed in Epic's revisions of 2 March 2000 to limit the information required from a 'User' as indicated in 3.5.5 above, that is, to limit the information to:

  that required to assess whether there is capacity to supply the requested service; and

  that required to update clause 9.2 (creditworthiness) information since it was first lodged.
- Third, Epic is to amend revised clause 6.2(c) so that a request to increase MDQ is not to be treated as a request for a separate, new contract when sufficient spare capacity is available to meet that request (subject to queuing). Such a request is to be treated as a request to vary service under clause 6.9;
- Fourth, Epic is to amend revised clause 6.2 by adding after clause 6.2(c) the following:

  Where the Service Provider reasonably believes that the service requested pursuant to clause 6.2(a) or clause 6.2(c) could only be provided with an extension to or expansion of the system, an Application Fee is not required until the Prospective User or User has consented to join the queue for FT Service.
- Fifth, Epic is to amend revised clause 6.7(a) to read as follows:

  All FT Requests will be placed in a queue and will be satisfied in the order in which they are received. Where the Service Provider reasonably believes that satisfaction of the Request for Service will require the construction of New Facilities, an FT Request will not be accorded any priority over any other FT Request falling in the same construction task. However, the priority of FT requests ranked in order of receipt will determine the order in which they are satisfied for all other purposes, including:

  (i) any construction associated with capacity enhancement for another party or parties, whether or not the construction is carried out under the terms of the access arrangement; and

  (ii) any allocation of spare capacity.
- Sixth, Epic is to amend revised clause 6.9(a) to include a request by a User to increase MDQ except:

  (i) where the Service Provider reasonably believes that assessment of the Request for Service will involve an assessment of the cost of constructing new facilities; and

  (ii) the User is informed of that fact before the Request for Service is accepted.

Proposed amendment A3.32

For the access arrangement to be approved, the Commission requires that clause 10 be amended to make the queuing policy applicable to requests for non-specified services.

Proposed amendment A3.33

For the proposed access arrangement to be approved, the Commission requires that Epic incorporate the revised clause 7 as proposed in its lodgement of 2 March 2000, subject to:

- Epic deleting from clause 7.2 all words after 'Month,';
- Epic deleting the amount '$5,000' in respect of 'Application Fee – IT Service' in Schedule 4 Tariff Schedule; and
- Epic modifying its proposed revision to clause 7.5(a) so that, in the phrase 'in the order or priority', the words 'or priority' are deleted.

Proposed amendment A3.34

For the access arrangement to be approved, the Commission requires that Epic revise clause 10 as proposed in its lodgement of 2 March 2000, except as indicated in the following points:

- First, revise the procedures for clearance of the queue in accordance with the indications given above, following public consultation on relevant threshold values for determining when applications for access would be reviewed and cleared from the queue;
- Second, amend the definition of 'I' in clause 10.4(l)(iii) so that it reads as follows:

  > 'I' = the present value calculation (using as the discount rate the nominal post-tax vanilla WACC assessed by the Regulator) over the term of the FT Service Contract of the Capacity Charge revenue ('CCR');

- Third, incorporate further revisions in the access arrangement to reflect the intentions stated in its letter dated 15 June 2000 (clause 10.5(a) expenditure limit; queue clearance in association with capacity enhancement for a party or parties);
- Fourth, incorporate provisions establishing the minimum parameters that would apply in respect of commercial negotiations over timetable and allocation of construction risks for enhancements to capacity, taking into consideration the issues raised by Santos;
- Fifth, subject to further public consultation as indicated above, provide for clearance of the queue at more frequent intervals than annually;
- Sixth, delete clause 10.5(a)(ii); and
- Seventh, amend clause 10.6 as proposed in Epic's lodgement of 2 March 2000 by replacing 'I' with 'the lesser of "A" and "I" '.

Proposed amendment A3.35

For the access arrangement to be approved, the Commission requires that Epic amend the access arrangement to provide for the revisions submission date and revisions commencement date proposed in clauses 1.2 and 1.3 of its lodgement of 2 March 2000.

Proposed amendment A3.36

For the access arrangement to be approved, the Commission requires that Epic amend the access arrangement by defining, in response to the further process of public consultation, specific major events (if any) that would trigger an obligation on the service provider to submit revisions prior to the revisions submission date.