

11 October 2002



BHP Billiton Petroleum Pty Ltd  
600 Bourke Street  
Melbourne Victoria 3000 Australia  
GPO Box 86A  
Melbourne Victoria 3001 Australia  
Tel +61 3 9609 3333 Fax +61 3 9609 3015  
bhpbilliton.com

Mr Mike Walsh  
Project Manager, Regulatory Affairs-Gas  
Australian Competition and Consumer Commission  
PO Box 1199  
DICKSON ACT 2602

Dear Mr Walsh

**Further Comments On GasNet's Access Arrangement Information**

Please find attached further comments responding to the additional information provided by GasNet, as required by the ACCC's draft decision.

BHP Billiton remains concerned with the GasNet access review process, particularly ACCC's decision not to convene a public conference, as had been requested by us. Accordingly, in the absence of the public conference, further comments are provided in this submission on the SWP roll-in, depreciation of the Longford-Pakenham assets, the WACC and on the issue of regulatory risk.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'D Murphy'.

David Murphy  
Manager Gas Marketing

DM:tc

Ref: ACCC111002

**BHP Billiton Submission**  
**to**  
**ACCC Draft Decision**  
**on**  
**GasNet Access Arrangement Application**

**Follow up response on**  
**Opex, Benchmarking, Benefit Sharing, MV Pipeline,**  
**and SWP Benefits**

11 October 2002

## Table of Contents

Follow up response on .....	1
Opex, Benchmarking, Benefit Sharing, MV Pipeline, and SWP Benefits .....	1
Executive Summary .....	3
1. Introduction.....	5
2. Benefit sharing .....	5
2.1 Mechanism .....	5
2.2 Loss of opex efficiencies exhibited by GasNet.....	6
2.3 Double dipping of opex.....	6
3. Future Opex .....	7
3.1 Past opex is alleged to be unsustainable .....	7
3.2 Basic opex levels .....	8
4. Benchmarking .....	9
4.1 Overview.....	9
4.2 International performance comparisons .....	10
4.3 Aggregation of VENCorp and GasNet operating costs .....	11
4.4 ACCC assessments of benchmarks provided by GasNet and stakeholders .....	12
5. SWP system wide benefits test.....	12
5.1 Increased competition .....	13
5.2 System security .....	15
5.3 Value of System Wide Benefits of SWP .....	18
5.4 Revenue required by SWP .....	19
5.5 GasNet response to draft decision .....	19
6. Depreciation of GasNet's L-P assets .....	20
7. Murray Valley pipeline .....	21
8. GasNet response on WACC, and assertions on regulatory risk.....	21

## **Executive Summary**

Further to our earlier submission regarding the ACCC draft decision on the GasNet application, subsequent to the release of additional information by the ACCC, comments are provided on the following issues: opex, benefit sharing, benchmarking, the Murray Valley pipeline, the SWP roll-in, depreciation of the Longford-Pakenham assets, the WACC, and the issue of regulatory risk.

BHP Billiton has been concerned with the GasNet access review process primarily because of its inadequate information disclosures and therefore, the inability of users and potential users to verify that the proposed tariffs are fair, reasonable and efficient.

The ACCC's draft decision has not allayed BHP Billiton's concerns about key aspects of the draft decision. This comment particularly applies to the lack of substantiation of significant costs claimed by GasNet, which is not in the spirit of good regulatory practice, nor is it consistent with Gas Code provisions. The ACCC's decision to preclude the convening of a pre-decision conference accentuates problems of inadequate transparency and substantiation that BHP Billiton has had with this access review and with the draft decision.

The additional information, which the ACCC has required in its draft decision to be provided by GasNet is grossly inadequate, and is consistent with the problems experienced with BHP Billiton throughout this access review process.

The additional information provided by GasNet on its past opex does not provide what was required nor does it provide any additional elucidation which would enable verification of its claims that opex savings are unsustainable. Similarly, the additional information provided by GasNet on the Murray Valley pipeline does not contain any quantification of the benefits, the costs involved, or the expected revenue stream, to substantiate its roll-in under the economic feasibility test.

BHP Billiton assesses that GasNet has not achieved unsustainable savings in its current opex. Furthermore, there are substantial concerns with the "double-dipping" of the pigging and other deferred costs proposed to be carried forward.

BHP Billiton also assesses that the justification to claim that GasNet's operational costs are higher than other transmission companies because of certain factors noted by the ACCC, is not valid as:-

- ↳ the gas control function is handled by VENCORP (not by GasNet);
- ↳ the PTS is a geographically compact system and despite the lower demands in summer, the PTS still has a good overall usage factor;

- ↪ comparisons between the Victorian distribution businesses and GasNet show that the benchmark “non-capital costs per kilometer of mains” for the distribution businesses is a little over one third that of GasNet; and
- ↪ there has been no verification of the GasNet claim that VENCORP provides benefits to its cost base valued at only \$660,000p.a., particularly in the light of VENCORP’s total yearly operational costs of \$16 million.

BHP Billiton is very concerned with the ACCC’s assessment of the SWP roll-in on the basis of the following:-

- ↪ very limited costing data (drawn from more than two years ago) in relation to substantiation of the system wide benefits claims;
- ↪ uncosted assertions by GasNet about reduced producer power and increased competitive forces.

BHP Billiton’s analysis (based on current data) suggests that, at best, the system security value of the system wide benefit test is \$3.06million over a five year period, or \$620,000 p.a.

BHP Billiton notes GasNet’s response to its analysis on the life of the Gippsland basin, but considers that the conclusions reached in the earlier BHP Billiton submission remain valid. Other comments are made on GasNet’s response on WACC and on regulatory risk, which overall, have little or no validity.

Overall, BHP Billiton recommends that the ACCC must:-

- ↪ reject GasNet’s claims that current period opex savings are unsustainable in the absence of any substantiation and must apply an appropriate (efficiency) X-factor (which is consistent with efficiency savings in the previous access arrangements period) to opex claims in the next regulatory period with the appropriate allocation of previous opex savings to users;
- ↪ reject GasNet’s claims in relation to the roll-in of the Murray Valley pipeline in the absence of any substantiation; and
- ↪ reject the roll-in of the SWP under the system wide benefit test in the absence of cost substantiation and quantification.

## **1. Introduction**

BHP Billiton provides further comments in this submission in response to the additional information provided (on 20 September) by GasNet, as required in the ACCC's draft decision. These concern the following issues: opex, benefit sharing, benchmarking and the Murray Valley pipeline.

Further comments are also provided on the SWP benefits, the depreciation of the Longford-Pakenham assets, the WACC and regulatory risk, in response to GasNet assertions.

## **2. Benefit sharing**

### ***2.1 Mechanism***

BHP Billiton reminds the ACCC that its "light handed" regulatory approach in relation to its review of GasNet's access arrangements application will only reward the overstating of costs. By not verifying costs on the unproven assumption that regulated businesses will provide an improved service because it gives them long term benefits and that these will flow to users, will simply disadvantage the interests of users and prospective users. This issue was the focus of our earlier response to the ACCC's draft decision on the GasNet application. Suffice to say BHP Billiton does not concur with the approach proposed by the ACCC in identifying benefits, and then limiting the proportion shared with users.

Of significant concern is the ACCC's acceptance of GasNet's claim that the reduced opex incurred during the current AA period is unsustainable. We consider that this claim should not be accepted unless there is verification through rigorous external benchmarking. As stated earlier, the benchmarking carried out on GasNet's opex has been distinctly lacking.

BHP Billiton supports a regulatory regime where there is an incentive provided to regulated businesses to improve performance (both in cost and service delivery). In the event that savings are identified, the model of benefit sharing proposed by the ACCC would provide an acceptable outcome for users to participate in sharing any future opex savings.

## **2.2 Loss of opex efficiencies exhibited by GasNet**

GasNet has claimed that some \$20million<sup>1</sup> (or \$4million p.a.) in opex savings allowed in the first AA, are unsustainable. GasNet forecasts that its opex will be at near budget level in the final year of the regulatory period, thereby avoiding the need to share with users any of the savings they would have undoubtedly achieved. The ACCC has accepted this claim with no apparent quantified substantiation provided.

The ACCC had advised BHP Billiton in a recent meeting that GasNet was to provide a detailed breakdown of opex over the current AA, and the ACCC further stated this requirement in its draft decision (page 85). This was noted as being required to establish the areas for the under-run on opex and would therefore assist in establishing whether the opex savings were in fact sustainable. The recent additional information provided by GasNet<sup>2</sup> provides no additional elucidation to enable verification of its claims that savings are unsustainable. Unless verification is provided, the ACCC must reject GasNet's claims that opex savings in the first AA cannot be sustained into the next regulatory period.

Similarly, the ACCC must reconsider its statement that subject to some adjustments it considers the increase in costs between 2001 (which were \$13.9million) and 2003 (forecast to be \$18.4million) is "...not unreasonable"<sup>3</sup>. The only justification for this opex increase of nearly one third, is apparently attributed to uncosted increases in staffing, pigging and other items. This is not an adequate explanation, as we will show in following sections.

## **2.3 Double dipping of opex**

GasNet advises that it did not incur certain opex costs although allowances were provided in the first AA. In its access arrangements application and subsequent information provided, it advises that these savings were achieved by deferral of costs, thereby justifying the so-called "unsustainability" of the savings" claims. For example, GasNet notes that it has significantly deferred pigging operations which now have to be carried out. The ACCC confirms this is the case and notes<sup>4</sup> :-

"To the extent that pigging operations have been deferred, additional costs would be expected in the second access arrangement period."(Emphasis added).

---

<sup>1</sup> ACCC Draft Decision, GasNet Australia access arrangement revisions for the PTS, 14 August 2002, Table 6.1.

<sup>2</sup> GasNet proposed amendments to revised AA and draft AAI, dated 13 September, table 3.6A (made available to users 20 September).

<sup>3</sup> ACCC Draft Decision, GasNet Australia access arrangement revisions for the PTS, 14 August 2002, page 85.

<sup>4</sup> *ibid*, page 84.

However, as GasNet has already been permitted an allowance in the current AA for carrying out tasks that it now claims a new allowance for carrying out in the new AA, then GasNet is effectively claiming payment twice for the same task. It is this double dipping of opex for the new period that supports the massive increase in GasNet's historical opex.

The ACCC must require GasNet to demonstrate the extent of the opex carried forward in this way before it can determine whether the opex currently claimed is reasonable. Again, as GasNet has not provided the break down of opex costs necessary for interested parties to comment (as required by the ACCC in its draft decision and reiterated to BHP Billiton in a recent meeting), it is difficult to provide any quantifiable response to the GasNet claims.

### **3. Future Opex**

#### **3.1 *Past opex is alleged to be unsustainable***

It is reasonable that past opex be taken the starting point for any assessment of efficient future opex claims.

GasNet advises that they consider that past opex savings are unsustainable – this then raises two questions: how did GasNet “unsustainably save” an average of \$4million p.a. over the current regulatory period and what does the ACCC propose to do with regard to the \$20million GasNet has now acquired from users?

As a possible response to these questions, the ACCC notes<sup>5</sup> in its draft decision:-

“GasNet states that it managed ‘to temporarily reduce some costs in response to large revenue losses resulting from warm weather and lost gas sales’ during that period. GasNet added that the reduction in costs was achieved through delays in filling vacant positions, lower levels of business marketing and reduced levels of administrative support. In addition, as noted above, no pigging expenses were reported for 1998, 1999 and 2000. As any deferred pigging operations would need to be undertaken in later years, associated costs savings would not be sustainable.”

However, we note the bland acceptance that GasNet made temporary cost savings in part due to the large revenue losses resulting from warmer weather and lost gas sales. Whilst we are aware that the K-factor adjustment does not fully recompense for reduced volume of gas sales, it does provide some relief. GasNet has claimed nearly \$14million of K-factor adjustment which was

---

<sup>5</sup> ACCC Draft Decision, GasNet Australia access arrangement revisions for the PTS, 14 August 2002, pages 84 and 85.



caused by the less than forecast gas sales, but offers no relief to users as a result of the reduced opex apparently resulting from the gas demand reduction. Either another “double dip” is being sought or more likely, there is significant overstatement of the impact of reduced gas sales on the savings. BHP Billiton is of the view that with GasNet’s relatively fixed overhead structure, its ability to reduce its opex as a result of reduced gas sales is relatively modest, and it is because of this, that GasNet has the ability to recover some of the lost revenue through the K-factor adjustment.

GasNet adds that savings were made by deterring the appointment of a CFO and other staff. A costing of the non inclusion of the staff noted as absent from the actual opex would amount to only a few hundred thousand dollars per year. GasNet does not state how long these vacancies existed nor the period of the vacancies. That GasNet had significant below budget actual opex for four of the five years of the current AA period (and the fifth year opex is based on forecasts and not actual costs) is not supported merely by the statement that GasNet may have been operating below optimum staff levels for some period during these four years.

### **3.2 Basic opex levels**

In its draft decision, the ACCC accepts the basic opex amounts proposed by GasNet, but denies the existence of a number of the asymmetric costs. As commented on in our earlier submission, we agree with the ACCC approach for the exclusion of these asymmetric costs, but we consider that the ACCC has made little attempt to verify the basic opex claims.

At the meeting between ACCC and BHP on 9 September, the ACCC advised that GasNet is required to provide more information regarding its opex proposal. Some information was finally made available on 25 September. Upon review it provides little additional information other than to state that a new benchmark (\$opex/PJ/KM) is included and that comparisons indicate that GasNet operations are in the low range. However, GasNet fails to explain any derivation of the base opex figure of \$16.64million<sup>6</sup> used for the calculation.

What is somewhat disconcerting is that the other key performance indicators do not support GasNet’s assertions that its basic opex request for the new period is appropriate, particularly when considering the intrinsic benefits GasNet has obtained.

What needs to be added to GasNet’s opex costs to allow for sensible comparisons is a reasonable allowance for VENCORP providing services in support of GasNet’s operations. The GasNet assertion that \$660,000 is the only benefit VENCORP provides indicates that either VENCORP’s costs of \$16million p.a. are simply too excessive, or GasNet has significantly understated the extent of the benefit. We refer to the comments on this issue

---

<sup>6</sup> GasNet response to Draft Decision, dated 20 September, annex E (made available to users on 25 September).

made under “Benchmarking – VENCORP aggregation” in the section covered later in this submission.

However, the ACCC has also overlooked a number of other benefits derived by GasNet. These are:-

- The ACCC notes that the GasNet system has many features similar to a distribution network. If this is so (and we agree that it is) then GasNet’s opex when compared to the distribution activities of other regulated businesses is too high. We refer to the comments on this issue under the “Benchmarking –overview” section below.
- We have previously noted the benefits that GasNet has over other transmission systems, with its well loaded and geographically compact system.
- It has a mature and well penetrated market.
- There is overt governmental support to extend the GasNet system to unserved parts of the State.

When GasNet’s operations are compared to those of its peers, not only should it be based on a straight comparison of appropriate benchmarks, but there is a need to recognise the extent of any benefits (and detriments) which apply in each circumstance. A fair assessment of the GasNet operations is that it has more benefits than detriments.

Overall, BHP Billiton is of the view that GasNet has not achieved unsustainable savings in its current opex. When properly assessed the benchmarks indicate that GasNet’s proposed opex costs are high in comparison with other service providers. The ACCC should note the “double dip” of the pigging and other deferred costs proposed to be carried forward. Further, the unsustainability of the past savings has not been verified and even if it is the case, the value of the savings noted does not equate to the difference between past opex and proposed opex.

There is clear evidence that GasNet has overstated its future opex needs and the ACCC needs to address this.

## **4. Benchmarking**

### **4.1 Overview**

The ACCC comments<sup>7</sup> that:-

“... the PTS is unusual for a transmission system as it has significant network characteristics not shared with other Australian transmission

---

<sup>7</sup> ACCC Draft Decision, GasNet Australia access arrangement revisions for the PTS, 14 August 2002, page 187.

systems. Further, the PTS has a very peaky load but little linepack. Accordingly, it would be expected to face significantly greater gas control costs than other Australian transmission pipelines.”

It uses this assumption to support the view that GasNet's operational costs might well be higher than other transmission pipelines. What the ACCC overlooks is that the gas control function is handled by VENCORP which therefore significantly reduces GasNet costs. Further, the PTS is a geographically compact system and well loaded by any comparative measure, so there is an expectation that GasNet costs should be lower on a comparative basis.

In its review of GasNet's opex, the ACCC notes that GasNet exhibits many features of a distribution network (as compared to other transmission gas pipelines) and that this means transmission pipeline benchmark comparisons are not easily translated to GasNet's operations. A review of the performance of Victoria's distribution businesses indicates that the benchmark “non capital costs per kilometer of mains” shows that this benchmark for all three businesses is just a little over one third<sup>8</sup> of the equivalent GasNet benchmark (even excluding any of the costs attributable to GasNet from VENCORP operations). In this regard it should be noted that each of these distribution businesses is also required to manage an average of 500,000 customers as a major part of their non capital costs.

It is quite clear that the benefits GasNet has by its compactness, its distribution-like transmission system and the (reduced) activities it does not have to carry out due to VENCORP operations, should result in significantly better performance comparisons to other transmission pipelines.

## ***4.2 International performance comparisons***

The ACCC notes that regulators must be alert for the inherent circularity of consistently comparing a few numbers of similar businesses to themselves<sup>9</sup>. We agree and note that it was because of this concern that the Gas Code contains a number of references to requiring performance comparisons to similar regulated international businesses. The ACCC notes that the work provided by GasNet in the Cap Gemini report has limited if any application to the current review<sup>10</sup> and adds that:-

“... the Commission considers that overseas benchmarks are potentially very useful.”<sup>11</sup>

---

<sup>8</sup> MultiNet Gas gas access arrangement application to Victoria ESC dated 28 March 2002, Access Arrangement Information, page 38.

<sup>9</sup> ACCC Draft Decision, GasNet Australia access arrangement revisions for the PTS, 14 August 2002, page 187

<sup>10</sup> *ibid*, page 187

<sup>11</sup> *ibid*, page 187.

The ACCC goes on to say: -

“The Commission prefers not to attempt to ‘micro manage’ GasNet with regard to its costs. It considers that effective efficiency incentives are more likely to lead to efficient performance. Accordingly, the Commission places considerable priority on the future incentives mechanisms applying to GasNet.”<sup>12</sup>

If the ACCC does not prefer to “micro-manage” it must provide “competition by comparison”. To defer this requirement to a future review is unacceptable to current users and potential users.

What this means for stakeholders is that for this GasNet review, the ACCC has not carried out any significant local or international performance benchmarking, despite this being a clear requirement of the Gas Code. Thus, the ACCC has not verified key elements of GasNet’s cost drivers against best practice performance to assess whether its costs are reasonable and efficient.

BHP Billiton therefore asks: In the absence of “micro-management” or proper benchmark comparisons, how it is possible for the ACCC to have assessed whether the amounts claimed by GasNet are reasonable and how can the ACCC have considered the interests of users and potential users as it is required to do. In this regard BHP Billiton refers to the Supreme Court of Western Australia-Court of Appeal declaration (Re: Dr Ken Michael AM; Ex Parte Epic Energy (WA) Nominees Pty Ltd & ANOR [2002] WASCA 231 (23 August 2002)) in relation to Section 2.24 of the Gas Code whereby the judge ruled the regulator must take into account a range of factors which includes “the interests of Users and Prospective Users” (2.24(f)).

### **4.3 Aggregation of VENCORP and GasNet operating costs**

The ACCC notes the BHP-Billiton contention that GasNet and VENCORP costs should be aggregated<sup>13</sup>. It notes that there is difficulty in comparing systems where there is a different trading basis. However, it then accepts **without any interrogation** the GasNet statement that the only benefit GasNet sees VENCORP provides over equivalent pipeline operators using the contract carriage model is valued at \$660,000 per annum over GasNet costs.

If the ACCC accepts this GasNet assessment then it must accept that VENCORP is managing a market carriage system model at a cost to consumers of some \$16million p.a., or a penalty of over 7 cents for every GJ of gas used in the State. Whilst BHP-Billiton has previously commented on the excessive costs of VENCORP, it does not accept that the value of VENCORP activities to the Victorian gas market is only \$660,000 pa.

---

<sup>12</sup> *ibid*, page 187.

<sup>13</sup> *ibid*, page 184.

We strongly recommend that the ACCC should require GasNet to substantiate its assessment of this cost (and gain VENCORP verification of the number as part of an independent assessment), and then add this amount into the revenue allowed GasNet so that true comparisons of operating costs can be demonstrated.

#### **4.4 ACCC assessments of benchmarks provided by GasNet and stakeholders**

The ACCC has stated that “GasNet’s KPI’s are inconclusive” and that “clear signals were not available to GasNet”<sup>14</sup>. These statements highlight a lack of preparedness to address a core aspect of the Gas Code which requires a clear *assessment by comparison* of GasNet’s opex proposals.

What the ACCC has denied for itself in this review process, is the input that can be provided by stakeholders in verifying many issues and claims by GasNet. Submissions made to the ACCC issues paper by stakeholders consistently provide clear calculations showing that the GasNet proposals are too high. Despite all this work, the ACCC has decided that due to the absence of just one additional benchmark (\$/TJ/km), they are unable to reach any conclusion as to the reasonableness of the GasNet proposal (based on benchmarks).

Overall, GasNet has failed to provide adequate benchmarking of its opex costs, and has understated the benefits it gets from VENCORP and other aspects of its operations. The ACCC has insisted on GasNet providing only one additional benchmark. The inherent circularity of comparing Australian transmission companies only with themselves has not been addressed.

### **5. SWP system wide benefits test**

Whilst not stated in the draft decision, and excluded from the current application by GasNet, BHP Billiton is advised that the ACCC considers that GasNet has provided costings for the system wide benefits of the SWP roll-in in its original application for SWP roll-in. The ACCC provided its observations as to the inadequacy of these costings in its earlier Final Decision on SWP although these (inadequate) costings are presumably now considered acceptable.

The ACCC decided in its Final Decision on the SWP application that the rules applying to extensions of the GasNet system did not permit aggregation of benefits – that an extension had to either be economically feasible in its own right, or it needed to provide sufficient system wide benefits to equal the costs of the investment, or it was essential for safety reasons. GasNet has never proposed that SWP was required for safety reasons. The ACCC decided that

---

<sup>14</sup> *ibid*, page 187.

neither of the other two tests were satisfied in isolation and in doing so decided that SWP should not be rolled into the PTS.

In its recent draft decision the ACCC notes that it considers it is only now able to value the contribution of SWP by aggregation of all of its benefits as part of the current reset. Therefore, in making the assessments of the benefit of SWP the ACCC must use current data and calculate the benefits, i.e. those benefits that apply as of now can only be considered, as the ACCC is assessing the roll in of the SWP as it affects the system in which it currently operates. Thus, the ACCC must not reflect on what might have applied at the time of GasNet's decision to build SWP. As a direct result, the ACCC's comment that GasNet has already provided costed benefits for SWP and that Interested Parties should refer to these, is demonstrably inappropriate and inadequate.

It is of concern that the ACCC must have used this cost data to support its draft decision in that the system wide benefits added to the economic contribution from SWP tariffs, provide sufficient justification for the ACCC to make its assessment that the (uncosted) contribution from system wide benefits is sufficient to make up the short fall between (uncosted) tariff revenue and (uncosted) SWP costs. Whilst we accept that the ACCC may have been provided the expected SWP tariff revenue by virtue of its access to the GasNet model, and also to the GasNet calculation of SWP costs, we would remind the ACCC that notwithstanding the Gas Code provisions, similar data has not been made available to Interested Parties. We can only assume that due to the reference made by the ACCC to the granting of the roll-in of the Interconnect assets (costing some \$40million) that the ACCC has assumed that about half of the cost of SWP is to be recovered from system wide benefits.

On review of the GasNet application on SWP (dated 11 September 2000) and the ACCC Final Decision on the application (dated 29 June 2001), the only costing data provided is a modest calculation (System Security Value = Quantity available x cost x probability), and there are uncosted assertions about reduced producer power and increased competitive forces. GasNet details two "system wide benefits" in its SWP application – increased competition and system security – and provides some costing to support the aspect of system security. These two benefits are examined in more detail below.

## **5.1 Increased competition**

The first element of increased competition noted by GasNet is that of reduced producer market power and the second element is that of increased competitive forces. Both of these need to be evaluated in the light of current and future expectations of gas supply to the PTS.

It is appropriate to highlight some of the changes that have occurred in relation to the PTS over the past two years:-

- Origin Energy has committed to the Yolla field development and is intending to bring new gas into Victoria on the eastern side of Melbourne.
- There has been new investment (both by Esso/BHP and by independent producers) in the Gippsland basin.
- BHP Billiton has not secured a Victorian buyer for its 90% holding in Minerva gas but is to sell it through a new pipeline to be built to Adelaide.
- Woodside is to sell its gas from Geographe and Thylacine to TXU along an enlarged SEAGas pipeline to the Adelaide market.
- The EGP is transporting gas from Longford to the Sydney market.
- The new Tasmanian gas pipeline from Gippsland to the Tasmanian market is nearly complete.
- There is modest gas flow between NSW and Victoria on the Interconnect between PTS and EAPL, with spare capacity.
- There is transfer of modest amounts of gas between WUGS and the PTS on SWP with significant unused capacity of both WUGS and the SWP.
- In Adelaide in recent months, with a constraint of supply of gas from Moomba, gas fired power stations have taken gas from the system constraining off industrial consumers, and resulting in SA generated electricity being transferred into Victoria.

In its SWP application GasNet claimed that access to Otway gas would bring pricing pressure onto gas from the main providers to the system. In fact, the building of SWP has done nothing to provide any such pricing pressure. Minerva gas remained untapped until there was an opportunity arising from the deregulation of the electricity and gas markets in South Australia, combined with an increased demand for gas in Adelaide.

The decisions to source gas for Tasmania from the Gippsland basin and for South Australia to source from the apparently higher cost<sup>15</sup> Otway basin indicate a pricing structure from Gippsland basin that is seen as competitive, discounting entirely the GasNet assertion of the supposed benefits arising from reducing producer market power and increasing competition by use of SWP.

Further, with the recent decision of TXU (the owner of WUGS) to source gas from Otway basin for its Adelaide power stations, there is a strong possibility that should the development of Woodside's Geographe and Thylacine fields be delayed, TXU will extract gas from the Gippsland basin for its Adelaide-based power stations via the PTS and SWP, causing pricing pressure on gas supplies in the PTS. In this way, SWP can be seen as a detriment to PTS gas users.

---

<sup>15</sup> If Minerva, Thylacine and Geographe gas was not developed for the Victorian market, but is commercially viable for the SA market which is served by the Cooper basin, then the cost structure for Gippsland gas must be seen as lower than from Otway.

What is very clear from the actions of gas consumers and producers, is that the introduction of SWP has done nothing to reduce the cost of gas to consumers connected to the PTS, and it could in fact cause increased costs by its ability to transfer Gippsland gas into the SA market. GasNet recognizes this potential by the recent introduction of a modest “SEAGas” tariff for injections from SWP to the new Adelaide pipeline.

Thus, there is a clear demonstration that there has been and still is no system wide benefit provided to PTS by the so-called ‘reduced producer market power factor’, nor by increased competition. The ACCC must accept that the value provided by SWP in this aspect can only amount to zero.

## **5.2 System security**

GasNet states that SWP is needed for system security, despite the limited availability of gas to supply any such security. The implication of the GasNet concept is that SWP will enable WUGS and Otway basin gas to provide for short term peaks which historically have been the result of the high domestic load on cold winter days. However, GasNet clearly identifies that there has been a consistent winter warming trend since the 1950’s which can only lead to a reduction of the previous winter peak demands. Further, GasNet identifies that there will be an overall increase in gas demand in Victoria, led by the increasing demand for gas from power generation in summer to satisfy the increasing sharp peaks of electricity needed in summer resulting from the increasing prevalence of domestic air conditioning. The overall impact of both of these trends must be to levelise the annual gas demand, reducing the need for peak supplies and increasing the need for an ability to guarantee constant supply, rather than for short term peaks in the way GasNet sees SWP providing a service.

With its SWP application forecast, GasNet alleges that the system security provided by SWP could be costed at between \$40million and \$400million<sup>16</sup>. This is based on the calculation of the annual amount of gas that SWP can deliver from WUGS (10 PJ) multiplied by an average gas price for all of this gas (\$80/GJ- \$800/GJ) multiplied by a risk factor (5%).

There are a number of issues that arise from this calculation. This is enunciated clearly by the ACCC statement:-

“Consequently, the Commission considers that GPU GasNet’s estimates in relation to VoLL, the probability of an incident and the volume of gas available result in it substantially overstating the system security benefits generated by the Southwest Pipeline”<sup>17</sup>.

---

<sup>16</sup> Application for Revision to Access Arrangement by GPU GasNet Pty Ltd for the Principal Transmission System Southwest Pipeline Dated 11 September 2000, page 14.

<sup>17</sup> Revisions to access arrangement for the Principal Transmission System – Final Decision page 53.



## Actual performance data of the Victorian gas market since inception<sup>18</sup>

In the 42 months up to end August 2002 (some 914 days), the daily spot price for gas has exceeded \$4/GJ only on 6 days with the spot price averaging ~\$5.50/GJ over those days. The daily price for spot gas has peaked at \$9.20/GJ.

Longford currently has the stated ability to deliver on a firm and non firm basis gas up to the nominal capacity of GasNet's L-P assets of 990TJ of gas per day. The Interconnect to Moomba has the ability to deliver at least another 92TJ/day.<sup>19</sup> Added to this capacity are additional gas supplies from line pack and LNG storage. Soon there will be additional gas supply from the Yolla gas field. The proposed cross connections to EGP and TGP to form the Longford hub will further increase linepack, although delivery from these sources may be impacted by constraints in L-P delivery capacity.

Thus, it is not the capacity of the Longford processing plant that constrains deliveries of gas but the constraint of the L-P assets that currently controls the amount of export from Longford. If ABARE forecasts for gas demand in Victoria are to be fulfilled then L-P assets need to be augmented. BHP Billiton contends that this would have been a more cost effective solution to the building of SWP.

Since the gas market began, there have been 15 days where the gas demand has exceeded the available level of 990TJ/day from Longford but less than the combined capacity of Longford and the Interconnect of 1082 TJ/d<sup>20</sup> (1.6% of days) and 3 days where the demand has exceeded 1082 TJ/d (0.3% of days). The highest recorded peak demand is 1150 TJ/d in May 2000 where the demand reached 6% above the combined Longford/Interconnect level. Thus, it is possible that for 3 days in a total of 914 days (i.e. ~0.3% of the time or for 151TJ) there may have been a need for some augmentation of gas supply to the PTS customers from sources other than Longford and the Interconnect. This amount of additional gas would have been readily supplied from the LNG storage without recourse to the limited linepack. The maximum price of spot gas on these three days peaked at \$9.20/GJ and averaged about \$6.50/GJ.

## Risk Factor

GasNet suggests a risk factor of 5% applies to a catastrophic failure of Longford. The ACCC notes that this is too high<sup>21</sup> but declines to nominate what it considers appropriate.

---

<sup>18</sup> Data sourced from VENCORP monthly Gas Market Reports (which provide daily demand and daily spot prices).

<sup>19</sup> Application for Revision to Access Arrangement GPU GasNet Pty Ltd, Access Arrangement by GPU GasNet Pty Ltd for the Principal Transmission System, dated 25 August 1999, page 15

<sup>20</sup> Longford output plus Interconnect supply

<sup>21</sup> *ibid* page 52.

Longford has been in operation for nearly 40 years, providing natural gas to Victorian consumers. This is a total of some 2000 weeks. In this time the facility has been unavailable to supply any gas for less than 10 days, although there have been severe restrictions at other times. This implies a risk factor of perhaps 0.10%.

However, there are three major gas processing facilities operating in Australia – Longford, Moomba and at Burrup Peninsula. There are a number of smaller facilities in other parts of the country. When assessing the likelihood of a major disaster, it is necessary to review the numbers on incidents from all of these facilities (as would an insurer) and not concentrate purely on the performance of one facility. There has not been a gas supply cessation of similar magnitude to that resulting from the Longford fire at either of the other major processing plants. Thus, when combined with the performance of these plants and all of the smaller processing plants, there is every expectation that the risk factor would reduce to perhaps 0.05%.

The actual demand on the GasNet assets indicates that since the gas market began there has been no need for any gas for security reasons to be supplied from WUGS or from the Otway basin.

#### SWP supply quantity

The SWP is rated to carry 200TJ/day<sup>22</sup> but as pointed in its Final Decision on SWP the ACCC is of the view that on average the quantity available from WUGS would not exceed 5 PJ.<sup>23</sup> If there was another disaster similar to the Longford fire (i.e. a 2 week outage), at 200 TJ/day the SWP would have only been able to access half the amount the ACCC considers would have been available before Longford was able to resume sufficient supply to exceed the supply via SWP. Thus, in the case of a repeat of the Longford disaster WUGS may have been able to provide some 2.8 PJ of gas over the period of the total loss of supply. Whilst the ACCC and GasNet both considered that the amount from WUGS may be augmented by contributions from Otway basin suppliers, current contractual arrangements would tend to preclude this possibility from arising.

In the event of a total loss of supply prior to 1998, the system has “survived” on the LNG storage, which when full, contains reserves of about 0.5 PJ of gas. With the addition of the Interconnect there is adequate supply to maintain essential services and keep pressure within the system to maintain system integrity. The addition of gas via SWP is no longer needed if system integrity is at risk.

#### Price

The observations of spot prices now being exhibited for a full half of a regulatory period, indicate that the spot price for gas needed at peak times

---

<sup>22</sup> GasNet AA – Submission dated 27 March 2002, Schedule 3, page 20.

<sup>23</sup> Revisions to access arrangement for the Principal Transmission System – Final Decision page 52.

has averaged \$5.50/GJ and averages \$6.50/GJ for the three highest usage days.

### The system wide benefit

Assuming that there will be no benefit from the LNG facility, Yolla or from the system linepack, using the GasNet proposed formula and adjusting the parameters to reflect reality, leads to a costing of the system security element of the system wide benefit of:-

Case 1 – Actual exceedence of gas demand from other sources  
Quantity of gas 151 TJ was used in one half of a regulatory period at \$6.50/GJ and 100% chance of occurrence

SSV = \$1.96M over one regulatory period or \$400k pa.

Case 2 – SWP delivery for a Longford loss as occurred in 1998  
Quantity of gas 2.8 PJ (14 days at 200 TJ/day SWP capacity) at VoLL \$800/GJ and chance of occurrence 0.05%

SSV = \$1.1M over one regulatory period or \$220k pa.

Both of these calculations are an attempt to cost different “system security” elements of the SWP and exclude any other benefit than Longford and the Interconnect. Although Yolla is not expected to be a “peaking” supplier, the impact of Yolla supply into the PTS will effectively provide for the gas shortfalls experienced to date.

### **5.3 Value of System Wide Benefits of SWP**

As stated, BHP Billiton considers that on an assessment of the facts as they apply now, there is clearly no benefit to PTS users arising from the SWP in relation to any increased competition. The gas available from Otway basin has been contracted to users in South Australia. Thus, there can be no value awarded to SWP for a system benefit for increasing competition.

Quantification of the system security element of the system wide benefit is at best \$3.06million<sup>24</sup> over a five year period, or \$620k pa.

In the above calculations, BHP Billiton provides a quantification of the assessments of the system wide benefits GasNet claims result from SWP but then fails to substantiate. The ACCC considers there are system wide benefits and despite the absence of any overt quantification of what they are, has assumed that they balance out the short fall from the revenue stream arising from SWP tariffs.

---

<sup>24</sup> This amount is the aggregate of case 1 and case 2 from above

The quantification analysis by BHP Billiton indicates that the system wide benefits of SWP might at best be valued at \$620k per annum.

#### **5.4 Revenue required by SWP**

Due to the lack of information provided by GasNet we have some difficulty in assessing the revenue likely to be required to flow from SWP, although in our submission of 18 July an attempt<sup>25</sup> was made:-

“It is noted that GasNet has valued SWP at \$85 million and requests a “real” WACC of 8.22%, which equates to about an 11% nominal return, “costing” \$9.35 million pa. GasNet has requested an opex allowance of \$21.9 million over all GasNet assets which when prorated over the length of GasNet assets gives an SWP opex allocation of \$1.7 million, with economic depreciation (at 2% pa) adding another \$1.7 million to SWP costs. In all, the required return of the SWP requires a revenue stream of \$12.75 million p.a..”

Whilst we accept that this simple calculation may not provide an accurate assessment of the amount of revenue needed, it is likely to be within the correct order of magnitude; neither the ACCC nor GasNet has provided users with their calculation of the revenue requirement of SWP.

We note with interest that GasNet has now accepted our view that gas could well flow from SWP into the SEAGas pipeline for delivery to Adelaide, but even so proposes a very modest withdrawal tariff from SWP at Iona.

However, without the model GasNet apparently has provided the ACCC for demonstrating its calculation of revenues and allocation of costs across the GNS, we are at an extreme disadvantage as to the calculation for the recovery of revenue from the SWP related tariffs. As GasNet has taken a number of steps to delay recovery of revenue from SWP, it is clear the SWP revenue recovery will not approach the revenue stream needed to balance the cost of SWP less the system wide benefit we have identified.

#### **5.5 GasNet response to draft decision**

In its response to the ACCC draft decision, GasNet alludes to the Longford proceedings<sup>26</sup> and comments made by Esso regarding the need for alternative supply pipelines. GasNet then implies that SWP would have provided the additional security to have satisfied this need.

---

<sup>25</sup> BHP Billiton submission on GasNet access arrangements application comments on K-Factor Mechanism, Forecasts of Demand and Basin Reserves, ‘Feasibility’ of the South West Pipeline, The Economic Life of South West Pipeline 19th July 2002, page 12.

<sup>26</sup> GasNet’s response to Draft Decision 20 September, page 7.

However, to have prevented the impact of the Longford fire would have required a separate gas processing plant the size of Longford (such as Moomba), a gas field of similar dimension to Gippsland basin (such as Cooper basin), and a delivery system for the gas similar in size to the EAPL. We consider GasNet's observation is invalid.

Overall, despite the lack of data and quantification by GasNet and the ACCC of the system wide benefits supposedly flowing from the introduction of SWP, we consider, and have established, that there is clear evidence that SWP provides little in the way of system wide benefits to users connected to the PTS. The quantification of benefits noted above indicates that at best the system wide benefits might reach \$620,000 pa, an amount well below that needed to justify the shortfall between the cost of the SWP and the revenue from the transport tariffs proposed for it.

## **6. Depreciation of GasNet's L-P assets**

GasNet observes that there would appear to be a warming trend<sup>27</sup> in Victoria, reducing the winter peak demand for gas, and in this observation, goes against the gas demand recommendations of VENCORP which are in part supported by ABARE projections. This approach by GasNet will lead to higher gas tariffs.

In the section on depreciation<sup>28</sup>, GasNet notes that ABARE projections show the life of the Gippsland basin will be shorter than the L-P asset life. GasNet seems to think that ABARE is correct. Following this approach by GasNet to reducing the life of L-P assets, will lead to higher gas tariffs.

However, what GasNet fails to acknowledge in its response to the ACCC draft decision, is that the BHP Billiton submission of 18 July on the Gippsland basin life<sup>29</sup>, is also based on the ABARE demand projections, despite the evidence provided in the submission that over the years ABARE gas demand projections have proven to be consistently high, a view GasNet notes in its view of the warming trend. The BHP Billiton calculations also used the Saturn projections for basin reserves.

What BHP Billiton then did in its submission was to view the reserves of the four basins (Gippsland, Cooper, Otway and Yolla) on a holistic basis and match these to the gas demand forecast by ABARE for all of NSW, Tasmania, Victoria and SA in order to develop the basin life forecasts provided in the submission. The prime error of the Saturn report was to assume that the gas demand for NSW, Victoria and Tasmania from Gippsland basin was related to the capacity of the pipelines leading from Longford, a patently incorrect notion.

---

<sup>27</sup> *ibid* page 35

<sup>28</sup> *ibid* page 33.

<sup>29</sup> BHP Billiton submission on GasNet access arrangements application comments on K-Factor Mechanism, Forecasts of Demand and Basin Reserves, 'Feasibility' of the South West Pipeline, The Economic Life of South West Pipeline 19th July 2002, pages 4 through 9.

The assumption used in the BHP Billiton calculation of EGP providing 25% of NSW is only a mechanism for allocating gas supplies between basins and in no way was intended to be an actual forecast. As one gas basin starts to take demand from another, there will be a resultant increase in the life of another. It was because of this inherent instability of identifying specific gas supply from one basin, that the submission was based on a holistic view of all demand and all supply in south eastern Australia.

Despite the views put by GasNet, the conclusions reached in our submission remain valid.

## **7. Murray Valley pipeline**

We have reviewed the additional information provided by GasNet to demonstrate its argument for the roll in of the Murray Valley pipeline. We concur with the ACCC that roll in of the pipeline can only be done in the context of the new facilities investment as permitted by the Gas Code.

However, the additional information provided by GasNet does not provide any quantification of the benefits that will accrue from the investment, nor does it provide any quantification of the costs involved or of the expected revenue stream. Accordingly we are unable to comment whether the Murray Valley pipeline achieves the minimum requirements of the Gas Code for roll in under the economic feasibility test.

As the economic benefits test requires only marginal recovery of O&M costs, and as GasNet intends to recover only the minimum revenue necessary for the pipeline to comply with the test, there is an implicit cross subsidy from other users of the PTS to the users of the MV pipeline. This is unacceptable and GasNet should attempt to recover the full costs of the expansion if it can do so. This is in keeping with the cost reflectivity requirements which underpin the Code.

## **8. GasNet response on WACC, and assertions on regulatory risk**

BHP Billiton has reviewed the GasNet comments in its response to the ACCC draft decision and would reiterate its contention that rather than the GasNet assertion that the WACC should be higher than in the draft decision, that the WACC included in the draft decision is still too high. BHP Billiton refers to the two Pareto Associates reports (previously provided) supporting this view.

However, we do comment on certain of the assertions made by GasNet.

- The WACC granted by the ACCC in its most recent draft decision (that for ElectraNet SA, an electricity transmission

business) calculates a WACC lower than that proposed for GasNet, indicating a move to lower WACC's, in part reflecting the recent moves in interest rates.

- GasNet makes extensive reference to the way it will have to access its borrowings. The ACCC is only required to assess a debt profile appropriate to a regulated gas transmission business, and relating this to what is available to competitive industry.
- GasNet raises concerns that an equity beta of 1.0 is too low for its business. What is often overlooked in the mathematics applying to the CAPM, is that an equity beta of 1.0 replicates the average of all competitive industries. As GasNet operates in a comparatively secure environment, its equity beta should be lower than unity, reflecting its place in the "pecking" order of risk faced by all businesses. That the equity beta of 1.0 was derived from the asset beta used implies that the asset beta used as the basis of the calculation was too high. This is the evidence Pareto Associates noted from its review of overseas regulatory decisions.
- GasNet refers to the make-up of its shareholders and their expectations when they decided to invest in GasNet. The ACCC is not permitted by the Gas Code to consider the expectations of investors in regulated businesses.

In addition to its comments on these aspects, GasNet makes extensive commentary on the issue of regulatory consistency, and the risk that regulated businesses face should regulators move from the approaches used by them in previous decisions. This issue is of great concern to all users as there are widely unsubstantiated claims relating to future investments in new infrastructure being curtailed as a result of low returns and regulatory uncertainty.

If such regulatory consistency was the prime driver behind the GasNet application, then it would have sought a real WACC premium equal to that it currently enjoys. In fact, GasNet actively sought an increase in the WACC margin above the risk free rate of return by some 17%<sup>30</sup>. Such an increase would certainly not be based on using the same regulatory principles embodied in the first access arrangement.

If the approach proposed by GasNet is taken to mean that the regulator must not vary from its previous decisions, then this removes from the regulator the flexibility built in to the Gas Code for the ability of the regulator to take account of changed circumstance. It also means that the regulator is not permitted to learn from previous errors and mistakes and so ensure that future regulatory decisions are fair and equitable to both service provider and users.

---

<sup>30</sup> GasNet's response to Draft Decision 20 September, pages 9 and 10.