Final Decisions

GasNet Australia
access arrangement revisions
for the GasNet System

15 December 2004

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Abbreviations and glossary

ACCC	Australian Competition and Consumer Commission
access arrangement	an arrangement for third party access to a pipeline provided by a service provider and approved by the relevant regulator in accordance with the Code
access arrangement information	information provided by a service provider to the relevant regulator pursuant to section 2 of the Code
access arrangement period	the period from when an access arrangement or revisions to an access arrangement takes effect (by virtue of a decision pursuant to section 2) until the next revisions commencement date
Code	*National Third Party Access Code for Natural Gas Pipeline Systems*
covered pipeline	a pipeline to which the provisions of the Code apply
CPI	Consumer Price Index
EDD	Effective Degree Day – a measure comprising temperature, wind chill, insolation and seasonal components that is used in the modeling of the relationship between daily weather and some gas demand
EGP	Eastern Gas Pipeline
GasNet	GasNet Australia (Operations) Pty Limited
GJ	gigajoule (one thousand million joules)
GNS	GasNet System
K-factor	A mechanism within GasNet’s access arrangement whereby if the average tariff achieved is different to the benchmark average tariff, future tariffs are adjusted to allow the under recovery (over recovery) to be recovered (paid back to users) in the next regulatory year. The average tariff is only affected by changes in product mix – not changes in total volumes.
market carriage	a capacity management system where the service provider does not normally require users to commit to a contract and charges are based on actual usage

ORG	Office of the Regulator-General, Victoria (now the Essential Services Commission of Victoria)
PJ	petajoule (one thousand terajoules)
prospective user	a person who seeks or who is reasonably likely to seek to enter into a contract for a service (including a user who seeks or may seek to enter into a contract for an additional service)
PTS	Principal Transmission System
reference service	a service which is specified in an access arrangement and in respect of which a reference tariff has been determined
reference tariff	a tariff specified in an access arrangement as corresponding to a reference service
reference tariff policy	a policy describing the principles that are to be used to determine reference tariffs
service provider	a person who is the owner or operator of the whole or any part of the pipeline or proposed pipeline
Tariff Order	Victorian Gas Industry Tariff Order
TJ	terajoule (one thousand gigajoules)
VENCorp	Victorian Energy Networks Corporation
WACC	weighted average cost of capital
WTS	Western Transmission System
WUGS	Western Underground Gas Storage

Summary

GasNet Australia (Operations) Pty Ltd (GasNet) lodged four proposed revisions to its natural gas transmission access arrangement with the Australian Competition and Consumer Commission (ACCC) on 24 August 2004:

- K-factor – GasNet proposes that where there is an over recovery of its average revenue in a year, the associated K-factor amounts would be spread over the remaining years of the access arrangement period, rather than all of it being allocated to the next year
- Refill tariff – GasNet proposes that exports via the WUGS facility should not be charged the lower refill tariff but instead charged the same tariff as exports via the SEA Gas off-take
- Weather pattern – GasNet proposes to adjust the demand forecasts in the access arrangement to reflect an increase in the warming shift in the Victorian weather pattern, and
- Timing – GasNet proposes a mechanism to allow implementation of the revisions for the calculation of its 2005 tariffs.

Section 2.28 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (Code) allows a service provider to submit revisions at any time. The regulator must then assess the revisions against the provisions of the Code.

On 10 November 2004, the ACCC issued draft decisions that it proposed to approve the revisions with respect to K-factor, weather pattern and timing and not to approve the revision with respect to the refill tariff.

After considering the submissions by GasNet and interested parties, the ACCC has decided to issue final decisions with respect to each of the four revisions:

- pursuant to section 2.38(a)(i) of the Code, the ACCC has decided to approve the revisions with respect to K-factor, weather pattern and timing, and
- pursuant to section 2.38(a)(ii), the ACCC has decided not to approve the revision with respect to the refill tariff.

The reasons are set out in this document.

1 Introduction

1.1 Access arrangement revisions

On 24 August 2004, GasNet Australia (Operations) Pty Ltd (GasNet) submitted to the Australian Competition and Consumer Commission (ACCC) for approval under the *National Third Party Access Code for Natural Gas Pipeline Systems* (Code) four proposed revisions to its access arrangement.

Prior to 2003, GasNet was subject to two separate access arrangements, which were approved by the ACCC in 1998, for the Principal Transmission System (PTS) and the Western Transmission System (WTS). In the scheduled review in 2002, these were combined into a single access arrangement which applied to both the PTS and WTS, the South West Pipeline that links them, and GasNet's segment of the Interconnect. GasNet now refers to these assets as the GasNet System (GNS). This single revised access arrangement, as amended by the ACCC, came into effect on 1 February 2003. It was later varied by the Australian Competition Tribunal.

Under the market carriage capacity management system operating on the GNS, users pay tariffs to both the system owner, GasNet, and the independent system operator, Victorian Energy Networks Corporation (VENCorp). Approximately 85 per cent of the combined tariff is paid to GasNet.

An access arrangement describes the terms and conditions on which a service provider will make access to its pipeline available to third parties. The current GNS access arrangement period is expected to end on 31 December 2007. However, section 2.28 of the Code gives service providers the discretion to submit revisions earlier than at a scheduled review and this is the basis of GasNet's proposal on 24 August 2004.

Under the Code, the ACCC is required to:

- inform interested parties that it has received the proposed revisions to the access arrangement and the associated access arrangement information (parties were notified by email on 30 August 2004 or letter on 31 August 2004 that the ACCC had received four proposed revisions)
- publish a notice in a national daily paper which at least: describes the covered pipelines to which the access arrangements relate; states how copies of the documents may be obtained; and requests submissions by a date specified in the notice (the notice was inserted in the *Australian Financial Review* on 1 September 2004)
- after considering submissions received, issue a draft decision which either proposes to approve the revisions or proposes not to approve the revisions (the draft decisions were issued on 10 November 2004), and
- after considering additional submissions, issue a final decision that either approves or does not approve each of the revisions (this document sets out the ACCC's four final decisions).

This process is different to that for revisions required by an access arrangement (for example, as part of a scheduled review) in that there is no provision for the ACCC to state the amendments (or nature of the amendments) which would have to be made to the revisions in order for the ACCC to approve them. Nor does this process provide for the service provider to submit amended revisions to the ACCC.

1.2 Criteria for assessing revisions to access arrangements

Pursuant to section 2.46 of the Code, the ACCC may approve revisions to an access arrangement only if it is satisfied that the access arrangement as revised would contain the elements and satisfy the principles set out in sections 3.1 to 3.20 of the Code, which are summarised below. Revisions to an access arrangement cannot be opposed solely on the basis that the access arrangement as revised would not address a matter that sections 3.1 to 3.20 of the Code does not require it to address. Subject to this, the ACCC has a broad discretion in approving or not approving revisions to an access arrangement.

An access arrangement, or a revised access arrangement, must include the following elements:

- a policy on the service or services to be offered which includes a description of the service(s) to be offered
- a reference tariff policy and one or more reference tariffs. A reference tariff operates as a benchmark as it sets out the specific tariff on which access to a specific service will be made available. Tariffs must be determined according to the reference tariff principles in section 8 of the Code
- terms and conditions on which the service provider will supply each reference service
- a statement of whether a contract carriage or market carriage capacity management policy is applicable
- a trading policy that enables a user to trade its right to obtain a service (on a contract carriage pipeline) to another person
- a queuing policy to determine the priority that a user has in obtaining access to spare and developable capacity on a pipeline
- an extensions and expansions policy to determine the treatment of an extension or expansion of a pipeline under the Code
- a date by which revisions to the arrangement must be submitted, and
- a date by which the revisions are intended to commence.

As the GNS is a market carriage pipeline, there is no trading policy.

The Code (section 10.2) provides that, where there is more than one service provider in connection with a covered pipeline, with one the owner and the other the operator, responsibility for complying with the obligations imposed by the Code is allocated among them by their access arrangements and each service provider is responsible for complying with the responsibilities allocated to it. GasNet does not have a queuing policy as that responsibility has been allocated to VENCorp.

The ACCC's approach to the assessment of the access arrangement as revised is set out in chapter 2.

In assessing proposed revisions to an access arrangement, the ACCC must take into account the provisions of the access arrangement as it currently stands and, pursuant to section 2.24 of the Code, the following factors:

- the legitimate business interests and investment of the service provider
- firm and binding contractual obligations of the service provider or other persons (or both) already using the covered pipeline
- the operational and technical requirements necessary for the safe and reliable operation of the covered pipeline
- the economically efficient operation of the covered pipeline
- the public interest, including the public interest in having competition in markets (whether or not in Australia)
- the interests of users and prospective users, and
- any other matters that the ACCC considers are relevant.

The ACCC's assessment of each of the four proposed revisions is set out in chapters 3 to 6.

In conjunction with its proposed access arrangement, a service provider is required to submit access arrangement information in accordance with the criteria established in Attachment A of the Code. This requirement is considered in chapter 7.

The ACCC's final decisions are set out in chapter 8.

1.3 Background

Relevant aspects of the Victorian gas industry structure include:

- GasNet owns the GNS in Victoria which transports gas supplied from the Esso-BHP Billiton fields in the Gippsland Basin, the Cooper Basin via the Interconnect Pipeline and the Otway Basin. VENCorp is the independent system operator for the GNS
- The TXU owned Western Underground Gas Storage (WUGS) facility (at Iona) provides a source of peak gas flows into the GNS via the Southwest Pipeline. The WUGS facility is also connected to the SEA Gas pipeline which transports gas from Iona to Adelaide in South Australia. As the SEA Gas pipeline is connected to the GNS at the Southwest Pipeline, gas will be able to flow from the GNS into the SEA Gas Pipeline either directly (once compression capacity is commissioned) or via the WUGS facility
- Alinta owns and operates the Eastern Gas Pipeline (EGP) which supplies Gippsland Basin gas to NSW and the Tasmanian Natural Gas Pipeline which supplies

Gippsland Basin gas to Tasmania. These are connected to the GNS at the VicHub, and

- a number of new gas sources, located primarily in the Otway Basin, are expected to commence supply to the GNS and to South Australian customers in the short to medium term.

2 Assessment of the access arrangement as revised

As noted in section 1.2, pursuant to section 2.46 of the Code, the ACCC may approve revisions to an access arrangement only if it is satisfied that the access arrangement as revised would contain the elements and satisfy the principles set out in sections 3.1 to 3.20 of the Code. Revisions to an access arrangement cannot be opposed solely on the basis that the access arrangement as revised would not address a matter that sections 3.1 to 3.20 of the Code do not require it to address. Therefore, the ACCC has considered whether any of the elements of the access arrangement as revised would be inconsistent with the requirements of sections 3.1 to 3.20 of the Code.

The ACCC has considered TXU's submission that it opposes 're-opening' GasNet's access arrangement during the term of an access arrangement period.[1] However, as noted in section 1.1 above, section 2.28 expressly provides that service providers may submit proposed revisions at any time during the term of an access arrangement period. Once proposed revisions have been lodged, the regulator must assess them in accordance with section 2.46. TXU has also raised a specific concern on whether a fixed principle in GasNet's access arrangement would be breached if the ACCC approves these revisions. This issue is considered later in this chapter.

The ACCC has also considered GasNet's submission that 'a number of operational anomalies have emerged which were not anticipated prior to the rollout of the Access Arrangement' and that its proposed revisions are intended to 'cure these anomalies'.[2] In this regard, the ACCC notes that the provisions of the Code do not expressly differentiate between types of revisions or allow for differential treatment on the basis that proposed revisions are described as curing anomalies.[3] This approach of GasNet's is considered further in section 5.4.

The ACCC's assessment of GasNet's four proposed revisions in terms of the section 2.24 requirements and sections 3.1 to 3.20 (as required by section 2.46) is provided in chapters 3 to 6. The ACCC has also considered the existing provisions of the access arrangement (as also required by section 2.46) in those assessments. The ACCC has concluded that the refill tariff revision would not satisfy relevant Code provisions. In assessing the various factors in section 2.24, the ACCC concluded that the likely detriments associated with the revision would outweigh the potential benefits. Accordingly, it does not approve this revision. The ACCC approves the other three revisions as they do satisfy the relevant Code provisions.

The ACCC completed a full review of the access arrangement in January 2003 when it drafted and approved a revised access arrangement for GasNet, which was subsequently varied by the Australian Competition Tribunal in December 2003. The

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1 TXU submission, pp. 4, 9-11.

2 GasNet, *GasNet Australia Access Arrangement – Application to revise*, 24 August 2004, (GasNet application) p. 2.

3 The Code does provide for a streamlined assessment process for proposed revisions that are not material and will not result in changes to reference tariffs or services (section 2.33), but that is not the case in relation to GasNet's current proposed revisions.

ACCC notes that all four revisions relate to aspects of the reference tariffs (sections 3.3 to 3.5 of the Code). Consequently, approval of the revisions would not impact on compliance with sections 3.1 to 3.2 and 3.6 to 3.20. Sections 3.4 and 3.5 respectively require reference tariffs and the reference tariff policy to comply with the principles of section 8.

While no submissions were received from interested parties that suggested the access arrangement as revised would be inconsistent with the requirements of sections 3.1 to 3.20 of the Code (although TXU submitted that it may be inconsistent with a fixed principle, which is discussed below), the ACCC is aware that considerations relevant to the access arrangement as approved in 2003 may have varied with the passing of time. In this respect, when assessing previous proposals to include the Interconnect Assets and the South West Pipeline in the regulatory asset base of the GNS, the ACCC discussed the potential impact of changes in the market for funds.[4]

In relation to the current proposed revisions GasNet submitted:[5]

> GasNet submits that the Access Arrangement as revised with these Access Arrangements Revisions is not taken outside the principles in section 3.1 to 3.20. Nor has the environment in which the Access Arrangement operates changed so substantially that the Access Arrangement no longer complies with the Code.
>
> However, if the ACCC considers that the environment has changed such that the reference tariff principles are affected, it is GasNet's view that this change is not so significant that the costs and uncertainties associated with this review are outweighed by the need to amend the Access Arrangement. GasNet notes particularly that the ACCC should not conduct a review at this point as this may amount to repeating the full review undertaken in 2002 or anticipating the review expected in 2007.

The ACCC is aware that Government bond rates (which serve as a proxy for the risk free rate) have fallen below the values used in the determination of the reference tariffs in GasNet's access arrangement as it currently stands. It is also aware that more recent overall demand forecasts for the GNS by VENCorp in its November 2003 *Annual Gas Planning Review 2004 to 2008* and November 2004 *Annual Gas Planning Review 2005 to 2009* indicate that forecast volumes may have changed since the 2002 review. These, and potentially other factors of which the ACCC is not currently aware, raise a question as to whether circumstances have changed such that GasNet's access arrangement as revised would continue to satisfy the requirements of sections 3.1 to 3.20 of the Code (including the requirements of section 8, as provided by sections 3.4 and 3.5).

The ACCC notes that some of these factors might potentially push towards lower reference tariffs (for example, lower interest rates) while others could have the opposite effect. It also notes that the potential implications of these factors are uncertain or unknown. In order to form a view that circumstances have changed such that the access arrangement as revised would no longer satisfy the requirements of sections 3.1 to 3.20, the ACCC would need to reassess various factors that contribute to the reference tariffs.

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4 ACCC, *Final Decision: Access Arrangement for the Principal Transmission System, Application for Revision by GPU GasNet Pty Ltd*, 28 April 2000, pp. 55-56; ACCC, *Final Decision: Access Arrangement for the Principal Transmission System, Application for Revision by GPU GasNet Pty Ltd, Southwest Pipeline*, 29 June 2001, p. 66.

5 GasNet application, pp. 29-30.

To the extent that such an assessment would be similar in scope to a scheduled review of an access arrangement, it would impose substantial costs on GasNet and interested parties.

The ACCC does not consider such a reassessment to be justified at this time given the nature and scope of the current proposed revisions. However, should further voluntary revisions be proposed during the access arrangement period, such a reassessment may be necessary and justified. In deciding whether to carry out such an assessment, the ACCC would take into account factors such as the cumulative impact of revisions and the length of time since the last full review of the access arrangement.

Incentives

As noted above, sections 3.4 and 3.5 respectively require the reference tariffs and reference tariff policy to comply with the principles of section 8. Section 8 provides that, where appropriate, the reference tariff and reference tariff policy should provide an incentive for the service provider to reduce costs (section 8.1(f)) and that incentive mechanisms (consistent with section 8) should be incorporated into the reference tariff policy (section 8.2(d)).

The tariffs in the access arrangement were established by applying the building block approach which estimates the total efficient costs involved in providing the regulated services. The total costs are an aggregate of estimates for return on equity, interest payments on debt, depreciation, operating and maintenance costs, and net tax payable. The development of these estimates includes many forecasts for the next access arrangement period. The estimated total costs are then divided by forecast volumes to derive the average revenue (which is the same as the weighted average tariff) that GasNet is to receive each year of the following regulatory period.[6]

With limited exceptions,[7] GasNet's tariffs are not adjusted throughout the rest of the access arrangement period in the light of actual costs incurred or actual volumes transported. This provides GasNet with incentives to grow the market and to reduce costs as it is able to keep the resulting increase in profits (at least until the next access arrangement period).[8]

A specific incentive mechanism in GasNet's access arrangement allows it to keep any increase in profits due to cost reductions for the year in which the cost reduction was achieved plus the following five years. This means that cost reductions early in the access arrangement period will not be any more or less beneficial to GasNet than the

6 This average revenue is 'guaranteed' by the operation of the K-factor mechanism (see chapter 3).

7 GasNet's access arrangement provides for the yearly adjustment (through the K-factor mechanism) of tariffs in the light of product mix changes. These occur when the proportions (between the tariff classes and zones) of actual volumes differ from those forecast. This allows GasNet to receive its regulatory average revenue. Any difference in total volumes does not affect tariffs. Also, the access arrangement allows for an adjustment of tariffs where actual costs differ from those forecast for particular 'pass through' events (see section 6 of the access arrangement).

8 It should be noted that while GasNet uses a CPI-X formula to describe its tariff path over the five years of the access arrangement period, the X is not a measure of any productivity factor or any incentive factor.

same reductions later in the access arrangement period. Thus, GasNet has an incentive to achieve the cost reduction as soon as possible.

The ACCC considers these incentive features of the GNS access arrangement are fundamental to it and if an unscheduled revision sought to adjust tariffs on the basis of changes to actual costs or volumes much of these incentive properties could be lost. Accordingly, the ACCC considers that any material change to the incentive features would represent a fundamental change to the regulatory framework for GasNet. As such, the incentive properties of the access arrangement could not be considered in isolation from the other provisions of the access arrangement.

In general, the ACCC considers that any proposal by a service provider to base revisions on substantial changes in circumstances which are favourable to it without recognising changes in circumstances which are not favourable to it ('cherry-picking') would have the potential to result in a material change to the incentive properties of its access arrangement.

As discussed in chapters 3 to 6, the ACCC considers that the three revisions that it has approved (and possibly the other revision as well) address minor specific issues and do not alter the incentive properties of the access arrangement.

A specific aspect of this incentive issue is discussed below.

Fixed principle

TXU has expressed concern that approval of the revisions would be inconsistent with a fixed principle of the 1998 Victorian Gas Industry Tariff Order:[9]

> Sect 9.2 of the Tariff Order sets out a number of fixed principles to apply for the duration of this access arrangement. These include the need to utilise incentive based regulation adopting a CPI-X approach and not rate of return regulation. TXU believes that if the ACCC re-open the access arrangements to change the operation of the "K" factor, abolish the refill tariff & re-open the demand forecasts, it risks implementing rate of return regulation.

TXU requests that the ACCC address the potentially competing tension between the fixed principle in clause 9.2(a)(1) of the Tariff Order (which requires the ACCC to 'utilise incentive based regulation adopting a CPI-X approach and not rate of return regulation') and the Code provisions governing the approval of revisions. TXU also recommended a regulatory approach which it considers would accommodate its concerns.

The interpretation of this fixed principle was considered at some length by the Victorian Supreme Court in an appeal by TXU Electricity Pty Ltd against a decision by the Office of the Regulator-General, Victoria (ORG, now the Essential Services Commission). TXU contended that aspects of the ORG's decision constituted rate of return regulation rather than incentive based regulation adopting a CPI-X approach.[10]

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9 TXU submission, p. 9.

10 The fixed principle affecting TXU Electricity differed slightly in that it was to '... utilise price based regulation adopting a CPI-X approach and not rate of return regulation', *1995 Victorian Electricity Supply Industry Tariff Order*, clause 5.10(a).

While the facts of that matter differ from those currently before the ACCC, it notes that the Victorian Supreme Court found that the ORG did implement incentive based regulation.

The ACCC considered the impact of the fixed principles as part of its 2002 review of GasNet's access arrangement, and commented:[11]

> [T]he Tariff Order established a number of fixed principles for this next access arrangement period. Fixed principles can only be changed with the agreement of the service provider. However, as GasNet has not proposed to alter any of the fixed principles, the proposed revised access arrangement must also comply with these principles.
>
> The first principle of relevance noted above is the requirement to use a CPI-X approach and not a rate of return approach. While GasNet has proposed to modify its price path mechanism further with the introduction of an expanded pass through mechanism, the basis of regulation for GasNet remains CPI-X. The approach has not been altered to the extent that it could be accurately described as rate of return.

The ACCC recognises that a range of regulatory approaches is possible between incentive based regulation adopting a CPI-X approach and one using a rate of return methodology. Its view is that in general a regulatory regime which gives service providers the discretion to submit revisions at any time would be closer to rate of return regulation than if it did not provide that discretion. However, the ACCC notes that the Code does provide this option to service providers. Accordingly, the question then is whether the fixed principle set out in clause 9.2(a)(i) of the Tariff Order would be breached if the ACCC approved some or all of GasNet's proposed revisions.

An important consideration in relation to this question is the extent of the revisions. A full reassessment of the access arrangement would result in a form of regulation that is closer to a rate of return regulatory regime. Also, revisions to the access arrangement so that differences between forecast and actual parameters occurring before the revisions are recovered in future tariffs would be a feature found in rate of return regulation. The ACCC has considered the nature and impact of its final decisions regarding GasNet's current proposed revisions. It has concluded that its final decisions would not result in the overall regulatory approach being altered to the extent that it could accurately be described as a rate of return regulatory regime. Accordingly, the ACCC is of the view that its final decisions do not conflict with clause 9.2(a)(i) of the Tariff Order. This view is consistent with the conclusion of the previous discussion that the ACCC's final decisions do not materially change the incentive properties of the access arrangement.

TXU has outlined a regulatory approach which it proposes that the ACCC adopt in order to resolve what it considers to be a possible conflict between the fixed principle and the ACCC's responsibilities directly under the Code.[12] The ACCC considers that aspects of TXU's approach may be incompatible with the existing provisions of GasNet's access arrangement (which it must take into account pursuant to section 2.46(b) of the Code) and might otherwise limit the options available to GasNet under the Code. For example, it is not apparent how the ACCC could set rules governing

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[11] ACCC, *Final Decision: GasNet Australia access arrangement revisions for the Principal Transmission System*, 13 November 2002, p. 239.

[12] TXU submission, pp 10-11.

GasNet’s ability to submit voluntary revisions given the explicit provision in section 2.28 that gives service providers the discretion to submit revisions ‘at any ... time’.

While the ACCC does not consider it appropriate to adopt the regulatory model suggested by TXU, it acknowledges TXU’s concerns about the potential for the ‘re-opening’ of an access arrangement during an access arrangement period to undermine its incentive properties. As discussed earlier in this chapter, the ACCC considers that any proposed revisions which would have the effect of materially altering the incentive properties of an access arrangement could not be considered in isolation from the broader provisions of the access arrangement. While the ACCC would assess any such revisions on their merits, it notes that there is in practice limited scope for approval of voluntary revisions (as the ACCC cannot propose amendments).

As noted earlier, the ACCC has concluded that its final decisions will not result in a rate of return style regulatory regime for GasNet. Thus the changes to the regulatory approach suggested by TXU would not be applicable in this instance.

3 K-factor

GasNet proposes that where there is an over recovery of its average revenue in a year, the associated K-factor amounts (which are part of its price control formulae) would be spread over the remaining years of the access arrangement period, rather than all of it being allocated to the next year.

3.1 Current access arrangement provisions

GasNet's access arrangement ensures that GasNet achieves the approved average revenue (that is, weighted average tariff) for each year, though not necessarily in that year. The average revenue for any given year is calculated by taking the weighted average tariff set for that year in the access arrangement (which is in 2003 dollars) and multiplying it by CPI-X for each year from 2003 up to the year before the year in which the weighted average tariff applies. GasNet bears the risk (positive and negative) of total volumes varying from the forecast volumes. However, if the weighted average revenue achieved is different to that set under the access arrangement (because the volume mix between high and low tariffs is different to that forecast) tariffs in the following year are adjusted (through the K-factor mechanism) so that any shortfall is recovered from users or any over recovery is distributed to users. Thus, the forecast average revenue is guaranteed.

A limit on the implementation of the weighted average tariff for any given year is that each individual tariff cannot be increased by more than CPI-X+2 per cent from the level in the previous year. If the increase in the average tariff is greater than this, then each individual tariff will be increased by this percentage and the portion of the weighted average tariff increase that cannot be implemented is carried over into the K-factor calculation in the following year.

3.2 GasNet proposal

GasNet notes that if there was a year of substantial average revenue over recovery followed by years of target average revenue recovery then it could face delayed revenue receipts. This is because the over recovery would lead to lower tariffs the following year but for the year after that tariffs may not be able to return to the level that would allow the recovery of the average revenue for that year. Rather they would be capped at an increase of two per cent above the CPI-X increase. The under recovery would be carried over into the following year(s).

GasNet is expecting a large decrease in 2005 tariffs (following a decrease in 2004 tariffs) due to over recoveries in 2003 and 2004. It predicts that, if demand matches forecasts in subsequent years (that is, 2005-2007), there will be an unrecovered K-factor amount at the end of the access arrangement period.

GasNet claims that two significant issues are raised:

a) it is not in GasNet's legitimate business interests for revenues to consistently fall below targets for any length of time

b) a large K-factor balance carried forward into the next access arrangement period would lead to higher tariffs for that period than would otherwise be the case.

GasNet notes one solution would be to apply the individual tariff cap only if tariffs were to rise above where they would have been if the forecast tariff path had been applied from the inception of the access arrangement period (which would be the case if actual volumes had matched forecast volumes). It calls this Option 1 but rejects it as it would lead to volatile revenues.

Instead, GasNet proposes that where there is an over recovery in a year, the associated K-factor amounts would be spread over the remaining years of the access arrangement period (Option 2), rather than all of it being allocated to the next year. GasNet claims that this approach is superior to the current methodology as it would lead to a higher probability of GasNet recovering its appropriate revenue in the current access arrangement period (which means lower tariff fluctuations between access arrangement periods), and also because there would be lower fluctuations in tariffs within the current access arrangement period.

3.3 Submissions to the proposed revisions

Origin submits that it is inappropriate to review this issue midway through an access arrangement period. It also submits that the concern expressed by GasNet about variability in transmission tariffs is misplaced as the majority of customers are on standing contracts and do not experience variability in retail prices and that large customers would prefer to have any reduction as soon as possible.[13]

TXU also considers it inappropriate to review this issue at this time and does not support this revision. It believes that detailed consultation with all stakeholders should take place first and this should be done at the end of the access arrangement period.

TXU notes that the revision would mean higher tariffs in the short term which it contends would not be in the interest of users (and so would be contrary to the consideration set out in section 2.24(f) of the Code). TXU claims that these tariffs would be inefficient (a consideration which is relevant to the objective set out in section 8.1(e)) although it does not explain how. TXU submits that any change to the price control formulae mid term would change GasNet's risk profile and have implications for the weighted average cost of capital (WACC). TXU also claims that the implementation of the proposed smoothing mechanism would lead to unnecessary regulatory risk and that the problem should be dealt with by addressing the rebalancing constraint at the end of the access arrangement period.[14]

AGL supports GasNet's proposed revision and notes that it would lead to less volatility in GasNet's revenues and users' costs each year.[15]

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13 Origin submission, pp. 1-2.

14 TXU submission, pp. 1-2, 5-6.

15 AGL submission, p. 1.

EnergyAdvice also supports this revision which it considers to be reasonable as ‘they [GasNet] can only recover what they are entitled to, [it] minimises tariff volatility and maintains the price cap on individual tariff rises.’[16]

3.4 ACCC’s draft considerations

The effect of the proposed change is that, given the expected scenario arising, GasNet would recover its revenues slightly earlier than it would under the current access arrangement provisions. It should be noted that any K-factor balances carried between years are adjusted by the value of the one year swap reference rate to compensate GasNet (or users) for facing the delay in receiving the revenue (or paying decreased tariffs). Consequently, GasNet’s proposed revision would not alter users’ or GasNet’s positions in present value terms.

One assertion made in the submissions is that it is inappropriate to review the K-factor methodology outside of a scheduled review. The broader question of the ACCC’s discretion in approving or not approving proposed revisions has been discussed in chapter 2.

Another assertion is that it is inappropriate to make mid term changes to the access arrangement simply because the volumes now expected are different to the forecasts in the access arrangement. The ACCC considers that this assertion has misconstrued the nature of the revision. It is not a response to variations in total expected consumption compared to forecast consumption but to changes in the product mix which have unforseen and unintended consequences.[17]

The advantages of the individual tariff cap are that it limits moves away from the cost reflective tariffs approved at the scheduled revision and it limits shocks to users from increases in tariffs. This second advantage means that users can have some confidence about the level of tariffs they will face over the access arrangement period, providing a basis on which to make decisions.[18] The ACCC understands that users appreciate the certainty that tariffs will not be significantly above what were forecast at the beginning of the access arrangement period. It is hard to imagine why users would be concerned if tariffs dropped below the expected level for a year. Thus, there appears to be little reason to protect users from a large increase in tariffs if that increase is simply reversing an unexpected decrease in the previous year. The ACCC notes that some parties consider that users would prefer to have over recoveries returned to them as soon as possible, while others prefer the lower volatility afforded by the delayed return. GasNet also sees the lower volatility associated with the delay of the return of over

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16 EnergyAdvice submission, p. 1.

17 GasNet also makes this point, *GasNet response to submissions*, 14 October 2004, (GasNet response) p. 4.

18 It should be kept in mind that ‘user’ in the context of this assessment (and the Code) means those who deal directly with the service provider. It does not mean the final end customer (unless that end customer is also directly contracted with GasNet). So the concern of the Code in section 2.24(f) is the interests of the retailers and other large users who deal directly with the service provider. Retail customers’ concerns are captured by public interest considerations (section 2.24(e)).

recoveries as an advantage of its proposal and claims that in its experience large users prefer this.[19]

The ACCC is of the view that tariff volatility would be unlikely to generate a material detriment to users as long as tariffs do not increase above the level expected at the beginning of the access arrangement period. Consequently, GasNet's contentions about the benefits of reducing tariff volatility provide limited support for the revision. In this respect, GasNet's Option 1 appears to be a more appropriate revision to make because it returns users' over payment to them with the minimum delay.

Submissions also claimed that the tariffs resulting from the proposed revision would be inefficient. However, no evidence was provided for this contention, and the ACCC is not aware of any basis for this claim. As GasNet subsequently stated, the tariff structure and level were set to reflect efficient pricing over the access arrangement period.[20] The tariffs for each year were then levelled. This revision is to adjust the timing of the K-factor adjustment with the result, GasNet claims and the ACCC considers likely, of a smoothing of the weighted average tariff (in the rest of this access arrangement period and also between this and the beginning of the next access arrangement period) compared to the situation that would apply in the absence of the revision. This addresses GasNet's second significant issue (regarding tariff volatility between access arrangement periods). A smoothing of the tariffs is unlikely to reduce their efficiency.

GasNet's first stated significant issue, or concern, is that 'it is not in GasNet's legitimate business interests for revenues to constantly fall below targets for any length of time'.[21] The ACCC understands that GasNet means that its average revenue should not be consistently below the average revenue set by the access arrangement.[22]

The ACCC notes that under GasNet's Option 1, GasNet's average revenue would be expected to be below target for the year following an over recovery. Under GasNet's proposed revision (that is, its Option 2) average revenues would be expected to be under target (but by a smaller amount) for all the following years to the end of the access arrangement period.[23] The ACCC makes two observations on this:

- to the extent that it is the length of time of being under its average revenue target that affects GasNet's legitimate business interests, Option 1 would provide the better remedy, and
- to the extent that it is the degree of volatility in average revenues over the years that affects GasNet's legitimate business interests, Option 2 would provide the better remedy.

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19 GasNet response, p. 5.

20 ibid.

21 GasNet application, p. 10.

22 The K-factor mechanism is concerned with average revenues, not total revenues.

23 For example, if at the end of 2004 there has been an over recovery of $3 million, Option 1 would result in a reduction in tariffs in 2005 so that $3 million would be under recovered and then an increase in tariffs in 2006 to the target level (assuming there was no under or over recovery in 2005). Option 2 would result in a reduction in tariffs in 2005-2007 so that $1 million would be under recovered in each year.

While GasNet does not raise the second point as one of its ‘significant issues’[24] it does appear to be GasNet’s main reason for preferring Option 2 over Option 1.[25]

Interested parties have claimed that implementation of this revision would change GasNet’s risk profile compared to that established at the scheduled review in 2002 and that to do so should be balanced by an adjustment to the WACC. GasNet's response is that the WACC was set largely by reference to industry wide factors and contained no allowance for this risk.[26]

While the ACCC did set the WACC in the 2002 review largely by reference to industry wide factors, it was mindful of GasNet’s complete regulatory framework and in particular the access arrangement overall (including the rebalancing formula). The ACCC agrees that the proposed revision would change GasNet’s risk profile. However, it considers that any change would be minimal (because the present value of GasNet’s forecast revenue stream is only minimally changed by the revision) and highly unlikely to justify an adjustment to the regulatory WACC.

Finally, a consideration of all aspects of this revision, including that it is largely about a timing difference and there is little net present value to GasNet, has led the ACCC to conclude that the incentive properties of the access arrangement will not be altered by the ACCC’s approval of this revision.

Overall, the ACCC is not persuaded of the merits of Option 2 over Option 1. However, as the current proposal is a voluntary revision, the ACCC is not able to propose any amendments to the revision. Therefore, the ACCC must either approve or not approve the proposed Option 2 as proposed.

The ACCC does consider that in the current expected circumstances GasNet may suffer an inappropriate detriment due to a delay to revenue recovery under the current K-factor mechanism. This would not be in GasNet’s legitimate business interests. The ACCC recognises that it may not be in the interests of users and in the public interest (given the broad impact of gas transportation charges) to approve this revision as it would delay the return of GasNet’s revenue over recoveries. However, the ACCC considers the detriment that would arise to GasNet of not approving the proposed revision would outweigh these other considerations. Having regard to this, the ACCC is satisfied that the access arrangement as revised with this revision would contain the elements and satisfy the principles set out in section 3.1 to 3.20. Therefore the ACCC proposed to approve the K-factor revision proposed by GasNet (its Option 2).

As already noted, the effect of the revision is to delay the return to users of revenue that has been over recovered by GasNet. That is, GasNet will receive its revenue during the access arrangement period earlier than was intended at the time of the 2002 scheduled review. While the provisions of the access arrangement ensure that GasNet would receive the same cash flows in present value terms regardless of the method adopted, this revised approach may provide GasNet with an incentive to forecast an inaccurate

24 see GasNet application, p. 10.

25 ibid., p. 13.

26 GasNet response, p. 4.

volume mix in order to achieve an earlier recovery of revenues.[27] For this reason and the others noted above, the ACCC anticipates that it will review this adjustment to the K-factor mechanism carefully at the next scheduled review to consider whether it is appropriate for it to continue into the third access arrangement period.[28] It may be that Option 1 is the preferable long term solution.

3.5 Submissions to draft decision

No submissions received after the release of the ACCC's draft decisions referred to this proposed revision.

3.6 ACCC's considerations

The ACCC is aware of no new information in relation to this issue and considers that the analysis and conclusion set out in its draft decisions document remain appropriate. Consequently, the ACCC affirms its draft decision and approves the K-factor revision.

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27 This incentive would arise if GasNet's own discount rate is higher than that used in the access arrangement. Incorporating into the access arrangement a lower demand forecast than is actually expected for high tariff zones and increasing the forecast demand for low tariff zones above what is expected (by the equivalent volume so that total forecast demand still equals that which is expected) would result in the tariffs for the high tariff zones being even higher than necessary (and tariffs for low tariff zones being lower than necessary). Assuming total actual demand is the same as that forecast, and the actual demand in each zone is as expected, this would lead to an over recovery of revenue in the year.

28 Being a scheduled review, the ACCC will have the ability at that time to require amendments (unlike for the current assessment). It may be that Option 1 is found to be the best option, but the decision the ACCC has to make at this time is between the 'second best' and the current approach. It proposes to approve the 'second best' because it considers it better than the current method.

4 Refill tariff

GasNet proposes that exports to South Australia via the Western Underground Gas Storage (WUGS) facility should not be charged the lower refill tariff but instead be charged the same tariff as exports via the SEA Gas off-take.

4.1 Current access arrangement provisions

Users who withdraw gas from the GNS into the WUGS facility operated by TXU are charged a tariff which reflects the marginal cost of transporting gas to this withdrawal point (primarily the additional compressor gas used). This costing approach is intended to encourage use of the WUGS facility for storage in recognition of the competition and system security benefits it affords users of the GNS. When users subsequently decide to use this gas, it is injected back into the GNS and withdrawn at a withdrawal point, and they are charged a withdrawal tariff that covers their fair share of common costs.

Users who withdraw gas at the nearby SEA Gas delivery point, also at Iona, (for transportation to South Australia) pay the withdrawal tariff for the South West zone which includes their fair share of common costs. For the 2002 revision, GasNet did not forecast any withdrawals from the SEA Gas delivery point for the 2003-2007 period.

4.2 GasNet proposal

GasNet advises that it is now possible for gas to be injected directly into the SEA Gas Pipeline from the WUGS facility without using the GNS. Gas exported to South Australia by this route enjoys the low refill tariff but does not give rise to the competition and security benefits mentioned above, nor contribute to common costs. GasNet considers that such an outcome is inequitable and not in its interests.

GasNet also notes that, once the Minerva compressors are operational, exports to South Australia via the SEA Gas delivery point would be at a cost disadvantage compared with exports via the WUGS facility.

In response to these developments GasNet proposes that exports via the WUGS facility should not be charged the lower refill tariff.

At the time of a withdrawal into the WUGS facility, it is not possible to determine whether that gas will be exported to South Australia or whether it will eventually be injected back into the GNS. Accordingly, it would not be practical to establish WUGS off-take withdrawal tariffs with different charges according to eventual use. Instead, GasNet proposes to charge the same tariff for withdrawals from the GNS into the WUGS facility as for gas which is withdrawn through the SEA Gas delivery point.[29] Any gas that is subsequently injected back into the GNS from the WUGS facility

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[29] This is the South West zone withdrawal tariff and the Cross System Withdrawal Tariff if applicable. In $2004, for Tariff D customers, the South West zone withdrawal tariff is $0.08/GJ and the Cross System Withdrawal Tariff is $0.13/GJ.

would attract a rebate which equals the difference between the withdrawal tariff at the SEA Gas delivery point and the current refill tariff.[30]

GasNet states that the only net benefit to it of this revision 'is the time value of the rebate between the withdrawal and re-injection of the gas.'[31]

4.3 Submissions to proposed revisions

Origin submits that users exporting through the WUGS facility do not get a 'free ride' but are 'subject to commercial rates for injection, storage, withdrawal, losses, compression and use of laterals.'[32] It considers that it is reasonable for exports via the WUGS facility to be charged a lower rate to encourage the efficient use of available resources (though it does not explain how this would be the result). Origin is concerned about the cost of additional working capital that would be needed by users until the rebate is returned for gas re-injected. Origin is also concerned that the higher tariff is not cost reflective (though it provides no evidence or argument to support this concern).

TXU submits that it cannot be accused of abusing the refill tariff as it negotiated access to the SEA Gas 18 inch arterial before it knew the quantum of the refill tariff. Now that it has access it will continue to use this route. It claims that gas transportation will be more expensive via the WUGS facility than directly through the 14 inch arterial (which will be available following the commissioning of the Minerva compressors) and therefore the lower refill tariff will not distort competition in South Australia. TXU suggests that gas exported to South Australia reinforces security of supply for that state and therefore should attract the low refill tariff. It notes that the low refill tariff is justified by the use of the WUGS facility enhancing the security of supply to Victorian users). Finally, TXU submits that the refill tariff should remain as it is because TXU entered into supply contracts based on this expectation.[33]

AGL supports this proposed revision subject to users who withdraw into the WUGS facility, and then re-inject into the GNS, not being disadvantaged by the delay in receiving the rebate.[34]

EnergyAdvice notes that 'if ownership of the gas changes while it is in Underground Storage, neither the person who withdrew the gas at Underground Storage or the person who injects that gas at Underground Storage, will get the benefit of the rebate.'[35] It suggests that GasNet should record transfers of ownership to preserve the intent and integrity of the refill tariff.

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30 The current refill tariff is $0.12/GJ. Withdrawals into the WUGS facility would cost most users $0.21/GJ (see previous footnote). Thus the rebate would be $0.09/GJ.

31 GasNet application, p. 18.

32 Origin submission, p. 2.

33 TXU submission, pp. 2-3, 7.

34 AGL submission, pp. 1-2.

35 EnergyAdvice submission.

4.4 ACCC's draft considerations

The ACCC acknowledges GasNet's claim that the only net benefit to it of this revision 'is the time value of the rebate between the withdrawal and re-injection of the gas',[36] and that some parties have expressed concern about GasNet obtaining this advantage. The ACCC understands that this benefit is likely to be in the order of a few tens of thousands of dollars a year. GasNet calculates that, if the full capacity of the WUGS facility was used to store gas for six months and that gas was then reinjected into the GNS, the time value of the rebate would be approximately $25 000.[37] The ACCC considers that, in the context of GasNet's revenues and profits, and the tariffs paid by users, this amount is unlikely to be material. Further, as this revision is voluntary, the ACCC cannot require a change to the revision to make it more revenue neutral by including the time value of money in the calculation.

GasNet's claim (that the only net benefit to it would be the time value of money) would be correct in the context of comparing the situation that would apply after the revision with the current tariff structure assumptions (that is, where all exports from the South West zone were charged the South West withdrawal tariff). However, one of the assumptions currently underlying the access arrangement is that there would be no exports, and therefore no income from exports.[38] This proposed revision would allow GasNet to benefit from these unforecast volumes. Thus, it is true to say that the revision would only give to GasNet a net benefit of the time value of the rebate compared to the tariff structure intended in the access arrangement. However, this is not the case compared to the forecast revenue in 2002, or compared to what would eventuate if the proposed revision were not implemented. Consequently, the ACCC does not agree with GasNet's claim that 'Nor does the revision allow GasNet to earn more or less revenue than was intended when the Access Arrangement was approved in January 2003.'[39]

Forecast and actual volumes of gas withdrawn into the WUGS facility are currently not included in the K-factor calculation. Consequently, the revenue GasNet currently achieves from exports via the WUGS facility is simply determined by the $0.12/GJ refill tariff (which is based on the marginal costs incurred). As part of this revision, GasNet says it 'will treat withdrawals at the WUGS facility in the same way as withdrawals at the adjacent SEA Gas delivery point'.[40] This means that any exports through the WUGS facility would be included in the K-factor calculations. As a result, as well as receiving $0.21/GJ[41] (instead of $0.12/GJ) from direct tariffs, the K-factor mechanism would calculate an under recovery of the average tariff (which is $0.34/GJ in 2004) and return extra revenue of $0.13/GJ, for all gas exported through the WUGS facility, to GasNet in the following year.

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36 GasNet application, p. 18.

37 GasNet response, p. 7.

38 GasNet assumed that there would be net imports and that parties would deal with any exports through gas swaps and thus save money. *GasNet Australia Access Arrangement* – Submission, 27 March 2002, p. 107.

39 GasNet application, p. 18.

40 ibid., p. 17. This appears contrary to GasNet's claim a few paragraphs later that it 'is not proposing to alter any forecasts or parameters which determine the Reference Tariff.' ibid., p. 18.

41 In $2004, for Tariff D customers, the South West zone withdrawal tariff is $0.08/GJ and the Cross System Withdrawal Tariff is $0.13/GJ.

This windfall could be regarded as a positive aspect of the volume risk GasNet faces under the access arrangement, in which case it is arguable that GasNet should be allowed to recover the revenues. GasNet argues that its ability to recover more than its target revenue (in this case by charging a full export tariff for exports via the WUGS facility) is part of its incentive mechanism.[42]

Alternatively, it could also be argued that GasNet's current inability to access this windfall gain is a negative outcome of the risk (positive and negative) GasNet took on when setting tariff structures under the access arrangement and that the access arrangement should not be changed now to allow GasNet to benefit. On this understanding, one would conclude that the acceptance of this revision would alter the incentive properties of the access arrangement.

It is relevant that if this revision were not made, GasNet would not suffer a loss of any revenue compared to that which was expected at the time the access arrangement revisions were approved in 2003. That is, GasNet does not need this revision to maintain the expectation of recovering the forecast regulatory revenue that it had at the time of that approval. To approve this revision would give GasNet the expectation of recovering more than the forecast regulatory revenue and thus over recovering the forecast efficient costs on which that revenue is based (contrary to section 8.1(a)).

GasNet claims that it would be discriminatory to charge lower tariffs to exporters using the WUGS facility than to those using the alternative route. The ACCC notes that both groups of (potential) exporters will receive essentially the same service from GasNet as the withdrawal points used are located very close to each other. The ACCC also notes that a fundamental principle of the GNS tariff design is that the same tariff applies for all withdrawals from any given zone.[43] The tariff for the South West zone was calculated on the same cost-reflective basis as most other tariffs in the access arrangement (contrary to the claim in one submission) and the ACCC is aware of no reason why users exporting from the WUGS off-take should not pay the same withdrawal tariff for the South West zone as other users. This tariff is more likely to promote efficiency (and thus satisfy section 8.1(e)) than the situation where some exporters pay only marginal cost and would result in all exporters paying a fair and reasonable share of common costs (section 8.38(b)).

GasNet contends that, if the tariff for those exporting through the WUGS facility is less than for those exporting through the SEA Gas off-take, then those using the WUGS facility route will have an inappropriate advantage over their competitors in the South Australian market. In contrast, TXU submits that there are additional costs that have to be paid by those exporting through the WUGS facility which make this route more expensive than exporting directly to the SEA Gas pipeline. These contentions raise a number of issues.

First, the ACCC has sought to confirm TXU's contention about the level of additional costs incurred when exporting through the WUGS facility. While TXU has provided

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42 GasNet response, pp. 9-10.

43 All users pay the same tariffs for withdrawals from a zone, though there are separate Tariff V and Tariff D charges. An exception to the general principle is that 'prudent discounts' apply in a number of instances where there is a threat of by-pass.

figures confidentially to the ACCC to support its claim, the ACCC has been unable to independently verify all the data.

Second, the ACCC notes that these costs are paid to the owners of the WUGS facility and the SEA Gas pipeline, not to GasNet. These costs may be of relevance in assessing the impact on competition in the South Australian market, but they are not relevant to the question of whether users receiving the same service from GasNet should pay different tariffs. If the total cost was less than the alternative then there may be a competitive advantage that could distort competition in the South Australian market and this would be a factor the ACCC would take into account under section 2.24(e).

Third, the ACCC notes that if it does not approve this proposed revision, to the extent that there may be a competitive advantage to those transporting gas to South Australia via the WUGS facility, the advantage would be likely to be short lived. The advantage does not yet exist (as the SEA Gas off-take is not yet an operational alternative) and the ACCC expects that GasNet would propose the same tariff for all exporters to South Australia for its next access arrangement period which is expected to begin in 2008.

The ACCC has taken these considerations into account in making its decision on this proposed revision.

It is also argued in the submissions that exports of gas from Victoria to South Australia contribute to security of gas supply in South Australia and that this provides grounds for using the low refill tariff. This argument would also suggest that withdrawal charges for direct supply to the SEA Gas pipeline should be reduced. However, the ACCC considers it is generally appropriate for those who benefit from enhanced security of supply to pay for that benefit.[44]

The ACCC considered a significant argument against approving this revision was that TXU has entered into contracts based on the expectation that the current tariffs will continue through to 2007.[45] TXU submitted that it would be materially disadvantaged if the revision were to be approved but said that its ability to substantiate this potential detriment has been hampered by its customers' concerns about the confidentiality of the terms of their contracts.

The ACCC understands that approval of an access arrangement (or of a revised access arrangement) provides a degree of certainty (for the service provider and for users) about the tariffs and the mechanism by which they can change for the duration of the access arrangement period. In this instance, TXU would have needed to make a judgement, when entering into arrangements for the period up until the end of 2007, about the likelihood of an unscheduled revision occurring that had the effect of increasing its tariffs. As there has been limited use by service providers to date of the option of submitting early revisions, some users may have discounted the likelihood of GasNet submitting voluntary revisions during the current access arrangement period.

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[44] See also GasNet response, p. 8.

[45] TXU submission, p. 2.

Approval of the proposed refill tariff revision would potentially expose those who have entered into fixed contracts to financial loss. This is not in the interests of users (section 2.24(f)) and especially not in the interests of those in binding contracts (section 2.24(b)). More broadly, approval of this revision might have the effect of reducing the degree of certainty that parties attach to reference tariffs in future.

EnergyAdvice noted in its submission that the proposed revision does not accommodate transfers of ownership of gas in the WUGS facility. GasNet has responded that changes of ownership can be dealt with under Schedule 1.5(d)(v) and (vi) of the access arrangement.[46] The ACCC made GasNet's submission available on its website and invited submissions from interested parties.[47]

In conclusion, an important tariff setting principle applied in the 2002 access arrangement revision was that a share of joint costs should be recovered from a reference tariff that is commensurate with the costs incurred in providing that reference service, and that each user pay its fair share of joint costs.[48] The use of the WUGS facility for storage was considered to have benefits that justified marginal cost pricing for withdrawals which will be re-injected as the appropriate share of joint costs would be recovered at the time of re-injection. The development of the ability to inject from the WUGS facility directly to the SEA Gas Pipeline has enabled use of the refill tariff in a way that was neither intended nor foreseen. Some users have benefited by accessing a reference service at an inappropriately low tariff and thus are not contributing their fair share to joint costs.

If approved, the effect of the proposed revision would be to restore the degree of cost reflectivity that was proposed by GasNet and accepted by the ACCC at the time of the 2002 scheduled review. Establishing the same tariff for users receiving essentially the same services would also promote efficiency in the use of the GNS (sections 2.24(d) and 8.1(e)) and re-establish a fair share of costs (section 8.38(b)). In addition, as noted earlier, approval of the revision would allow GasNet to receive a windfall gain, which would be consistent with its legitimate business interests (section 2.24(a)).

However, access to the windfall gain would allow the expectation of recovering more than efficient costs, which is contrary to section 8.1(a).[49] Also, approval of the proposed revision would potentially expose parties who have entered into fixed contracts on the basis of the current tariffs (with the expectation that they will not increase more than CPI-X+2 per cent per year) to financial loss. Rejection of this revision would protect

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46 GasNet response, p. 9.

47 No submissions were received in response to the draft decisions. The ACCC understands that this concern has been alleviated by GasNet's response.

48 Code sections 8.38 and 8.42; ACCC, Final Decision 2002, pp. 209-235.

49 As a general principle, reference tariffs should be calculated so that, when applied to forecast volumes, they produce a forecast revenue that matches forecast efficient costs. Higher tariffs would result in the expectation of recovery exceeding efficient costs. Such an expectation would be undesirable as it would go beyond the objective set out in section 8.1(a) of the Code and conflict with the objectives in sections 8.1(b), (e) and (f). It is in this sense that the ACCC considers 'the expectation of GasNet recovering more than forecast efficient costs' as a result of the refill tariff revision (and associated incorporation of exports into the K-factor calculations) to be undesirable. In contrast, the intended outcome from the operation of an incentive mechanism of higher than forecast returns is considered desirable.

these parties from this exposure, which would be consistent with section 2.24(b) of the Code (recognition of existing contracts) and in the interests of users (section 2.24(f)). The ACCC does not accept GasNet's assertion that there is a benefit to other users of ending the discriminatory pricing that outweighs the benefit to these parties. The ACCC understands there to be no monetary benefit to other users of these parties paying a higher tariff. In fact, as noted earlier in section 4.4, the approval of this revision would result in all users paying more as they share in the funding of the $0.13/GJ difference between the South West withdrawal tariff and the average tariff. Therefore the approval of this revision would be detrimental to all users. If this revision was not approved, GasNet's expectation of recovering the target revenue established as part of the 2002 review, which is consistent with GasNet's legitimate business interests (section 2.24(a)), would not be altered.

On balance, the ACCC considers the likely detriments associated with approval of this proposed revision would outweigh the potential benefits that may arise. Having regard to this, the ACCC is not satisfied that the access arrangement as revised with this revision would contain the elements and satisfy the principles set out in section 3.1 to 3.20. Consequently, the ACCC proposes not to approve the refill tariff revision.

4.5 Submissions to draft decision

GasNet submitted that TXU's original submission,[50] which raised the possibility of approval of this revision leading to adverse effects on TXU, is unclear and unsubstantiated. GasNet considers that it would be simple for a user to substantiate its claims (by providing copies of the relevant contracts to the ACCC on a confidential basis) and very difficult for the service provider to contradict the claims (as it does not have access to the relevant material). GasNet argues that the ACCC should examine the relevant contracts.[51]

More generally, GasNet claims that downstream contracts are either regulated or unregulated. Unregulated contracts allow the pass through of increased charges due to changes in regulatory charges and, given that GasNet's tariffs fluctuate, it would be curious if TXU's contracts did not have a pass through mechanism. When setting regulated retail tariffs, the South Australian Energy Minister includes an allowance for transmission costs and recognises that these costs can fluctuate.[52]

TXU responded to GasNet's submission by reaffirming its claim that its competitive standing in South Australia was gained in part by being able to provide customers with a degree of certainty on pricing. TXU states that this certainty was provided by it on the basis of its understanding that existing GasNet tariffs would not increase by more than the CPI-X+2 per cent cap. TXU states that, if this revision is approved by the ACCC, it could either attempt to pass the increase in charges through to customers (potentially resulting in disputes and loss of credibility) or absorb the increase (which would result in a substantial financial loss over the five year access period).

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50 TXU submission, 30 September 2004.

51 GasNet response to ACCC Draft Decision, 19 November 2004 (GasNet submission 2), pp. 2-4.

52 GasNet submission 2, pp. 5-6.

In addition, TXU claims that there would be ‘undesirable consequences for … competition in the SA gas retail market’[53] if the revision is approved. It does not explain what these consequences are. TXU claims that the approval of this revision would put it at a significant competitive disadvantage. In response to GasNet’s claim that typical gas supply contracts contain pass through clauses, TXU says that its contracts are not ‘typical’.[54]

Commenting on TXU’s submission, GasNet notes that TXU does not claim that it is not able to pass through tariff changes from this revision. It also notes that the magnitude of any financial impact on TXU has not been substantiated. GasNet claims that the current situation is a ‘loophole’ and that any one taking advantage of a loophole should expect that it may be closed at any stage. GasNet also asserts that in utilising the loophole TXU currently has a commercial advantage over other users of the SEA Gas pipeline.[55]

GasNet acknowledges that approval of this revision would lead to it receiving increased revenue due to exported volumes through the WUGS facility not attracting the proposed rebate. However, it considers the characterisation of this revenue as a ‘windfall’ to be incorrect. Rather, it considers the increased revenue to be a legitimate outcome of the incentive mechanism built into the refill tariff.[56]

GasNet claims that the increased revenue would be a function of increased exports and not the change in the application of the refill tariff it is proposing. It asserts that the ACCC should instead consider the revenue impact of the revision in the context of the 2002 forecast and not the present forecast. GasNet states that ‘[a]rguing that increased revenue from an unforseen change in volumes is contrary to section 8.1(a) of the Code could be used to disallow any incentive based tariff model.’[57]

4.6 ACCC’s considerations

In the draft decision to this proposed revision the ACCC concluded that the detriments associated with approval of this revision would be greater than the benefits. The ACCC identified the potential detriments as:

- expectation of GasNet recovering more than efficient costs[58]

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53 TXU response to GasNet response to ACCC Draft Decision, 1 December 2004 (TXU submission 2), p. 3.

54 TXU submission 2.

55 GasNet Final Comments on Application to Revise the WUGS Transmission Refill Tariff, 2 December 2004 (GasNet submission 4).

56 GasNet’s Second Response to ACCC Draft Decision, 26 November 2004 (GasNet submission 3), pp. 3-4.

57 GasNet submission 3, p. 4-6.

58 As a general principle, reference tariffs should be calculated so that, when applied to forecast volumes, they produce a forecast revenue that matches forecast efficient costs. Higher tariffs would result in the expectation of recovery exceeding efficient costs. Such an expectation would be undesirable as it would go beyond the objective set out in section 8.1(a) of the Code and conflict with the objectives in sections 8.1(b), (e) and (f). It is in this sense that the ACCC considers ‘the expectation of GasNet recovering more than forecast efficient costs’ as a result of the refill tariff revision (and associated incorporation of exports into the K-factor calculations) to be undesirable. In

- exposure of parties, who have entered contracts on the basis of the tariff and tariff adjustment mechanism approved by the ACCC in 2003, to loss, and
- tariffs for all users will increase through the operation of the price control mechanism.

The identified potential benefits were:

- the tariff paid by exporters via the WUGS facility would be cost reflective (like most other tariffs) and include a fair share of joint costs, and
- the pricing of similar services (exports via the WUGS facility and exports directly to the SEA Gas pipeline) would be the same, which (along with being cost reflective) would promote efficiency in the use of the GNS.

Most of GasNet's and TXU's submissions deal with the second point under 'detriments' while the first point is also addressed by GasNet. The third point under detriments, and the points under 'benefits' were not addressed. The ACCC is aware of no new information in relation to these points and considers that the analysis set out in section 4.4 remains appropriate.

In regard to the first detriment point (the over recovery of revenues), GasNet claims that the expected increase in revenue is a result of increases in exports (up from 'nil') rather than a result of the proposed change in reset tariffs. To the extent that the proposed revision can be divided into constituent parts, this is true. The ACCC agrees with GasNet that the increased revenue would not come from parties re-injecting gas (except for the time value of the money associated with the rebate) but instead from exporters. However, this revision would not just increase the refill tariff and then rebate this increase to users who reinject the gas into the GNS at a later date. GasNet also proposed to include in the K-factor calculations the volumes that are not reinjected into the GNS.[59] This means, as discussed in the draft decision, that not only would the exporters pay \$0.21/GJ (rather than the \$0.12/GJ paid by those who reinject the gas) but \$0.13/GJ would be recovered from all other users through the K-factor calculations.[60] When considering the proposed revision, this increased revenue is relevant, even if it can be ascribed to users other than those who use the WUGS facility and then reinject into the GNS because it will result from the proposed revision.

In the draft decision, the ACCC noted that the collection of this increased revenue would provide GasNet with the expectation of recovering more than its efficient costs which would be contrary to section 8.1(a) of the Code. GasNet responded, '[a]rguing that increased revenue from an unforseen change in volumes is contrary to section 8.1(a) of the Code could be used to disallow any incentive based tariff model.'[61] The ACCC agrees that if the section 8.1(a) objective was interpreted to rule out any increase (or decrease) in revenue from unforseen changes in volumes then it would rule out the current incentive based tariff model. However, the ACCC did not state that any

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contrast, the intended outcome from the operation of an incentive mechanism of higher than forecast returns is considered desirable.

59 This aspect is affirmed by GasNet in submission 3, pp. 5-6.

60 GasNet's submissions make no comment on this point.

61 GasNet submission 3, pp. 4-6.

increased revenue from changes in volumes were contrary to the section 8.1(a) objective.

When considering a proposed access arrangement or revisions to an access arrangement, the ACCC considers whether the proposal gives a reasonable expectation that the service provider can recover its efficient costs (as it is required to under the section 8.1(a) objective). Subsequent variations in actual volumes (or costs) compared to those forecast will affect revenues, and these variations (negative or positive) can be retained by the service provider as part of the access arrangement’s incentive mechanism. What is important is that at the time of assessing the proposed tariffs, the approved tariffs give the service provider the expectation of recovering efficient costs. The current proposed revision is no different. The ACCC has to consider whether the access arrangement as revised allows GasNet the expectation of recovering its efficient costs. The revision as proposed would allow the expectation that revenues above efficient costs will be recovered, because it provides GasNet with an expectation of revenue greater than that associated with the 2002 revision while forecast costs are those established at the 2002 revision.

GasNet notes that the above argument is based on the knowledge that there are exports via the WUGS facility whereas the 2002 revision used a forecast of zero exports. It argues that the ACCC should consider the impact of this revision in the context of the 2002 forecast and not the present forecast. Viewed from this perspective there would be no forecast exports and the proposed revision would not result in an increase in expected revenue. The ACCC acknowledges this result would arise if the proposed revision was approved. However, the ACCC also notes that if the proposed revision was not approved, there would not be an expected revenue that is less than an amount which would recover efficient costs. As discussed in the draft decision, not approving the proposed refill tariff revision would not result in a decrease in the expected revenues for GasNet over the remainder of the access arrangement period. Thus the ACCC concludes that approving or not approving this revision will not alter GasNet’s expectation of recovering efficient costs.

The second detriment identified above referred to (potential) losses that would be faced by users (in this case, TXU) and, potentially, end users if the revision is approved. TXU has claimed that if this revision is approved, there would be undesirable consequences for competition in the South Australian market, TXU would be unable to pass on the resulting cost increases in a competitively neutral way and that it will suffer a substantial loss.

TXU does not explain what the ‘undesirable consequences’ of approving this revision would be on competition in the South Australian market. It implies that the market generally will suffer because TXU would not be able to compete as well as it does now, but there is no evidence presented as to whether an increase in the refill tariff would place TXU closer or further away from its competitors. That is, an increase in TXU’s costs could result in TXU’s cost disadvantage compared to its competitors increasing (making it more difficult for TXU to compete). Alternatively, the cost advantage that TXU enjoys could be diminished (resulting in increased competition).

Discussing the possible increase in the refill tariff, TXU states that it has an ‘inability … to pass these through in a competitively neutral way’.[62] The ACCC understands that TXU is referring to an economic or competitive inability, rather than a legal inability.[63] In addition, TXU did not explain what it means by a ‘competitively neutral’ way. The ACCC understands TXU’s statement to simply mean that if the refill tariff increases, TXU could not pass on that increase to its customers without affecting its current competitiveness in South Australia.

The ACCC has considered TXU’s claim that it would suffer a ‘substantial’ loss from the approval of this revision. Based on information provided confidentially by TXU to the ACCC, and on other data available to it, the ACCC considers that while the potential loss could be characterised as being material, it may not be large enough to be characterised as ‘substantial’ in the context of TXU’s total business operations in Australia.

In assessing the potential impact of the revision, an important consideration, as noted in the draft decisions document, is the extent that parties entered into contracts on the expectation that the transmission usage charges they faced would be governed by the tariff mechanism approved by the ACCC for GasNet for the period to the end of 2007 (which limited individual tariff increases to CPI-X+2 per cent) and whether it was reasonable to have such an expectation.

The ACCC notes TXU’s submission that part of its ‘competitive standing’ in the South Australian gas customer market is due to it offering contracts to customers ‘based on the expectation that the existing rates of tariff will not increase more than (CPI-X+2) per cent per year until 2007’.[64] TXU submits that its customers ‘would not expect’ to incur higher charges ‘on the basis of a regulatory ruling in Victoria’. On the basis of TXU’s submission, it would appear that its customers would have had a reasonable expectation that individual tariff increases would have been limited to CPI-X+2 per cent for the period to the end of 2007.

Nevertheless, while TXU submits that it entered into these contracts ‘based on the expectation that the current tariff will continue through to 2007’, the ACCC understands that major direct participants in the natural gas sector are generally aware of the key provisions of the regulatory regime. That is, key participants are aware that section 2.28 of the Code permits a service provider to propose revisions to its access arrangement at any time.

TXU’s Victorian gas distribution business, TXU Networks (Gas) Pty Ltd, proposed unscheduled revisions to its access arrangement on 27 June 2000. The Office of the

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62 TXU submission 2, p. 2.

63 As GasNet notes, TXU does not claim that it cannot pass through any tariff increases to its customers. In its analysis for the draft decision, the ACCC took into consideration the possibility of TXU facing commercial and legal limitations on its ability to pass on tariff increases. It now understands that TXU’s argument only refers to a commercial inability. See point 8 on page 2 of TXU submission 2.

64 TXU submission 2, p 1.

Regulator-General (ORG) subsequently rejected those revisions, specifying the following three reasons:[65]

- the revised access arrangement would reduce the incentive to reduce costs across a substantial part of TXU's operations, whereas any benefits would only accrue in relation to a very narrow class of projects
- a mid-term revision would mitigate the effectiveness of incentive based regulation applying to TXU, and
- the interpretation and application of the proposed revision would be likely to give rise to disputes at future price reviews.

The ACCC understands that TXU was aware at the time it negotiated contracts with its South Australian customers that GasNet had the ability to propose unscheduled revisions to its access arrangement. However, TXU may have discounted the likelihood of GasNet proposing such revisions and them being approved by the ACCC in light of its own experience. The ACCC acknowledges that there is little precedent of regulators considering such revisions. However, it is not clear to what extent the facts of the 2000 TXU matter, and the reasons published by the ORG, would have encouraged TXU to conclude that any proposed revisions by GasNet during its current access arrangement period would be unlikely to be successful.

GasNet refers to the fact that exports from the WUGS facility are only charged the refill tariff, as a 'loophole' which TXU is exploiting and suggests that TXU (or any user) should know there is a risk that a loophole could be closed at any time. The ACCC considers that a large user like TXU would be sufficiently familiar with the pricing principles in GasNet's access arrangement to conclude that the ability to export gas via the WUGS facility at the cost of the refill tariff was unintended. However, as noted above, TXU may have reasonably expected that this 'loophole' would not be closed until the next scheduled review in 2007.

To summarise, if the revision is approved:

- TXU will face some detriment, paying 9c/GJ more than it currently does on exports via the WUGS facility. It will suffer through reduced profits, or pass on the tariff increase to its customers with detriment to its competitive position
- users as a whole will have to fund the other 13c/GJ that will enable GasNet to recover the average revenue on the volumes exported via the WUGS facility, and
- exports via the WUGS facility will face a cost reflective tariff that will promote efficient use of the GNS.

If, as GasNet argues, a comparison is made between the proposed revision and the expectations in 2002, GasNet will have the expectation of recovering efficient costs whether or not this revision is approved. The ACCC considers the advantages of the third point above are outweighed by the disadvantages of the first and second points. It also considers that the new information presented in submissions in response to the

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[65] Office of the Regulator General, *Application for revision to Westar's (TXU) gas access arrangement*, February 2001, p. 26.

draft decisions, while providing a different perspective on some issues, does not alter the ACCC's analysis in the draft decisions to the extent that it should depart from the draft conclusion. Consequently, the ACCC does not approve this revision.

5 Weather pattern

GasNet proposes to adjust the demand forecasts in the access arrangement to reflect a warming shift in the Victorian weather pattern.

5.1 Current access arrangement provisions

The tariffs currently in the access arrangement are based on demand projections set out in VENCorp's November 2001 *Annual Gas Planning Review 2002 to 2006,* but with yearly totals reduced by an average of 0.9 PJ to account for a warming trend identified by GasNet. The warming trend was expressed as a reduction of 5.5 Effective Degree Days (EDD) per year from the base of 1445 EDD for 2001.

In September 2002, during the ACCC's assessment of GasNet's scheduled revisions to the access arrangement, GasNet submitted some evidence of a greater shift in weather pattern. However, GasNet chose not to submit revised volume forecasts at that time so that the approval process would not be delayed by a further round of public consultation. The ACCC noted in its final decision document 'that GasNet may seek an early review of its revised access arrangement if it has sufficient evidence to support its contention that a further warming trend in terms of 10 peak days needs to be accommodated'.[66]

5.2 GasNet proposal

GasNet is proposing to adjust the demand forecasts in the access arrangement to reflect the shift in the Victorian weather pattern for which it says it now has new evidence. In particular, GasNet notes that VENCorp has incorporated the shift in its 2003 annual planning review forecasts. GasNet's proposal would reduce the current forecasts by 1.53 PJ each year, which would increase the average transmission tariffs for 2004-2007 by an average of 0.65 per cent. The annual impact on GasNet's forecast revenue would be an increase of $0.5 million.

5.3 Submissions to proposed revisions

Origin submits that the ACCC's comments in the 2002 final decision document, acknowledging that GasNet may seek a mid term revision if further evidence of a warming shift emerged, were framed in terms of the impact of the warming trend on 10 peak days and not the annual demand. Origin also submits that part of the proposed revision has a retrospective effect which is inappropriate. Origin notes that VENCorp, in its 2003 review of EDD, did not accept that there has been a recent step change in the climate. It considers that any adjustment to the demand forecasts to reflect a step change in weather patterns should be done after VENCorp's proposed 2005 review of the weather standard in which this issue will be considered in the context of broad consultation with industry.[67]

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66 ACCC, Final Decision 2002, p. 205.

67 Origin submission, pp. 2-3.

TXU considers that the question of whether a warming trend has caused reduced demand is too complex to clearly answer. It does not consider clear evidence to be available and states that the trend is not supported by 2003-2004 actual demand data. TXU notes that allowing a mid term review introduces asymmetry into the regulation of the GNS and questions whether the ACCC would, if it could, request a variation to the access arrangement if forecast volumes were too low. It also questions whether this asymmetry was factored into the cost of capital at the recent review.[68]

AGL supports the proposed alteration to forecast volumes.[69] EnergyAdvice considers that the revision is reasonable and in accordance with the principles of the Code and the spirit of the access arrangement.[70]

5.4 ACCC's draft considerations

As noted in the submissions, the ACCC's comments in its 2002 final decision document which acknowledged GasNet's discretion to initiate an unscheduled revision were framed with respect to 10 peak days demand and not the annual demand.[71] These comments were made in that context because GasNet had suggested a modification to the peak demand forecasts which the ACCC considered not to be appropriate at that time. GasNet had not proposed a modification to the annual demand forecast it presented in the March 2002 proposed revisions.

The comments made in the submissions and by GasNet suggest a misinterpretation of the ACCC's comment. The ACCC was simply acknowledging that under the Code, GasNet (like any other service provider), is able to propose revisions at any time. It was not a concession made to GasNet because there was not time to consider the issue in 2002 and still implement the new tariffs at the beginning of 2003. Neither was it an endorsement of GasNet's proposal.

In response to concern expressed in the submissions that allowing an unscheduled review introduces asymmetry into the regulation of the GNS, the ACCC reiterates that the Code has always explicitly stated that service providers may submit unscheduled revisions at any time, and thus any such asymmetry has always been an aspect of the gas regulatory regime. This was the context in which the ACCC considered the cost of capital in the 2002 GNS review, and indeed in its assessment of all access arrangements for gas pipelines under the Code.

GasNet presents this weather pattern revision as a correction of incorrect information currently in the access arrangement.[72] As noted in chapter 2, the ACCC does not agree with such a characterisation. The volume forecast proposed by GasNet for the 2002 access arrangement revision was based on the information available at the time. GasNet's current proposed EDD calculation (that is, this revision) is based on later evidence which it claims is 'more conclusive and reliable than the evidence on which

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68 TXU submission, pp. 4, 8.

69 AGL submission, p. 2.

70 EnergyAdvice submission, p. 2.

71 ACCC, Final Decision 2002, p. 205.

72 GasNet application, p. 24.

GasNet relied in March 2002.'[73] This, however, does not logically lead to a conclusion that the adjusted forecast is a 'correct' or 'accurate' forecast compared to an 'incorrect' or 'inaccurate' forecast in 2002. Unless an outcome is exactly the same as a forecast, it is inappropriate to label a forecast as accurate. This certainly cannot be claimed in advance of knowing the outcome. GasNet's new forecast could be claimed to be more 'conclusive and reliable' than the previous forecast (as GasNet does). It could also be described as more up to date, which would be expected of any forecast made at a later date using consistent methodology. Similarly, it would be expected that a forecast made in the future will be more reliable and up to date than a current forecast. Thus, the ACCC rejects the suggestion that it should accept this revision on the grounds that this would correct an error. The ACCC has considered this revision on the same basis as any other revision it may receive under section 2.46 of the Code.

While the ACCC does not accept the 'correcting errors' argument, it does recognise that this revision is intended to implement a solution to an issue GasNet raised during the 2002 revisions assessment and is not seeking to revise the whole volume forecast (for example, by adopting the VENCorp November 2003 forecast in total). The ACCC considers that this is a relevant factor to take into account when balancing the competing factors in section 2.24 of the Code. The ACCC considers that it is appropriate for a revision of this nature to be made during an access arrangement period as it is designed to resolve an issue that was identified but unable to be settled at time of the last scheduled review and does not alter the incentive properties or any other fundamental properties of the access arrangement.

TXU questions whether there is sufficient evidence for the warming trend. However, the ACCC notes Origin's submission to VENCorp that it 'believes that there has been a step change in the climatic patterns over this nine year period, and therefore that last nine years may not be representative of current EDD trends. Origin considers that an annual EDD standard of 1396 is too high given recent annual weather patterns.'[74] Despite this, Origin suggests that the ACCC should reject GasNet's proposed step change. However, as the ACCC understands the proposed revision, GasNet is not proposing a step change. It is proposing that the trend, which was incorporated in the volume forecasts of the access arrangement in 2002,[75] be increased.[76]

The ACCC notes that this trend has been adopted by VENCorp which conducted a rigorous and transparent public consultation process as part of its 2003 review of the weather standard (to which TXU made no submission). The ACCC considers that the methodology and approach adopted by VENCorp should allow parties to have confidence in its findings on this matter. GasNet is merely proposing that the same trend at the same quantum be incorporated into its access arrangement. The ACCC sees

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73 ibid., p. 25.

74 Origin Energy, *Submission on the recommendations of VENCorp review of EDD weather standards used for forecasting annual and peak day gas demand,* 25 July 2003.

75 Origin claims that in 2002 the ACCC did not accept the inclusion of a trend (Origin submission, p. 2). This is not correct: see section 5.1 of this document and ACCC, Final Decision 2002, p. 204.

76 GasNet's use of 'step change' in 2002 referred to the observation that if the warming trend was incorporated into the forecast volumes then a comparison of forecast demand from the 1998 access arrangement and the 2002 revision reveals a significant drop, or step, between 2002 and 2003. See ACCC, Final Decision 2002, p. 204.

no reason to dismiss VENCorp's conclusions and no reason to wait until this matter is reconsidered by VENCorp in 2005 (as Origin suggests).

GasNet is proposing to vary its demand forecasts for 2004-2007 and its tariffs for 2005-2007. While GasNet is not proposing that the tariffs for 2004 be changed, which would be difficult to implement, it is proposing that the volume forecast for 2004 be changed because this feeds into the calculation of the average tariff appropriate for 2004. When this new average tariff is used in the calculation of the 2005 tariffs at the annual reset, a larger under recovery (or smaller over recovery) will be calculated by the K-factor mechanism than currently would be the case and the tariffs for 2005 will be increased accordingly. Thus, without changing the 2004 tariffs, GasNet will achieve the revenue it would have obtained if the 2004 tariffs had been changed at the beginning of 2004 (though the revenue would only be received in 2005).

The ACCC is concerned that approval of this proposed weather pattern revision would have the effect of users, as a group, paying higher tariffs for gas transported during 2004 than anticipated when they made their gas transportation decisions. The ACCC considers that users should be able to rely on published tariffs and not have them increased after the relevant gas has been transported (even if the increase is only conceptually, through the operation of the K-factor adjustment mechanism). The ACCC also notes that in 2002, GasNet was only proposing that its later change to demand forecasts would alter the forecasts for 2005-2007.[77]

The ACCC notes that in its response to comments on retrospectivity in the submissions, GasNet does not mention the above issues but simply points out that the maximum tariff users can face in each of the next three years will not increase as it will be capped by the CPI-X+2 formula.[78] This is true, but it does not address the point that the likelihood of that cap being reached would be enhanced by this proposed revision and that part of the increased tariffs and revenue as a result of this revision would relate to gas that has already been transported.

In summary, the ACCC considers the proposed adjustment for the warming trend to be an appropriate component of the formulation of demand projections for Victoria. However, it is not convinced of the merits of the adjustment to the 2004 volumes. Even though there would be no retrospective change to tariffs, the adjustment would result in GasNet deriving increased revenue relating to volumes in almost a year before this decision and more than half a year before its application was submitted.

While the ACCC has concerns about the adjustment to the 2004 volumes, it has considered these within the context of the Code provisions relevant to a proposed unscheduled revision which only allows it to approve or not approve the revision as a whole. The ACCC is mindful that this is a small revision which would have a small effect on tariffs. The ACCC considers the incorporation of the proposed weather adjustment into the volume forecast, and the consequential 0.65 per cent rise in average tariffs, will increase the probability of GasNet achieving its target revenue and thus

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77 GasNet, *GasNet's Response to Draft Decision*, 20 September 2002, p. 36. GasNet acknowledges this in its application, p. 22.

78 GasNet response, p. 12.

recover its efficient costs (section 8.1(a)). The proposed revision is to a forecasting parameter rather than actual results and the ACCC considers that the approval of this revision will not alter the incentive properties of the access arrangement.

The ACCC understands that the small tariff increase would add marginally to users' costs. Accordingly, it expects that users and prospective users would prefer that the proposed revision not be approved by the ACCC. However, to not approve the revision would be disproportionately contrary to GasNet's legitimate business interests (section 2.24(a) of the Code).

On balance, the ACCC considers that GasNet's interests in having a target revenue based on the proposed forecast volumes outweighs the small effects on users and prospective users (section 2.24(f)) and of end use customers (as incorporated in consideration of the broader public interest under section 2.24(e)). Having regard to this, the ACCC is satisfied that the access arrangement as revised with this revision would contain the elements and satisfy the principles set out in section 3.1 to 3.20. Accordingly, the ACCC proposed to approve this proposed revision to alter the demand forecasts in GasNet's access arrangement for the years 2004 to 2007.

5.5 Submissions to draft decision

No submissions received after the release of the ACCC's draft decisions referred to this proposed revision.

5.6 ACCC's considerations

The ACCC is aware of no new information relative to the issue and considers that the analysis and conclusion set out in its draft decision document remain appropriate. Consequently, the ACCC approves the weather pattern revision.

6 Timing

GasNet proposes a mechanism to allow implementation of the proposed revisions for the calculation of the 2005 tariffs.

6.1 Current access arrangement provisions

Each November, as required by the access arrangement, GasNet lodges for the ACCC's approval a calculation of its tariffs for the following year. This incorporates both the CPI-X and the K-factor adjustments and any pass through amounts. The ACCC is required to approve or not approve the new tariffs within 20 business days. The process anticipates the new tariffs commencing on 1 January of the new year.

6.2 GasNet proposal

The weather pattern revision, if approved by the ACCC, will result in changes to the average tariffs that feed into the 2005 tariffs to be calculated in 2004. In addition, if approved, the K-factor revision would impact on the 2005 annual reset calculation. However, the changes to the access arrangement consequent to these revisions may not come into effect in time to be incorporated into GasNet's lodgement of its 2005 tariff reset application which is due on or before 17 November 2004.[79] As a result, the revisions may not be implemented until the calculation of the 2006 tariffs.

GasNet proposes to add to the access arrangement a mechanism which, if the current proposed revisions are approved after the November reset is lodged with the ACCC, allows it to resubmit the reset calculations accommodating the effect of the revisions.

6.3 Submissions to proposed revisions

AGL supports this proposal.[80] Origin, TXU and EnergyAdvice did not comment.

6.4 ACCC's draft considerations

The ACCC notes that the purpose of the revision is to incorporate the 2004 and 2005 weighted average tariffs into the annual reset calculations this year. In the absence of this timing revision, depending on when the ACCC makes its final decision, GasNet may not receive any benefit from the ACCC's approval of the change to the 2004 volume forecast. In addition, without this revision, GasNet may not benefit from ACCC approval of the K-factor revisions or benefit from a change in 2005 volumes until 2006. This would be contrary to GasNet's legitimate business interests (see section 2.24(a) of the Code).

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[79] Clause 3.1 in Schedule 3 of GasNet's access arrangement requires GasNet to lodge its proposed tariffs for the following year at least 30 business days before the start of that year. Pursuant to section 2.48 of the Code, GasNet's revisions would come into effect no earlier than 14 days after the ACCC makes its final decision.

[80] AGL submission, p. 2.

The ACCC considers that this proposed revision is of a mechanical nature. As noted above, the ACCC does not favour the retrospective effect of the change to the 2004 volumes forecasts. However, this concern was not sufficient to persuade it not to approve the weather pattern revision in total. The ACCC has also considered this issue in reference to this timing revision. It considers that although there would be benefit in not approving the revision because this would remove the retrospective element of the weather revision, it does not outweigh the benefits of approving this revision to allow the K-factor revision to be implemented for the 2005 tariffs.

A typographical error appears in the proposed revision that the ACCC expects GasNet will correct when it lodges the complete revised access arrangement document at the end of the current approval process.[81]

Accordingly, the ACCC proposed to approve this revision relating to the timing of tariff adjustments.

6.5 Submissions to draft decision

No submissions received after the release of the ACCC's draft decisions referred to this proposed revision.

6.6 ACCC's considerations

The ACCC notes that, in fact, this final decision has not been issued in time for the K-factor and weather revisions to be incorporated in the tariff reset which was lodged on 16 November 2004. Thus, this timing revision is necessary to implement these two revisions for the 2005 tariffs.

The ACCC is aware of no new information relative to the issue and considers that the analysis and conclusion set out in its draft decision document remain appropriate. Consequently, the ACCC approves the proposed timing revision.

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81 On page 43 of GasNet's application, in clause 3.7(c), the reference to 'clause 3.5' should be to 'clause 3.6'.

7 Information provision

7.1 Code provisions

In conjunction with its proposed access arrangement (or revised access arrangement), a service provider is required to submit access arrangement information in accordance with the criteria established in Attachment A of the Code. The service provider’s access arrangement information must contain information that, in the opinion of the regulator, is sufficient to enable users and prospective users to:

- understand the derivation of the elements in the proposed access arrangement described in sections 3.1 to 3.20 of the Code, and
- form an opinion as to the compliance of the access arrangement with the provisions of the Code (section 2.6).

7.2 GasNet proposal

GasNet notes that incorporation of the proposed weather pattern revision would require consequential amendments to its access arrangement information and has provided those proposed changes in Schedule 2 to its application.[82]

7.3 Submissions to proposed revisions

No submissions were received from interested parties on this matter.

7.4 ACCC’s draft considerations

The ACCC considers that the existing access arrangement information continues to satisfy the relevant Code requirements other than with respect to the weather pattern revision. The ACCC considers that the access arrangement information would fully comply once the proposed changes listed in Schedule 2 of GasNet’s application are incorporated.

7.5 Submissions to draft decision

No submissions received after the release of the ACCC’s draft decisions referred to this issue.

7.6 ACCC’s considerations

The ACCC is aware of no new information relative to the issue and considers that the analysis and conclusion set out in its draft decisions document remain appropriate.

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[82] GasNet application, p. 5.

8 Final decisions

GasNet submits that each proposed access arrangement revision is independent and acceptance or rejection of one would not require acceptance or rejection of the others:

> GasNet seeks each Revision both individually and collectively in each combination of two or more Access Arrangement Revisions.[83]

The ACCC accepts this form of revisions to the access arrangement. It has made separate draft decisions with respect to each of the four proposed access arrangement revisions.

Pursuant to section 2.38(a)(i) of the Code, the ACCC approves the following revisions:

- K-factor revision
- Weather pattern revision
- Timing revision.

The timing of the commencement of the revised access arrangement is at the ACCC's discretion. The ACCC has decided that these revisions are to come into effect on 1 January 2005. This will align with the commencement of GasNet's revised tariffs for the 2005 calendar year following its annual tariff rest.

Pursuant to section 2.38(a)(ii) of the Code, the ACCC does not approve the following revision:

- Refill Tariff revision.

The ACCC's reasons for these decisions are set out in this decision document.

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83 ibid., p. 4.

Appendix: Submissions from interested parties

To the proposed revisions

Origin Energy	29 September 2004
TXU	30 September 2004
AGL Victoria	4 October 2004
EnergyAdvice	8 October 2004
GasNet	14 October 2004
TXU	28 October 2004

To the draft decision

GasNet	19 November 2004
GasNet	26 November 2004
TXU	1 December 2004
GasNet	2 December 2004