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Ms Kanwaljit Kaur
General Manager
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Australian Competition and Consumer Commission
PO Box 1199
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Dear Ms Kaur

Issues Paper: Applications for Revisions Lodged by GasNet Australia (Operations) Pty Ltd and Victoria Energy Networks Corporation

Duke Energy International (DEI) welcomes the opportunity to comment on the recently released Issues Paper in respect of the Applications for Revisions Lodged by GasNet Australia (Operations) Pty Ltd and Victoria Energy Networks Corporation.

To aid reading, this submission is referenced back to the numbering sequence adopted by the Australian Competition and Consumer Commission (ACCC) in its Issue Paper.

1.5.3 – Prudent Discounts

DEI has significant concerns at the widely differing tariffs applicable to the injection pipelines when considered from the viewpoint of c/km/GJ basis. DEI recognises that the cost differential may be due to the combination of flow levels of the respective pipes, differing pipe diameters (costs) and the application of prudent discounts (but not impacted by pipeline ages). However, as a result of these differentials, those producers seeking to access the Victorian market are faced with significantly different transportation costs, on a c/km/GJ basis, depending on their location. While differences are to be expected to a certain extent, the quantum of the differences is worrisome. For example, it is 600% more expensive to inject at Port Campbell than it is at Culcairn (assuming the destination market is the Metro Withdrawal Zone). Clearly, this places certain producers at a significant, and unexplained, disadvantage relative to others.

While DEI accepts the tariff structure may be cost reflective in a narrow economic sense, DEI is concerned that the adoption of the proposed tariffs may have significant unintended adverse consequences. What are unclear are the drivers behind the significant differentials. It raises the question as to whether the service provider may have over-invested in certain sections of the network (given forecast demand) which may be the cause of the very high price differentials on those sections. Alternatively, it may be that the differentials arise purely because the pricing principles applied are inconsistent with the development of a liquid wholesale gas market. DEI urges the ACCC to establish the drivers of these tariff differentials.

DEI also notes that the Victorian transmission system has many of the characteristics of a distribution network, with multiple injection and withdrawal points and the possibility of variable gas flow directions across the system. This is in contrast to most transmission pipelines in Australia, which are linear pipelines with generally constant gas flow directions and an associated ease of establishing a non-distortionary tariff structure. Applying the proposed pricing principles, which seem to be increasingly more consistent with a contract carriage rather than a market carriage system, to a network system, may result in unintended distortions which are likely to limit the development of new sources of gas and new loads.

DEI sees a clear need to analyse the efficiency and effectiveness of the tariff principles and resultant tariffs, and whether they would have the effect of creating disincentives to enter the market. This analysis needs to establish the appropriateness of the pricing principles, and secondly, verifying the application of the principles. Such consideration needs to be undertaken cognisant of a primary aim of the market carriage structure – that is, the development of a liquid wholesale gas market.

1.5.4 – Differences in demand forecasts

DEI recognises that it is not unusual for two parties to arrive at differing demand forecasts for the same market. At the same time however, there is little rationale in basing the pricing structure for the two Access Arrangements (which cover the same market) on different demand forecasts – consistency across the two access arrangements should be required.

DEI also considers GasNet's forecast flows, as detailed in Schedule 6, do not represent the most likely levels of production within the Victorian network. For example, assumed daily quantity flows for the proposed VicHub facility (35TJ) significantly underestimates likely volumes. DEI also considers that GasNet has overestimated forecast flows from Thylacine and Geographe, and that it is likely the start-up date for these fields may be outside this access arrangement period. The rationale behind the increase in the forecast for the Latrobe Zone in 2002 of 2,262TJ is also unclear (Table 4.4 of the Access Arrangement Information). An in depth analysis of the demand forecasts is warranted.

2.1.2 – Inclusion of the Southwest Pipeline

DEI is essentially indifferent to the inclusion or otherwise of the SWP into the PTS, provided that the infrastructure satisfies the New Facilities Investment criteria of the Code. Clearly, any assessment of the capital value to be rolled in to the asset base needs to take account of the age of the facilities and any government or user contributions.

DEI also notes that to enable the merging of the WTS with the PTS, GasNet proposes to unwind existing contracts on the WTS with TXU, and to replace these contracts under an AMDQ credit certificate allocation. DEI firmly believes that any contractual arrangements in place prior to coverage under the Code should be maintained to the fullest. DEI also recognises that to maintain the pre-existing arrangements in this situation, it may be necessary to enter into new arrangements. However, DEI is concerned to ensure that the ACCC does not approve new arrangements which provide benefits above and beyond those which are currently enjoyed by TXU.

2.2.2 – Reference Tariff Methodology

As noted above, the proposed pricing structure results in producers facing significant cost differentials, on a c/km/GJ basis, depending on their locations. While it may well be that

pricing outcomes are cost reflective, given an important aim of the market carriage system is a liquid wholesale gas market, these significant cost disadvantages represent a disincentive to enter the market. Given this, DEI urges the ACCC to critically examine the appropriateness, and application, of the reference tariff methodology.

DEI also has significant concerns with GasNet's proposed approach to assignment of injections and withdrawal locations, particularly as it relates to the definition of "shipper". As currently proposed, it appears that a deemed withdrawal requires that the person that transports the gas on the network (ie. the shipper) is the same person that withdraws that gas. This imposes a significant disadvantage on traders of gas into the Victorian market, which ultimately benefits incumbent retailers. This is because ordinarily, an incumbent retailer is a shipper in respect of the gas that it uses, and therefore, when that retailer withdraws that gas, a deemed match has occurred. Where this match occurs in a rebate zone, substantial savings are realised. However, in the situation where a trader transports gas to sell to a third party user (ie. the user is not the shipper), the injection is not matched to a withdrawal and therefore the full tariff would apply. This full tariff applies irrespective of whether the withdrawal was within a rebate zone. Clearly, this situation places traders at a disadvantage, is not conducive to the liquidity of the wholesale gas market and limits the potential scope of the benefits arising from the imminent introduction of full retail contestability.

This issue could be resolved by changing the definition of shipper. For example, a user could be deemed to be a shipper (for the purpose of matched withdrawals), where there is a contract in respect to the sale of that gas. This would allow for matching to occur and thereby potentially increase the liquidity of the wholesale gas market. Matching should be possible under amended nominations and balancing arrangements, as traders are primarily seeking to inject to meet the needs of retailers and other contracted customers withdrawing from the PTS.

DEI is also of the view that the Cross System Withdrawal Tariff, and the matching methodology in general, is inconsistent with a market carriage system. GasNet's Access Arrangement appears to agree (s.5.1(c)):

> *"…In respect of actual charges to be levied on Users, there is no assumed relationship between injections and withdrawals, except in certain zones where matched rebates are offered. This corresponds to the Market Carriage Structure, where Users can inject and withdraw as they please…."*

As recognised by GasNet, a Cross System Withdrawal Tariff is inconsistent with a market carriage system. In fact, such a tariff is actually consistent with a contract carriage system. DEI is of the view that this tariff should be removed and the matching methodology reviewed.

In the event the Cross System Withdrawal Tariff is retained, DEI makes the observation that as GasNet improves its matching algorithms, revenue from this tariff is likely to grow. DEI urges the ACCC to review the forecast revenue from this tariff to establish the growth, if any, that has been factored in to reflect the potential improvements in the matching algorithm.

2.7 – Reference Tariffs

DEI notes that the tariff for injecting into the Longford Zone, where the matched withdrawal is into the Metro Zone, has effectively increased. While there has been a reduction from the existing charge of $2.703/GJ to $2.3152/GJ, this is coupled with a change from 5 peak days to 10 peak days and effectively results in a tariff increase of up to 171%. Given there

has been no, or little, augmentation on this section of the network, this increase does not seem warranted.

DEI also notes that due to data limitations, it is not possible to accurately establish the total forecast revenue to be generated from the different withdrawal and injection pipes. It is therefore not possible to comment on the efficiency of the proposed tariffs.

3 – VenCorp Access Arrangement

If the current uplift system is maintained, DEI is of the view that it would be beneficial to include the uplift payments in the market pool price and remove the dependence on AMDQ and AMDQ credits. The pool price would then reflect the true cost of gas and provide improved market signals for further investment.

The market also appears to be skewed to the incumbent retailers due to the advantage associated with the allocation of AMDQ. New entrants are forced to purchase higher price gas, for example, through WUGS, to obtain some AMDQ credits. These credits then ultimately hedge the new entrant against uplift and curtailment. The generation of AMDQ credits appears to be provided to offset the strong market position that the incumbent retailers inherited during the market launch. DEI urges the ACCC to review the Uplift payment mechanism and the allocation of AMDQ and AMDQ credits within the market. Considering the diversity of supply into Melbourne, DEI considers the use of AMDQ and AMDQ credits to be an inefficient, cumbersome and expensive mechanism to control capacity within the pipeline network.

Should you wish to discuss any of the issues raised in this submission, I can be contacted on (07) 3334 5897.

Yours sincerely

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