Submission to the Australian Competition and Consumer Commission on GasNet Australia (Operations) Pty Ltd Access Arrangement for the Victorian GasNet Transmission System 2003 – 2007

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Submission to the Australian Competition and Consumer Commission on GasNet Australia (Operations) Pty Ltd draft Access Arrangement for the Victorian GasNet Transmission System

Joint Submission prepared by
EnergyAdvice Pty Ltd
on behalf of:

ACI Glass Packaging
Barrett Burston
Bonlac Foods
Cabot
CSR Limited
Insulation Solutions
Mobil Altona Refinery
Norske Skog
Overall Forge
Pilkington Glass
Qenos
Tatura Milk

1 Introduction

This is a joint submission to the ACCC on the proposed GasNet Access Arrangement for the GasNet Transmission System. The submission has been prepared by EnergyAdvice on behalf of a number of major gas users, whose sites are serviced by Distribution systems connected to the GasNet Transmission System.

The following organisations are participants in this joint submission:

- **ACI Glass Packaging**
- **Barrett Burston**
- **Bonlac Foods**
- **Cabot**
- **CSR Limited**
- **Insulation Solutions**
- **Mobil Altona Refinery**
- **Norske Skog**
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- **Tatura Milk**

These end users in aggregate consume in excess of 12 PJ per annum at a number of sites throughout Victoria and in Albury, New South Wales. They represent approximately 7% of the Victorian gas market demand and 15% of the Tariff D market demand. They represent a broad cross-section of user sites in terms of gas demand, daily load factor and location.

2 Headline Issues

The GasNet proposal, albeit comprehensive, fails to address or justify the massive increase in the cost of service which will apply from 1 January 2003 if it is accepted in its present form by the Commission.

Based on our modelling, the overall effect on the proposed Tariff D end users (including increases or decreases across each of the zones) is an increase in the order of 26%. The average increase is approximately 40% if the Echuca, Latrobe and Lurgi zones are excluded.

Testing the proposed tariff against various representative load profiles for Tariff D end users reveals transmission cost increases of between 20% and 130%. The increases for large gas

users are effectively being locked in for a five year period under the proposed Access Arrangement escalating by a CPI - X factor from 2004 onwards.

In their Executive Summary, section 1.4 (page 3) GasNet provides what we believe is a misleading statement regarding the increase viz. "11% in real terms from the 2002 published tariffs to the discounted weighted average tariff to apply over 2003 to 2007". The average effect of the proposed tariff regime across the zones is, by our calculations, closer to 26% in the first year falling slightly below the annual CPI percentage rise in subsequent years as a result of the proposed X factor. The X factor differs across transmission zones and in effect discounts the annual CPI escalation by between zero and five percent (depending on the zone) from 2004 onwards. The net effect of the X factor over 5 years amounts to less than 1% on an assumed annual CPI increase of 3% per annum and does not account for the difference between the tabled 11% and our modelled 26% increase.

In the Echuca, Latrobe and Lurgi transmission zones the proposed tariff represents a decrease against current tariff rates. It is however noted that, in relative terms, the customers with a better (higher) load factor receive a lesser decrease than poor load factor customers.

There has been a noticeable skewing of the revenue collection from peak day demand to volume demand using the proposed methodology. This potentially sends out the wrong pricing signals to users by failing to reward those end users who utilise the system capacity more efficiently. In the longer term, this pricing signal will not discourage peakier load and is likely to prejudice all system users.

Although the transmission component constitutes less than 10% of the total delivered cost of gas, the magnitude of these increases will have a significant impact on gas delivery costs over the term of the Access Arrangement for all end users. The increase will only serve to continue to erode the competitiveness of manufacturers using gas.

The merging of the Western and Principal Transmission systems without conferring Authorised Maximum Daily Quantity (AMDQ) rights to the end users effectively creates two types of customers viz. those that have AMDQ rights and those that do not. The proposed Access Arrangement indicates that the conditions for termination of the WTS Agreement will involve VENCorp granting AMDQ Credits to TXU maintaining TXU's current position of having a virtual monopoly on transmission capacity for this portion of the system.

3 Tariff Re-Design

3.1 Injection Tariffs / Withdrawal Tariffs (Tariff D)

Currently the Longford injection point is subject to an injection point tariff which is published. Injection tariffs also apply to Culcairn and Iona, however these are unpublished. GasNet is proposing to do away with the five peak withdrawal day injection charge component and proposes to effectively roll that revenue into the volume tariff component. This has the effect of removing any recognition of daily load

factor from withdrawal tariffs which diminishes the incentive for end users to lower their peak day demand.

The number of published injection points has been expanded to include Culcairn, Port Campbell (Iona and WUGS), Pakenham (Yolla Gas) and Dandenong (LNG) under GasNet's proposed Access Arrangement.

GasNet claims that the tariff redesign was necessary to meet their revenue targets, and to limit large end of the year adjustment amounts resulting from the final calculation of the injection charges when the system withdrawal peak days are finalised.

We fail to see any benefits to end users in respect to end of year cost shock in respect to this component of the transmission charge. Even if there is a reduction in the average deviation from the end users contracted MDQ, the effective doubling of the tariff rate will still provide the potential for a large adjustment sum at the end of the year.

Both retailers and Users have continually argued against the effects of the potentially large adjustments at year end on their budgeting capability.

We believe that the dominant issue for GasNet in applying their tariff to ten injection peak days, instead of five, is to provide greater revenue certainly for them by increasing the difficulty for end users in avoiding heavy gas usage on perceived system peak injection days.

Notwithstanding the massive increase in the cost of the withdrawal component, this GasNet proposal takes away any incentive for end users to efficiently use the transmission system and does not encourage off peak utilization. The proposed GasNet withdrawal tariff by doing away with a demand based component and applying what is an increased anytime volume charge as a withdrawal tariff provides the wrong signal to end users and encourages inefficient use of their system.

3.2 Matched Withdrawal and Prudent Discount Tariffs.

While we recognise the need for these tariffs to discourage bypass, the adjusting down of costs allocated to these tariffs only serves to add costs to other areas resulting in higher tariff charges for the overwhelming majority of end users. It could be argued that when the interconnect was proposed in 1998, the threat of bypass to the Wodonga Zone was recognised and that the consequent reduction in revenue determined that a reduction in the revenue base was required (and should have been factored into the revenue calculations). In light of this, we believe that there is a case for GasNet to fund the cost of discounted tariffs from its revenue base.

3.3 Tariff Bias

The proposed GasNet tariffs have the effect of reversing a traditional bias towards demand based tariffs where those who contributed the most towards peak demand relative to their annual usage paid a higher unit cost for transmission services – Daily Load Factor (DLF) being the measure of efficient system utilisation.

By applying and separating the demand and volume components of the current and proposed GasNet Tariffs, there is an obvious movement in revenue collection from demand to volume related income streams.

Demand / Volume Revenue Split

Zone	Load Factor	Existing Tariff		Proposed Tariff	
		Demand	Volume	Demand	Volume
Metro	90 %	42%	58%	19%	81%
Metro	81 %	44%	56%	20%	80%
Metro	70 %	48%	52%	23%	77%
Metro	61 %	51%	49%	26%	74%
Echuca	80 %	56%	44%	10%	90%
Echuca	65%	61%	39%	12%	88%
Wodonga	60%	67%	33%	8%	92%

In all cases there is a significant reversal of bias, from demand to volume related revenue.

The rationale for GasNet moving to rely on and to collect a greater percentage of revenue from a volume tariff component is difficult to comprehend. The incentive for end users to try to avoid system peak withdrawal days has significantly diminished with the tariff redesign, however we are unaware of end users actively seeking to avoid these costs under the current tariffs.

GasNet's greater revenue recovery on the volume side becomes subject to risk where forecast gas sales are not achieved. The key signal being sent to end users is, that the value of demand on the GasNet transmission system has diminished and is therefore of less value than in the past. Such a view, we believe, is inconsistent with efficiently operating gas transmission pipelines.

The incentive (or reward) for end users to control or reduce their demand has also significantly diminished. It could be concluded that there must be increased capacity in the transmission system to the extent that capacity and constraints on capacity are no longer an issue and this message is likely to be adopted by end users (large and small). We do not believe that undervaluing system capacity, as against throughput, acts in the long term interests of end users nor in the public interest generally. If demand were to increase significantly due to end users (particularly Tariff D end users) undervaluing demand management, (consistent with the price signals being provided by GasNet), then eventually the supply side (being the transmission capacity) will be stressed thus forcing premature upgrading of the system. This inefficient investment will lead to

further tariff increases to recover that investment or forced constraints on end user demand. Furthermore, this leaves the door open for GasNet, in future, to argue that capacity has become scarce (albeit through their own pricing signal) and to justify future returns on a resource that would then be considerably more valuable because of the greater supply / demand imbalance.

4 Impact on End Users

The impact of the proposed changes to the GasNet Access Arrangement differs for each of the participants of this document depending on their designated transmission Zone. To demonstrate the effects of the proposed changes, a proxy load representing a non-specific end user in a stated zone, has been included below.

Zone	Load Factor	Current Transmission $/GJ	Proposed Transmission $/GJ	Increase / (Decrease) $/GJ	Increase / (Decrease) %
Metro	90%	$ 0.1930	$ 0.3194	$ 0.1265	66%
Metro	75%	$ 0.2090	$ 0.3315	$ 0.1224	59%
Metro	60%	$ 0.2332	$ 0.3495	$ 0.1163	50%
Echuca	90%	$ 0.6301	$ 0.6563	$ 0.0262	4%
Echuca	75%	$ 0.6970	$ 0.6682	-$ 0.0288	-4%
Echuca	60%	$ 0.7982	$ 0.6863	-$ 0.1120	-14%
Wodonga	90%	$ 0.6324	$ 1.1150	$ 0.4827	76%
Wodonga	75%	$ 0.7055	$ 1.1271	$ 0.4216	60%
Wodonga	60%	$ 0.8140	$ 1.1449	$ 0.3309	41%

In the Metro and Wodonga zones, the proposed 2003 GasNet Tariff represents a significant increase over the current tariff whilst in the Echuca Zone, there has been an effective reduction for those users with lower load factors.

The tables above also demonstrate the effect load factor has on price for each zone. It is common practice to recognise and reward a high load factor user by lowering the transmission cost relative to a low (poor) load factor user. In this way a user is rewarded for the relative level of efficiency of their usage relative to the burden this usage poses on the capacity of the pipeline.

The results in the all zones demonstrate a movement away from ‘normal’ load factor principles. In the Metro and Wondonga Zones the increase for the more favourable higher load factor users is greater than for those customers demonstrating a lower load factor. Although the end users in the Echuca zone are proposed to receive a reduction in annual charge, the reduction is inversely proportional to the load factor.

End users in the Wodonga zone experienced a significant increase in delivered gas cost when the current access arrangement was implemented and gas was purchased under the approved

tariff. They are now expected to absorb a further substantial increase over this current tariff with even less opportunity to gain relief through demand management. The prudent discount alluded to in the proposed Access Arrangement provides no comfort whatsoever to the end user but merely retains a reserve level of revenue for GasNet.

5 Other Issues

5.1 Overarching Principles

As stated in section 4.2.4 of GasNet's Access Undertaking the most significant criteria under section 2.24 of the Code in relation to Reference Tariffs are:

- GasNet's legitimate business interests and investment in the GasNet transmission system.
- The public interest
- And interests of Users and Prospective Users.

Given the thrust of the Access Undertaking, the proposed initial price shock and the movement of revenue from the demand stream to the volume stream:

Does the GasNet proposed Access Arrangement provide a balance of these significant criteria in the short and long term and represent the reasonable expectation of all stakeholders?

5.2 Merging of the Principal and Western Transmission Systems.

Whilst the merging of the Principle Transmission System with the Western Transmission System (WTS) into a single market carriage system (GasNet Transmission System) is a positive step towards a consistent gas market, the issue of terminating the GasNet/TXU contract carriage WTS Agreement should be of concern to end users taking gas from the Western Transmission System.

TXU at present has a virtual monopoly on firm transmission capacity. The proposed Access Arrangement indicates that the conditions for termination of the WTS Agreement will involve VENCorp granting AMDQ Credits to TXU which would maintain TXU's current monopoly position on firm capacity.

Such capacity rights are effectively a barrier to entry for other prospective retailers who (as would their customers) be exposed to uplift payments and curtailment risk due to them having no AMDQ. We understand that a small number of end users on the WTS are currently taking supply from a retailer other than TXU but we can presume that this can only be on an interruptible basis thus exposing the end user to the possibility of interruption. The construction of a proposed Iona to Adelaide pipeline may provide an entry point for prospective retailers if laterals are provided to serve Warrnambool and Koroit from that pipeline a concept recognised by GasNet by the tabling of a prudent discount tariff.

The merging of the Principal and Western Systems has the effect of creating two classes of end users on what will be the same system. End users on the PTS have AMDQ allocated to them whilst those end users on the WTS will very likely have to commit to TXU to be covered by AMDQ. End users on the WTS, having no AMDQ and not wanting to commit to TXU, have few options for firm gas supply in the absence of the Iona to Adelaide pipeline (if in fact there is a lateral available to supply them). If TXU is granted AMDQ in settlement for agreeing to terminate the WTS Agreement then the end users are will gain nothing from the whole process of gas industry reform in Victoria.

The uplift exposure associated with not having AMDQ and the possibility of curtailment will have to be weighed carefully by any end user against any lower gas price that may result from new retailers and competition in general.

Are there any economically feasible alternative methods of resolving the retail level competition issue besides granting TXU AMDQ Credits i.e. compensation? If TXU is granted AMDQ Credits, particularly in respect to Tariff D end users, would such credits be transferable to the end user?

5.3 Increasing the Asset Base Value and Related Items.

We note that GasNet proposes a significant increase to the capital base of $102m which is predominantly the roll in of the Southwest Pipeline into the GTS. GasNet is also seeking to introduce a capital asset of $40m for easements which were disallowed in the current access arrangement.

GasNet contends that the capital base at 1 January 1998 was $399.5m and not the $358m that the Commission used to fix the initial Reference Tariffs.

From the level of the proposed increase in the Asset Base for past and current expenditure, and, together with claims for accelerated depreciation and “K” factor carry over, it is no surprise that the level of increase in the cost of service to end users in the first year (2003) is of the magnitude previously stated.

GasNet by amending down VENCorp gas consumption forecasts for “warming trend” may create a positive “K” factor if the downward forecast gas demand adjustments fail to materialise.

It is for the ACCC to assess and decide on the appropriateness of increases sought by GasNet. However, we believe those increases to be grossly excessive and constitute the basis for price shock for end users when the resultant proposed tariffs are applied.

Furthermore, it would be expected that the inclusion of capital costs associated with looping the Brooklyn to Corio and the recommissioning of the Gooding compressor station to be allocated to the winter peak bias of the tariff as both of these events are only required for that period of the year and therefore should be borne by that segment of the market.

5.4 Rate of Return

We note GasNet's proposal for a higher rate of return based on what they perceive to be an increase in the level of risk.

In respect to item 6.1(b)(ii) (the price cap regime), GasNet, by redesigning the tariff to move revenue from the peak day demand revenue stream to a volume revenue stream, is creating or adding to their potential risk level; ie. increasing rather than decreasing the risk to the revenue base.

Is it reasonable for users of the GasNet system to pay higher charges resulting from a higher rate of return where GasNet, if not having created the problem, is, in effect, compounding it?

We further note that GasNet favours a pro-infrastructure philosophy in determining the WACC, providing them with a higher rate of return.

5.5 Promotion of Gas and Increased Sales

We note that GasNet has appointed a Business Development Manager to promote gas use with particular attention being paid to large use applications viz.

- Cogeneration
- Power station developments
- Large scale industrial users

Given the magnitude of the initial tariff increases which are effectively locked in over the next five years, GasNet may have a difficult job attracting new or incremental loads. This is particularly true of customers who will have experienced significant price shock as a result of this Access Undertaking being implemented in its present form and were contemplating further use of gas for plant expansion or new projects.

Can they expect another price shock in five years through inappropriate tariff design?

5.6 Cogeneration

The financial returns of cogeneration have to date been seen as marginal by many prospective operators and has consequently not achieved wide acceptance. GasNet's proposed tariff increases do nothing to enhance new prospects and investment thereby entrenching the status quo. By viewing gas transmission as one of the components of the 'broader' national energy market, the impact of the significant price shock is not only prohibitive to new cogeneration projects but also adds considerably to the marginal cost of gas fired generation. This is likely to adversely impact energy pricing in general.

5.7 Ongoing Litigation Expenses

We note that GasNet seeks to include under Non Capital Costs litigation, expenses arising from the Longford incident in 1998. There is no indication of the level of costs involved but they must be of some significance for GasNet to include them in the cost base.

As a general principle we would expect that where such costs are recoverable as a result of a successful judgement for GasNet, then the costs should be disallowed and the cost base reduced accordingly. If GasNet has a judgement against it, then there is a reasonable presumption that GasNet was in some way at fault and therefore should bear the resultant costs.

Should end users be required to fund GasNet's legal expenses which are recoverable through litigation or lost due to judgement against GasNet.

5.8 Cost Allocations

The change in the method of allocating costs provides the underlying basis for the bias to volume based revenue streams. The change from a one in twenty peak winter flow to a one in two peak winter flow has the effect of moving costs from peak demand to volume as it is reasonable to expect that one in twenty peak demand is significantly larger than a one in two peak demand.

The change in final revenue allocations from 65% demand and 35% volume to 60% demand and 40% volume again moves costs (and revenues) from demand to volume.

The effects are:

- An undervaluing of system demand.
- Greater reliance by GasNet on risky volume revenue
- Good (higher) DLF customers are penalised with larger than average price increases for the transmission service.
- Promotes inefficient use of the system by encouraging poor DLF customers to use the system at peak times in certain zones.

5.9 Extensions and Expansions Policy

We believe that there is a case to review the extensions and expansions policy. To illustrate one area we believe in need of review we provide the following scenario.

A potential end user customer intends to establish a processing facility in a greenfields area not too distant from a GasNet pipeline and the potential end user has a significant requirement for gas which requires a lateral to be constructed to a metering facility adjacent to the proposed site. This foundation end user, being the only end user at that time to be served by the lateral, is asked to pay the capital cost of the lateral. The applicable transmission tariff (in full) is applied for the transmission service as the lateral is considered a covered pipeline under the Access Arrangement.

- The potential end user has no absolute capacity rights on that lateral pipeline albeit that they have funded the pipeline construction (if the lateral is on the WTS the end user may not even have an AMDQ).

- Other new end users have access to the pipeline but are not required to reimburse the initial end user for the pipeline capacity which they utilise. We therefore do not believe it is fair and reasonable for new entrants to "piggy back" to the detriment of the foundation end user.

If the foundation end user was to have GasNet install a meter at the offtake point of the existing GasNet system, which now becomes a withdrawal point, and engages a contractor to install a dedicated pipeline to the new facility then the capital cost of the two options can be similar.

The foundation end user still pays the same amount to GasNet for the transmission service and could now negotiate an Operation and Maintenance charge only for the dedicated pipeline as well as capitalising the cost of the pipeline.

Under this scenario the new pipeline is not a covered pipeline and the foundation end user has exclusive rights to it.

We do not favour the alternative option as it is a cumbersome alternative and excludes others that could be supplied using spare capacity. Policy in such matters should provide protection for foundation end users in respect to capacity and reimbursement for capital expenditure when new entrants seek to share an end user funded extension.

There needs to be a balance between protecting foundation end users who pay for or contribute to the cost of pipelines, access provisions that are equitable, and conditions that encourage efficient capital expenditure. We doubt that the current policy achieves this.

5.10 Benchmarking of Tariffs to Other Transmission Pipelines

The proposed GasNet tariffs were compared to those tariffs currently in place and proposed for the EAPL pipeline from Moomba to Wilton (EAPL) as well as the tariffs on Duke Energy's Eastern Gas Pipeline (EGP) from Longford to Horsley Park. To provide a meaningful comparison, the tariff for each of the pipelines was adjusted for DLF and distance to give a dollar per Terajoule per kilometre of pipeline. The consumption parameters for each of the groups included in this submission were used to calculate the $/TJ/km rate that would have been incurred on all three transmission pipelines. A summary of the findings follows:

Customer	Load Factor	GasNet $/TJ/km Current	GasNet $/TJ/km Proposed	EAPL $/TJ/km Current	EGP $/TJ/km Published	EGP $/TJ/km July 2003
Metro	90%	$1.11	$1.83	$0.56	$1.19	$0.87
% of Current GasNet		100%	166%	51%	108%	78%
Metro	75%	$1.20	$1.90	$0.67	$1.43	$1.04
% of Current GasNet		100%	159%	55%	119%	87%
Metro	60%	$1.34	$2.01	$0.82	$1.79	$1.30
% of Current GasNet		100%	150%	62%	134%	97%
Echuca	75%	$1.55	$1.49	$0.67	$1.43	$1.04
% of Current GasNet		100%	96%	43%	92%	67%
Echuca	60%	$1.78	$1.53	$0.82	$1.79	$1.30
% of Current GasNet		100%	86%	46%	101%	73%
Wodonga	75%	$1.39	$2.23	$0.67	$1.43	$1.04
% of Current GasNet		100%	160%	48%	103%	75%
Wodonga	60%	$1.61	$2.26	$0.82	$1.79	$1.30
% of Current GasNet		100%	140%	51%	111%	81%

Note: Calculations are based on a customer with an annual volume of 1 PJ with the load factor adjusted by varying the Maximum Daily Quantity.

The findings indicate that, of the three transmission pipelines examined, the GasNet proposed Tariff D is the most costly on a dollar per TJ per kilometre basis in all instances except the Echuca Zone for a relatively average load factor. It also highlights the relative insensitivity to load factor of the proposed GasNet tariff structure compared with other comparative pipeline tariff structures.

6 Summary

This submission is predominantly focused on the outcome as viewed from an end user's perspective, however we have also taken this opportunity to comment and pose questions on other related issues.

The significant price increase for 2003 over the 2002 tariffs for most zones constitutes price shock and has not been justified by GasNet in its application. The component of any price path reduction is negligible when compared to the impact of the proposed significant 2003 tariff increase over the 2002 tariff. GasNet fails to justify to end users through any argument that what was their haulage cost of about 12 cents per Gigajoule must now be about 30 cents per Gigajoule.

Although end users are predominantly concerned with the bottom line or price that they will pay for the service, end users are also concerned with future costs and the certainty of an efficient, reliable and unconstrained service. GasNet, by significantly increasing its dependence on volume revenue, is increasing its exposure to volume related revenue streams and potentially prejudicing the end users in the longer term if this strategy fails.

The GasNet proposal does not fully recognise the value to the system of good load factor customers and their efficient use of capacity. The pricing signals to end users resulting from the redesigned tariff with its bias towards volume based revenue sends the wrong message to all end users. Capacity is finite, and inappropriate increases in demand will eventually lead to a supply demand imbalance with end users having to pay for inappropriate investment in upgrading the system in the future. This impact is avoidable or at least could be deferred by appropriate tariff structuring.

Failure to acknowledge the load characteristics of the end users by adopting appropriate pricing signals could be construed to be a form of cross subsidisation of inefficient users by efficient users. Furthermore, where once good load factor customers were encouraged to invest in demand management, they will now be penalised for taking steps to effectively add capacity to the GasNet system as well as adding revenue into the coffers of GasNet.