SUBMISSION TO ACCC RE REVISED ACCESS ARRANGEMENT FOR MOOMBA TO ADELAIDE PIPELINE SYSTEM (MAPS)

The SA Government reiterates its detailed submission to the ACCC on the draft decision issued by the ACCC on 16 August 2000.

In response to revised Access Arrangement subsequently submitted by Epic Energy, Energy SA offers the following comments:

Queuing Policy and Extensions and Expansion Policy

Public Interest

I consider that the purported Queuing Policy announced by representatives of Epic Energy at the public consultation on the MAPS Access Arrangement in Adelaide on 2 November 2000 is not a valid Queuing Policy for the purposes of the MAPS Access Arrangement. This is because (quite regardless of the content of the Queuing Policy) the final Queuing Policy is that in the Access Arrangement as approved by the Relevant Regulator.

A "first in, first served" queuing policy is not fair and equitable, nor practical from the point of view of good public policy which seeks to produce optimal outcomes for all parties.

The purported policy is to the effect that all requests for Service will be entered in the queue, regardless of whether they can be satisfied at that time. This policy would have the effect that present Users will be unable to get supplies of gas if they are not in the queue before the available capacity has been contracted for. This policy has been restated in the revised Epic Access Arrangement at clause 10.1.

At present the arbitration provisions of the *Natural Gas Pipelines Access Act 1995* (the 1995 Act) are still available. Section 50(4) of the *Gas Pipelines Access (South Australia) Act 1997* provides that arbitration or legal proceedings relating to a Code pipeline that have commenced but not been completed when an Access Arrangement is approved, may be continued as if the Access Arrangement had not been approved.

Arbitration proceedings have commenced under the 1995 Act in response to TXU's request for arbitration in respect of its access to the MAPS.

It would appear that if the arbitration is concluded, the arbitrated outcome will effectively replace the Queuing Policy, at least between the parties to the arbitration. Nevertheless, sections 2.24 and 3.12-3.15 of the Code require an Access Arrangement to include a Queuing Policy and outline its requirements.

I consider that the Queuing Policy proposed by Epic should not be approved. The policy should, at a minimum, provides for notice of the policy itself, and changes in the policy to all existing Users and (known) Prospective Users. This should avoid a situation in which a particular User is unaware of a change in the

Queuing Policy, and finds that capacity for a future time has been sold to other Users.

The recent TXU arbitration has raised the possibility that a power station whose retailer had failed to secure a renewed supply of Gas because Users or Prospective Users had contracted for most or all of the Capacity of a Pipeline, could "miss out" on Gas.

The Code does not expressly provide for priority to be given to one use of Gas over another. Any public interest in a continued supply of Gas to a power station could be addressed in one or both of two ways.

Firstly, matters of rationing can however be dealt with under section 37 of the *Gas Act 1997*.

Secondly, it would, in my view, be possible under the Code for the Relevant Regulator to approve a Queuing Policy that considers the public interest. This is possible because section 3.14 of the Code provides that:

3.14 The Relevant Regulator may require the Queuing Policy to deal with any other matter the Relevant Regulator thinks fit taking into account the matters listed in section 2.24.

Section 2.24 lists the various matters that a Relevant Regulator must take into account when approving an Access Arrangement. These include;

2.24 (e) the public interest, including the public interest in having competition in markets (whether or not in Australia);

(g) any other matters that the Relevant Regulator considers are relevant.

<u>Size of Demand</u>

It would appear that under the proposed queuing policy, if there were a very small demand for gas (which there is enough spare capacity to satisfy) in a queue just behind a larger demand for gas (which there is not enough spare capacity to satisfy) both could miss out on gas.

Clarification of clause 10.2(c) is needed. This provides:

> 10(2)(c) The Service Provider may deal with Requests for Service outside of their priority provided that the Request/s for Service ahead in the queue are not ultimately disadvantaged

<u>Implications for future tariffs</u>

The ACCC has expressed its concern that, in view of the need to expand the capacity of the MAPS with the construction of the Darwin to Moomba Pipeline, the revised extensions/expansions policy may result in multiple tariffs for haulage on the MAPS, with new Users facing higher tariffs than existing Users.

I am concerned that it will be difficult to apply the requirements of section 8.16 of the Code (re New Facilities Investment). This is because it is difficult at this

stage to determine what investment is "prudent" in view, for example, of uncertainty as to which new pipelines that will bring gas to the SA market will actually be constructed. A rigid application of section 8.16 (with capital roll-in in mind) could act as a deterrent to new investment, and thereby could (ironically) discourage future competition.

SA considers that investment must be interpreted in an "engineering" sense to allow fully for both variability and growth in demand. This is analogous to, for example an "efficient" bridge builder who would build not only for current demand, but would also provide for "peak" traffic and future growth in traffic. Similarly an architect who designed a building only for the number of persons usually expected to stand in an area might find that the floor collapses at times of particularly popular functions. The critical issue is that ***dynamic efficiency tests*** must be applied to the regulation of gas infrastructure, since it is economically efficient to allow for ***excess capacity over and above*** the currently projected ***peak*** (not average) requirement when augmenting or building new pipelines. This issue is particularly critical to the MAPS since the existing capacity is insufficient to meet current demands for capacity.

The "root issue" would appear to be that in view of gas discoveries in the Timor Sea and off the Victorian coast, several new pipelines are being contemplated. If they were all to go ahead, it is likely that the volume of gas on the Australian market would increase considerably, and prices could fall in such a competitive environment. In such an environment, it would be very difficult for a Relevant Regulator to apply a Code provision to determine what constitutes prudent investment.

It is arguable that in the economic environment described, market forces would act to limit any differential between established Users and new Users. In any event, in some areas the potential "new" Users of the MAPS would be able to benefit from competition from other new pipelines.

Although there is a possibility that new Users will face higher tariffs than existing Users, the size of this difference is likely to be limited by competitive pressures. Attempts to eliminate this possibility fully could have the effect of distorting or restricting investment decisions. On balance, I consider that market forces can best resolve this issue.

Incentive Mechanism (clause 5.3)
Eligibility for the Rebate is not wholly clear. In particular, it is not clear why clause 5.3(d) is required at all, if those eligible for the Rebate have been identified in clause 5.3(a).

Extension of Term (clause 11.3)
Clause 11.2 provides for a minimum term of 2 years.

Clause 11.3(b) which provides that unless the right of the User to extend the Term is included in the Agreement, any subsequent negotiation and agreement to extend the Term of the Agreement will be subject to the Queuing Policy, will,

if it is to stand, need to be drawn to the attention of Users and Prospective Users.

It is possible that a right to extend the term of the Agreement will be negotiated with some Users but not others.

Liabillity for fraud or wilful disregard (clause 35.3)
This provision appears to be reasonable. A legal remedy for fraud or wilful disregard should be available regardless of the Access Arrangement, but there would appear to be no objection to also expressly providing for it in the Access Arrangement. The application of the provision to all contracting parties makes it "even-handed."

Provision for back haul or part haul
SA considers that provision for back haul and part haul is essential. Back haul in particular, is an integral part of the services normally offered by Pipelines.

It is considered that a provision for back haul and part haul is consistent with the requirements of section 3.3 of the Code. SA considers that the requirements of this provision for inclusion of Reference Tariffs are satisfied by Services for which a demand is likely to arise in the future. It is likely that these services will to be sought by a significant part of the market, especially with the possibility of connection of the MAPS with other pipelines and demand for gas en-route between Moomba and Adelaide.

Other Matters

Trigger Mechanisms
It is questionable whether a trigger mechanism is needed, or would, if included in the Access Arrangement, be effective.

Section 3.17 of the Code that provides for trigger mechanisms, is not a "civil penalty provision." In effect, there is no penalty for failure by a Service Provider to comply with it.

Further, it is probable that in the event of significant developments which could adversely affect the economic operation of the pipeline, the Service Provider would have an incentive to seek to reopen the Access Arrangement under section 2.28 of the Code.

If, despite the above-mentioned problems, a trigger mechanism were inserted, it would need to be formulated carefully to ensure that it does not operate to reopen the entire Access Arrangement every time a new pipeline into the SA market is constructed. Such multiple reopenings could impose high administrative costs on both Epic and the Relevant Regulator.

WACC
It is of interest that the pre-tax WACC proposed by Offgar for the Dampier to Bunbury Pipeline in its Draft Decision of 21 June 2001 is 7.85% (compare with the post-tax WACC of 6.7% proposed by ACCC for MAPS). It is important that the regulated WACC imposed does not discriminate against future

augmentation of the MAPS, since it is now known (vide supra, regarding the current arbitration dispute under the SA *Natural Gas Pipelines Access Act 1995*) that there is insufficient capacity in that pipeline to meet current requirements. This augmentation will be required within the period of the current Access Arrangement.

Clauses 14 and 15

Clause 14.3 should explicitly recognise the need to operate the Pipeline System in accordance with all applicable legislative requirements, including those under the *Gas Act 1997* and the *Petroleum Act 2000*.

Clause 15.2 as worded suggests that the Service Provider has a discretion as to whether it will adopt any uniform Gas specification. There is no such discretion. Compliance with the Gas Specifications as outlined in the Regulations under the *Gas Act 1997* is required. If the Gas Specification in the *Gas Act 1997* were to be replaced by a new gas specification, then the new gas specification would apply.

SA however recognises the need to provide for the acceptance of Non-Specification Gas into the Pipeline System if, following co-mingling, it conforms with the Gas Specification at each Delivery Point.

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ENERGY SA