



Australian
Competition &
Consumer
Commission

Final Decision

**Revised access arrangement
by GasNet Australia (Operations)
Pty Ltd and GasNet (NSW) Pty Ltd
for the
Principal Transmission System**

30 April 2008

File: M2007/220

**Commissioners
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Contents

Overview	iii
Abbreviations and glossary	vii
Summary	xi
1. Introduction.....	1
1.1. Access arrangement revisions	1
1.2. Consultative process	2
1.3. Criteria for assessing revisions to access arrangements.....	2
1.4. The previous access arrangement assessment.....	5
1.5. Regulatory framework	5
1.6. Background	6
2. Reference tariff method.....	10
2.1. Reference tariff policy	10
2.2. Reference tariff methodology	10
3. Capital base	12
3.1. Roll forward of the capital base	12
3.2. New facilities investment.....	17
3.3. Forecast capital expenditure.....	23
3.4. Capital redundancy	55
3.5. Depreciation	56
4. Rate of return	61
5. Forecast revenue and revenue elements.....	73
5.1. Non-capital costs.....	73
5.2. Pass-through events.....	90
5.3. Inflation.....	95
5.4. Volumes	96
5.5. Revenue.....	104
6. Reference tariffs	111
6.1. Cost allocation and tariff structures	111
6.2. Reference tariff path.....	154
6.3. Reference tariff variation policy	158
6.4. Reference tariff principles.....	170
7. Performance and incentives	171
7.1. Incentive mechanisms	171
7.2. Key performance indicators	173
8. Non-tariff elements	175

8.1.	Services policy	175
8.2.	Terms and conditions	177
8.3.	Capacity management policy	180
8.4.	Queuing policy	181
8.5.	Extensions and expansions policy.....	183
8.6.	Review of the access arrangement	189
9.	Final decision	190
10.	Amendments	191
	Appendix A: Submissions.....	201
	Appendix B: Attachment A of the code	202
	Appendix C: Gas Transportation Deed Principles	203
	Appendix D: Consultant reports	205
	Appendix E: Pipeline map.....	206

Overview

On 30 April 2007, GasNet submitted a revised access arrangement (AA) for the Victorian Principal Transmission System (PTS) for the period 2008–12 to the Australian Competition and Consumer Commission (ACCC) for approval under the *National Third Party Access Code for Natural Gas Pipelines* (the code).

The PTS is the main high pressure gas transmission pipeline network in Victoria and is owned and maintained by GasNet, and operated by the Victorian Energy Networks Corporation (VENCorp). The PTS is a covered pipeline under the code and is also subject to a market carriage capacity management system, where users are charged for actual usage and not on a contractual basis for a specified quantity of service.

GasNet proposed to increase reference tariffs between the AA2 (the first scheduled revision following AA2 covering the period 2003-07) and AA3 (the second scheduled revision which is proposed to cover the period 2008-12) periods by 36 per cent on average in real terms, from \$0.295/GJ (the average tariff at the end of the AA2 period) to \$0.401/GJ (the average proposed tariff at the commencement of the AA3 period). In addition to this step change, GasNet proposed an annual real average increase for the majority of its reference tariffs of 2.8 per cent per annum over the AA3 period. These proposed increases can principally be attributed to:

- the actual annual volume/tariff mix outcomes during the AA2 period which required GasNet to reduce tariffs through the period, such that in 2007 tariffs were 15 per cent lower than if the original allowed tariff path in 2002 (forecast volume/tariff mix) had been followed
- the proposed increases in operating costs (30 per cent increase) and capital expenditure (400 per cent increase)
- The proposed lower forecast volumes (2 per cent lower) for the AA3 period in comparison to the AA2 period.

GasNet submitted that increased investment is required to refurbish and upgrade assets as they age and deteriorate and also to augment the PTS, particularly in the northern parts of the state, to accommodate anticipated increases in demand over the AA3 period in certain areas. Similarly, GasNet submitted that increased operating costs are due to an expansion of the network and are also required to recover the costs associated with changes in regulatory and technical requirements.

In relation to volume forecasts, GasNet originally proposed 2 per cent lower aggregate annual volume forecasts for the AA3 period than the AA2 period. This forecast reduction was based on VENCorp's earlier (2006) volume projections which included a stronger weather warming trend compared to previous years. It also reflected GasNet's more modest forecasts of gas usage by gas powered generation (GPG). Following the draft decision, GasNet submitted revised 2007 VENCorp forecasts which updated the weather warming effect and concluded this effect is even more severe than previously assumed, which would lead to even lower volumes.

This final decision accepts the majority of GasNet's refurbishment and upgrade capex proposals. Regarding GasNet's augmentation proposals, however, the ACCC maintains its primary view from its draft decision that a number of these projects can either be deferred until after the AA3 period and do not meet the requirements of the code, on the basis of an independent review prepared by Sleeman Consulting and further modelling by VENCORP. This results in total approved capex (capital expenditure) of \$187.8 m compared to \$93.1 m in the draft decision and \$334.1 m proposed by GasNet in its AA revisions.¹ This final decision also accepts the majority of GasNet's proposed operating costs. In its draft decision, the ACCC proposed reductions in corporate overheads resulting from cost savings expected from the APA Group's acquisition of GasNet in 2006. The ACCC has reconsidered its draft decision and has allowed GasNet to retain any cost savings for a period of time after which any savings will be passed on to users.

In considering GasNet's volume forecasts, including its GPG forecasts, the ACCC considered that GPG volume forecasts in particular may not reflect recent volume growth trends as a result of the impact of drought conditions on electricity generation. The ACCC engaged ACIL Tasman who modelled the electricity market over the AA3 period accounting for variables including drought impacts and the likely timing of any comprehensive emissions trading scheme. In its draft decision, the ACCC, consistent with ACIL Tasman views, adopted higher GPG forecasts. The ACCC also considered that it is possible that the increased development of emission schemes over future periods may trigger the need for potential capital expenditure to facilitate further GPG expansion. It considered, however, that the impacts of emission trading schemes are likely to materialize in subsequent AA periods.

This final decision accepts the updated 2007 VENCORP aggregate annual volume forecasts, which when combined with the ACCC required GPG volumes results in projected aggregate annual volumes for the AA3 period which are 3 per cent lower than for the AA2 period.

The combined effect of the ACCC's final decision to reduce GasNet's proposed capital and operating costs, a higher required rate of return (reflecting increased borrowing costs) and reductions in overall forecast volumes relative to GasNet's initial proposals for the AA3 period, is expected to result in an increase in the real average tariff by 51 per cent between 2007 and 2008. It will also increase the average tariff annually by a further 2.8 per cent over the remainder of the AA3 period. This compares to GasNet's proposal of a 36 per cent increase between 2007 and 2008 and a 2.8 per cent annual increase for the remainder of the period.

This increase of the initial real average tariff to \$0.446/GJ (compared to GasNet's proposed \$0.401/GJ and the draft decision of \$0.343/GJ) is principally due to the following factors:

- an increase in the nominal rate of return (9.01 per cent proposed initially by GasNet and the approved rate of return for this final decision of 10.55 per cent). This increase

¹ . Notwithstanding the ACCC's decision, the code also allows GasNet to submit capex proposals to the ACCC for approval at any time during the AA period.

is due to the increased cost of borrowing which reflects ongoing global credit conditions impacting on the domestic financial market

- annual volume forecasts decreasing further as a result of the incorporation of 2007 VENCORP volume projections reflecting stronger weather warming impacts than the previous 2006 volume projections.

GasNet proposed a number of changes to its reference tariffs including: its cost allocation methodology for deriving tariffs; introducing a postage-stamp tariff for tariff-V (small) users; and levying the peak injection tariff on winter volumes instead of the top 10 peak winter period days. In its draft decision, the ACCC proposed not to approve any of these proposed changes on the basis that they would result in reference tariffs which are less cost reflective in both the short-run and long-run. The ACCC maintains in its final decision that ensuring tariffs are cost reflective will facilitate efficient usage and investment decisions by users and is consistent with the requirements of the code. Similarly, the ACCC maintains that GasNet's proposal to levy the peak injection tariff on winter volumes will not provide users with the incentive to minimise usage on peak system days.

The ACCC has also identified that GasNet will receive revenue from issuing and administering Authorised Maximum Daily Quantity (AMDQ) /credit certificates under the Market and System Operations (MSO) rules over the AA3 period. AMDQ/credit certificates provide benefits to market participants in the form of preferential access to the PTS (i.e. priority in the event of load shedding and in tied bidding) and also in the form of risk mitigation (i.e. avoidance of uplift payments). In its draft decision, the ACCC expressed a concern that revenues from the sale of these instruments would result in GasNet earning more than its efficient costs. Stakeholders have in addition expressed the view that AMDQ revenue should be regulated and that the allocation of AMDQ/credits should be more transparent.

The ACCC considered that establishing a regulated tariff for AMDQ/credit certificates would undermine the development of a tender process for these instruments as envisaged in the MSO rules and suggested by GasNet. Such a process is expected to better reflect the value placed on AMDQ/credit certificates by participants, and also result in a transparent and efficient allocation of these instruments. The ACCC also considered regulating the revenues from AMDQ/credit certificates as a rebatable service under the code, which would not require a regulated tariff and would allow a tender process to be implemented. This was not pursued given uncertainties in satisfying the code definition of rebatable services which requires market separation between the rebatable service and the reference service.

The ACCC notes that there are broader issues regarding the use of AMDQ/credit certificates by the industry that are likely to justify a review and potential amendments to the MSO rules. Firstly, the ACCC considers that the relative roles of VENCORP and GasNet under the MSO rules with respect to the allocation of AMDQ/credit certificates should be clarified. Secondly, the role of AMDQ/credit certificates in the operation of the Victorian gas market is unclear and has already been the subject of a broader review by

VENCorp in 2004.² Specifically, this noted various limitations of AMDQ/credit certificates as a mechanism for users to invest in pipeline expansions, a criticism also repeated by stakeholders as part of GasNet's access review. VENCorp's recommendations were made to the Victorian Government and the ACCC understands that these are still under consideration. The ACCC considers that it would be preferable to reconsider both the need for and form of regulation of AMDQ/credit certificates following further consideration of VENCorp's recommendations or following a separate review of the MSO rules. In the interim, GasNet has advised that, for future investments not funded by participants, it will auction AMDQ/credit certificates transparently to the highest bidder which would address a concern the ACCC has heard from market participants that they have previously been omitted from the allocation process.

As well as the aspects highlighted above, the ACCC has considered as part of this final decision a range of other issues including capital and non capital expenditure, tariff setting, prudent discount proposals, the form of price control, as well as non price terms and conditions. The ACCC requires as part of this final decision amendments to be made to GasNet's Access Arrangement which include alterations to its expansions policy, services policy, the inclusion and removal of certain prudent discounts, as well as adjustments to its price control formula and process for applying for tariff variations.

Until recently, both GasNet and VENCorp were service providers under the code. However, legislation implemented in 2007 by the Victorian Government has removed the requirement for VENCorp to submit an AA to the ACCC for approval. Instead, VENCorp will continue to operate the PTS in accordance with the MSO rules and be responsible for the queuing policy (which sets out the policy for the allocation of spare and developable capacity). VENCorp will no longer have a direct commercial relationship with gas users. This means the gas transportation deeds (GTD), which provide terms and conditions in respect of the gas transportation service for users will now be agreed between GasNet and users rather than VENCorp and users. This requires GasNet to include a standard GTD as part of its revised AA, whereas previously this was included as part of VENCorp's AA.

This final decision proposes 42 amendments the ACCC considers are necessary in order for it to approve GasNet's proposed AA.

It should be noted that under the Australian Energy Market Agreement between the Commonwealth and the states, a new national gas law will be introduced in 2008, which amongst other things, will change the regulatory arrangements for gas transmission and distribution networks. In the case of gas transmission networks, regulatory responsibilities will be transferred from the ACCC to the Australian Energy Regulator (AER). In the meantime, the AER has provided advice to the ACCC in its assessment of GasNet's proposed AA.

² VENCorp, *Victorian Gas Market Pricing and Balancing Review, Final Recommendations to Government*, 30 June 2004.

Abbreviations and glossary

AA	Access arrangement
AAI	Access arrangement information
AA1	The access arrangement approved in 1998 in which GasNet's initial capital base was set
AA2	The first scheduled revision of AA1 covering the period 2003–07
AA3	The second scheduled revision following AA2 which is proposed to cover the period 2008–12
AA4	The third scheduled revision following AA3 anticipated to cover the period 2013–17
ABDP	Amadeus Basin to Darwin pipeline
ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
APA	APA is the Australian Securities Exchange code for Australian Pipeline Trust, GasNet's parent company
AMDQ	Authorised maximum daily quantity
AS	Australian standard
ASX	Australian Securities Exchange
Bppa	Basis points per annum
Capex	Capital expenditure
CAPM	Capital asset pricing model
CGS	Commonwealth Government Securities
Code	National Third Party Access Code for Natural Gas Pipeline Systems
CPI	Consumer price index
Dandenong LNG storage	Dandenong Liquefied Natural Gas storage
DORC	Depreciated optimised replacement cost

DBNGP	Dampier to Bunbury natural gas pipeline
DVP	Dawson Valley pipeline
EAPL	East Australian Pipeline Limited
EDD	Effective degree day
EGP	Eastern Gas pipeline
ERA	Economic Regulatory Authority (Western Australia)
ESC	Essential Services Commission (Victoria)
ESCOSA	Essential Services Commission of South Australia
FRC	Full retail contestability
GAPR	VENCorp gas annual planning report
GasNet	GasNet Australia (Operations) Pty Ltd which lodged the proposed revised AA and GasNet (NSW), the other owner of the PTS
GJ	Gigajoule (1 000 000 000 joules)
GPG	Gas powered generation
GTD	Gas transportation deed
ICRC	Independent Competition and Regulatory Commission
IDC	Interest during construction
IPART	Independent Pricing and Regulatory Tribunal
IPO	Initial public offer
IRR	Internal rate of return
KPI	Key performance indicators
LNG	Liquefied natural gas
m	Million
MAOP	Maximum allowable operating pressure
MAPS	Moomba to Adelaide pipeline system
MDQ	Maximum daily quantity
MCE	Ministerial Council on Energy
MRP	Market risk premium

MSP	Moomba to Sydney pipeline
MSO rules	Market and System Operations Rules
MVP	Murray Valley Pipeline
NCC	National Competition Council
NEM	National Electricity Market
NER	National Electricity Rules
NFI	New facilities investment
NPV	Net present value
opex	Operating and maintenance expenditure
PJ	Petajoule (equal to 1 000 000 Gigajoules)
PTS	Principal Transmission System (Victoria)
QCA	Queensland Competition Authority
RBA	Reserve Bank of Australia
RBP	Roma to Brisbane pipeline
SEA	Service envelope agreement
SRP	Statement of regulatory principles
SWP	Southwest pipeline
TJ	Terajoules (equal to 1 000 Gigajoules)
Tribunal	The Australian Competition Tribunal
UGS	Underground gas storage
VENCorp	Victorian Energy Networks Corporation
WAAV	Weather adjusted actual volumes
WACC	Weighted average cost of capital
WTS	Western Transmission System
WUGS	Western Underground Storage

Summary

Introduction

On 30 April 2007, GasNet³ submitted a revised access arrangement (AA) for the Principal Transmission System (PTS) to the Australian Competition and Consumer Commission (ACCC) for approval under the *National Third Party Access Code for Natural Gas Pipelines* (the code). This is the ACCC's second scheduled review, following the second AA it approved in 2002.

GasNet is part of the APA Group, the owner of the PTS. The Victorian Energy Networks Corporation (VENCorp) is the operator of the PTS, and until recently, both have been designated as service providers under the code. This has meant that in the past the terms and conditions of access to the PTS have been provided in GasNet and VENCorp's AAs and revisions sought for these AAs have been considered concurrently. This arrangement, however, has been altered by Victorian legislation to remove VENCorp's obligation to submit a revised AA to the relevant regulator for approval.

The PTS (also known as the GasNet system) is the primary system for the transmission of natural gas at high pressure in Victoria. The PTS is not a traditional point-to-point pipeline as there are a number of injections and withdrawal points. Gas injected into the PTS is primarily delivered into Victoria's gas distribution network and serves approximately 1.4 m residential users, 45 000 industrial and commercial users as well as some electricity generators. In addition, a small amount of gas is exported and some gas is provided for storage.

Draft decision

After considering GasNet's proposals and submissions by interested parties, the ACCC made a draft decision which proposed not to approve GasNet's proposed AA in its current form. The draft decision set out the proposed amendments (or nature of the proposed amendments) which the ACCC considered necessary in order for the proposed revised AA to be approved.

Interested parties were invited to make written submissions on the draft decision by close of business on 14 December 2007. The ACCC received submissions from the service provider and 12 interested parties.

³ Clause 9.3 of the Proposed Access Arrangement advises that both GasNet Australia (Operations) Pty Ltd and GasNet Australia (NSW) Pty Ltd are owners of the PTS and all references to GasNet in the Proposed Access Arrangement should be taken to refer to both GasNet Australia (Operations) Pty Ltd and GasNet Australia (NSW) Pty Ltd severally.

Final decision

The ACCC has considered the issues in submissions by interested parties and by GasNet. It has made a final decision not to approve the revised AA. This final decision document sets out the ACCC's considerations on the issues raised in response to the draft decision and the amendments (or nature of the proposed amendments) which the ACCC considers necessary in order for the proposed revised AA to be approved.

Key issues

The key aspects of this final decision include the following:

- capital base
- actual and forecast capex
- capital redundancy
- depreciation
- rate of return
- forecast non-capital costs
- pass-through events
- volume forecasts
- revenue and AMDQ/credit certificate revenue
- cost allocation and tariff structures
- reference tariff path
- reference tariff variation policy
- incentive mechanisms
- services policy
- terms and conditions and
- extensions and expansions policy.

Capital base

In its draft decision the ACCC largely accepted GasNet's proposed roll forward of its regulated capital base. However, the ACCC required adjustments relating to estimated capex and inflation for 2002, the last year of the previous period, which were not able to be updated at the time of the previous decision. Specifically, an overestimate of capex for 2002 resulted in a higher return on capital for the AA2 period, while GasNet did not receive certain revenues associated with an underestimate of inflation for 2002. The ACCC also required GasNet to recognise the amount of expenditure incurred on the Brooklyn-Lara pipeline in the AA2 period and treat the remainder as forecast new facilities investment for the AA3 period.

In response to the draft decision, GasNet notes that the ACCC has miscalculated the benefit associated with the overestimate of capex for 2002. It noted that it is indifferent to when expenditure associated with the Brooklyn Lara pipeline is recognised, provided IDC (interest during construction) is calculated appropriately.

The ACCC confirms that it had miscalculated the return on capital associated with the overestimate of capex for 2002. For the final decision the ACCC has recognised expenditure incurred on the Brooklyn Lara Pipeline, as well as on the Gooding Compressor, to 31 December 2007 as actual expenditure for the AA2 period. Other changes relating to expenditure for the AA2 period are discussed in the next section.

In making these changes, the ACCC has calculated an indicative roll-forward calculation of GasNet's regulated capital base in table A.1.

Table A.1: Final decision—roll-forward of the capital base

nominal \$ m	2003	2004	2005	2006	2007
Opening capital base	496.18	487.97	479.70	473.88	476.34
Depreciation allowance	-20.61	-21.60	-22.81	-23.92	-24.41
Capital expenditure	0.498	0.70	3.57	10.97	92.54
Disposals/redundancies	0.00	-0.02	0.00	0.00	0.00
Inflation	11.74	12.64	13.43	15.42	14.09
Closing capital base	487.80	479.69	473.89	476.35	558.55
Adjustment for 2002 capex overestimate					-0.11
Adjustment for 2002 inflation underestimate					0.34
Adjusted closing capital base					558.78

Source: ACCC analysis.

Actual capital expenditure incurred during AA2

The ACCC assessed the capex incurred during the AA2 period and considers that the majority of the expenditure meets the requirements of the code. The main exception relates to corporate restructuring costs (\$8.84 m), which GasNet submitted to have been incurred as part of the APA Group's takeover of GasNet in 2006. The ACCC considers that \$58.92 m of capex satisfies the requirements of the code and should be included in the capital base. Table A.2 sets out the ACCC's assessment.

Table A.2: Final decision—AA2 actual capex incurred

nominal \$m	<i>Proposed</i>	<i>Draft decision</i>	<i>Final decision</i>	<i>Difference</i>
Forecast^(a)				
Gooding compressor refurbishment ^(b)	22.21	16.03	14.77	-1.26
Lurgi pipeline refurbishment	5.67	2.82	2.82	0.00
City gate upgrades and heaters	9.21	5.38	5.38	0.00
Wollert compressor station automation	2.86	2.76	2.76	0.00
Gas chromatographs	0.92	0.46	0.46	0.00
Other maintenance capex	5.97	4.70	4.70	0.00
Total forecast	46.84	32.16	30.89	-1.26
Non-forecast				
Brooklyn Lara pipeline	N/A	47.19	47.27	0.08
Brooklyn compressor redevelopment	17.46	17.46	17.46	0.00
South Melbourne cut in	2.98	2.98	2.98	0.00
Wollert compressor station (miscellaneous)	2.15	2.15	2.15	0.00
Pig traps	0.72	0.72	0.72	0.00
Safety and security	0.79	0.96	0.96	0.17
Iona cooler upgrade ^(c)	0.70	0.60	0.00	-0.70
Regulators work	0.42	0.42	0.42	0.00
Maximo	1.37	1.37	1.37	0.00
Corporate restructuring	8.84	0.00	0.00	-8.84
Total non-forecast	35.42	82.52	73.33	-9.29
Total actual capex	82.26	114.67	104.22	-10.55
^a values exclude IDC				
^b \$1.26 m of expenditure on this project will be recognised as forecast capex for the AA3 period				
^c This project is forecast, whereas, GasNet initially proposed this project as actual capex.				

Forecast capital expenditure

GasNet proposed a capex program comprising augmentations and refurbishments/upgrades of \$334.08 m to the PTS over the AA3 period, which is some five times the amount actually expended in the AA2 period. The ACCC's assessment (in response to submissions received on the draft decision) concludes that \$187.79 m of GasNet's capex proposals (most which relate to refurbishment/upgrades) are reasonably expected to satisfy the requirements of the s. 8.16 of the code. Table A.3 details the ACCC's assessment.

Table A.3: Final decision—AA3 forecast capex

\$2006 Dec m	<i>Proposed</i>	<i>Draft decision</i>	<i>Final decision</i>
Augmentations			
Northern zone	79.03	0.00	79.03
Sunbury loop	12.46	0.00	0.00
Ballarat loop	29.03	0.00	0.00
Warragul loop	4.84	0.00	0.00 ^(a)
Pakenham loop	1.22	0.00	1.22
Stonehaven compressor	26.19	0.00	0.00
Carisbrook loop	24.05	0.00	0.00
Brooklyn Lara (Corio) pipeline	63.71	18.19	21.01
Brooklyn Wollert easements	5.37	0.00	0.00
Total augmentations	245.90	18.19	101.26

Refurbishments/upgrades			
Gooding compressor station	N/A	N/A	1.22
Gas heating facilities	9.21	7.25	7.74
City gate works	6.68	6.18	6.18
Pipeline upgrades	9.65	7.65	9.65
Safety and security systems	4.25	2.93	4.25
Brooklyn compressor station	49.57	49.57	49.57
Wollert compressor station	1.58	0.005	0.005
Other compressor stations	2.96/2.91	1.29	2.91
Iona cooler upgrade	N/A	N/A	0.70
Other	4.3	0.00	4.30
Total refurbishments/upgrades	88.15	74.88	86.53
Total capex	334.05	93.07	187.19

Source: ACCC analysis.

^(a) Amount subject to application of economic feasibility test using recalculated tariffs which reflect revised parameters in this final decision (e.g. WACC and volume forecasts).

In assessing GasNet's proposals in its draft decision, the ACCC has considered the independent review of GasNet's proposals prepared by Sleeman Consulting, the independent network planning and timing reports and further advice from VENCORP, as well as submissions in response to the draft decision. The ACCC maintains its draft decision that these assessments demonstrate that a number of GasNet's capex proposals, particularly in relation to augmentation expenditures, can either be deferred until after the AA3 period or a need for the proposals has not been demonstrated. These capex proposals include the Sunbury loop (\$12.5 m), Ballart loop (\$29 m), Stonehaven compressor (\$26.2 m), Carisbrook loop (\$24 m) and Brooklyn Wollert easements (\$5.4 m), totalling \$97.1 m of the \$245 m augmentation expenditures proposed.

This final decision, however, accepts that GasNet's proposed capex to augment the Northern zone is consistent with maintaining the integrity of services (by restoring export capability of 17TJ/d through the Interconnect) and maintaining the quality of services on the Echuca lateral at Shepparton. This final decision also requires GasNet to re-calculate the amount of capex for the Warragul loop that is expected to be recovered by Lurgi zone users at the prevailing (approved) tariffs. These changes result in nearly \$95 m of additional approved capex compared to the draft decision.

Capital redundancy

In its draft decision, the ACCC considered that GasNet's proposal to amend its capital redundancy policy would introduce ambiguous terminology and weaken the incentive to manage its investments. The ACCC has maintained its position in this final decision not to accept GasNet's capital redundancy policy.

Depreciation

In its draft decision, the ACCC accepted all of GasNet's proposals except for the assumed economic life of the Longford pipeline. The ACCC highlighted several sources of information which indicated that the production life of the Gippsland Basin would extend beyond 2023.

In response, GasNet argues that much of the information referred to by the ACCC did not take into account uncertainties regarding expected demand and that it should give more

weight to GasNet’s business interests in addressing these uncertainties. The ACCC has accepted these arguments and accordingly considers that the economic lives underlying GasNet’s proposed depreciation schedule are appropriate.

Rate of return

GasNet proposed a nominal vanilla WACC of 9.01 per cent for the AA3 period. In its draft decision, the ACCC considered GasNet’s approach to determine the rate of return using the capital asset pricing model, including its WACC parameter proposals, was generally consistent with the requirements of the code. For this final decision, the ACCC has where appropriate re-calculated the WACC parameters using up to date data, resulting in a nominal vanilla WACC of 10.55 per cent. This rate of return reflects an increase in the debt margin from 114 bpp as proposed by GasNet and the latest financial data which provides a debt margin of 299 bpp. The ACCC notes that the significant increase in the debt risk premium is driven by the ongoing global credit crisis impacting on financial markets, which has significantly raised the cost of borrowing.

The ACCC received submissions in response to the draft decision noting the inconsistency of using a 60:40 gearing ratio and the use of a BBB credit rating to calculate the debt margin. The ACCC notes that businesses with a credit rating of BBB generally have a higher gearing ratio. Accordingly, as the ACCC is maintaining a gearing ratio of 60:40, it is assumed that the benchmark cost of debt reflects a credit rating of BBB+. Table A.4 details the ACCC’s assessment.

Table A.4: Final decision—AA3 WACC parameters

<i>WACC parameter</i>	<i>Proposed</i>	<i>Draft decision</i>	<i>Final decision</i>
Real risk-free rate	2.68%	2.86%	3.52%
Nominal risk-free rate	5.85%	5.95%	6.29%
Bond maturity period	10 years	10 years	10 years
Forecast inflation rate	3.09%	3.00%	2.68%
Debt margin	1.14%	1.62%	2.99%
Debt raising costs	0.125%	0.104%	0.104%
Credit rating	BBB	BBB	BBB+
Cost of debt	7.12%	7.67%	9.38%
Market risk premium	6.00%	6.00%	6.00%
Gearing ratio	60:40	60:40	60:40
Value of imputation credits	0.50	0.50	0.50
Equity beta	1.00	1.00	1.00
Return on equity	11.85%	11.95%	12.29%
Nominal Vanilla WACC	9.01%	9.38%	10.55%
Real Vanilla WACC	5.74%	6.19%	7.67%

Source: ACCC analysis.

Non-capital costs

In its draft decision, the ACCC accepted many of the individual cost increases proposed by GasNet. However, the ACCC proposed to reduce GasNet’s corporate overheads by \$2 m per annum in anticipation of cost savings resulting from the integration of GasNet into the APA Group.

In their responses to the draft decision, GasNet and other interested parties disagree with the ACCC’s approach. They submit that any synergies achieved as a result of the

acquisition of GasNet by the APA Group should be treated similarly to any other efficiency gains and included in the carry-over (incentive) mechanism. The ACCC accepts these submissions and has decided not to reduce GasNet's overheads by \$2 m per annum. The benefits of the synergies will be passed on to users in later periods through the operation of the carry-over mechanism when the actual amount of the savings becomes clear.

Pass-through events

GasNet forecasts a substantial increase in its fuel gas costs compared to the actual costs incurred in 2006. Given the volatility of fuel gas prices the ACCC proposed that any increases over the fuel gas costs in 2006 should be treated as a pass through event. While GasNet has no objection to this approach in principle, in response to the draft decision it submits that its best estimates rather than the actual costs in 2006 should be used as the base costs. The ACCC has approved this proposal.

In its draft decision, the ACCC did not agree with GasNet's proposal to include an asbestos event as a pass-through event. As an alternative, the ACCC indicated that it would consider any substantiated proposal for self-insurance. In response to the draft decision, GasNet still submits that the appropriate approach is to include an asbestos event as a pass-through event. The ACCC is not convinced by GasNet's arguments and has decided not to include an asbestos event as a pass-through event. The ACCC maintains this issue can be addressed through self-insurance.

Volumes

The ACCC has assessed GasNet's volume forecasts on the basis of all the information available to it. It has largely relied on VENCORP forecasts arrived at independently of GasNet. Some GasNet volume forecasts are particularly subject to uncertainty (gas power generation (GPG) forecasts, the source of likely injections) and the ACCC therefore requested stakeholder comments prior to this decision. For this final decision, the required volume amendments are based on updated forecasts in relation to GPG volumes and further information as to contractual arrangements at Culcairn, which it is considered should be reflected within volume forecasts.

GasNet originally proposed annual and peak volume forecasts which match the medium economic growth scenario volume forecasts produced by VENCORP for its 2006 Gas Annual Planning Report (GAPR). GasNet now proposes adopting the updated 2007 VENCORP GAPR forecasts. As a result, GasNet's proposed anytime withdrawal volume forecasts for the AA3 period are now approximately 3 per cent less than those proposed for the AA2 period. The ACCC accepts that the lower withdrawal forecasts reflect an updated assessment of a more severe weather warming impact and its downward effect on gas usage in Victoria generally (especially residential usage). The decrease from AA2 aggregate volume forecasts occurs even though, as noted in the draft decision, GPG forecasts should be revised upwards, on the basis of advice to the ACCC from ACIL Tasman. In response to the draft decision, GasNet accepts that drought impacts in the electricity market will cause more GPG to be required over the AA3 period than originally forecast. Also, with a view that prima facie it should lead to a small increase in overall system volumes, the ACCC requires GasNet to amend its Culcairn export withdrawal volume forecasts to reflect AMDQ contracts it has entered into subsequent to

lodgement on take or pay terms and which should incentivise more flows of gas to actually occur.

The ACCC has assessed GasNet's proposed injection volume forecasts. The ACCC considers the basis for GasNet's increased forecasts of injections from the Otway Basin to be reasonable based on the commissioning of the Otway gas plant in September 2007 and the completion of the Corio loop before winter 2008.

Revenue requirement

GasNet's proposed revenue requirement is summarised in table A.5:

Table A.5: Proposal—revenue requirement

\$2006 Dec m	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>
Return on capital	32.42	37.63	41.86	42.42	42.43
Depreciation	22.53	25.79	28.09	28.58	29.40
Non-capital costs	27.37	26.25	26.03	27.59	29.40
Total revenue requirement	82.30	89.68	95.98	98.59	101.23
Forecast revenue	86.18	89.77	93.79	96.87	100.55

For the AA3 period GasNet proposed to assume that capital expenditure is recognised in the middle of each year, in contrast to the end of the year as per the current arrangements. This results in depreciation and return on capital being calculated for an additional six months in the year capex is spent. GasNet submitted a monthly model which it used to illustrate that this change would result in a closer alignment of costs and revenues than in the absence of this assumption.

In its draft decision, the ACCC considered it appropriate to recognise capex in the middle of each year, however, it also required GasNet to apply the present value adjustments that featured in its illustrative monthly model to its actual modelling of revenues.

In its response, GasNet argued that the ACCC has misinterpreted the intent of its monthly model and that the application of present value adjustments is inappropriate. In subsequent discussions with GasNet, the ACCC confirms that GasNet's annual revenue calculations were already consistent with its monthly model and the addition of present value adjustments has not been required in this final decision.

As a result of changes required in this final decision, the ACCC's estimate of GasNet's revenue requirement is summarised in table A.6.

Table A.6: Final decision—revenue requirement

\$2006 Dec m	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>
Non-capital costs	27.85	25.53	25.08	26.27	27.67
Depreciation	25.06	27.86	29.55	29.47	29.71
Return on capital	43.54	48.32	51.14	49.47	47.88
Net tax liability	0.00	0.00	0.00	0.00	0.34
Total revenue requirement	96.45	101.71	105.77	105.22	105.60

Authorised MDQ and AMDQ credit certificate revenue

GasNet receives payments through the sale of authorised maximum daily quantity (AMDQ)/credit certificates. GasNet's procurement and sale of AMDQ/credit certificates is governed by s. 5.3 of the MSO rules and its service envelope agreement (SEA) with VENCORP. In its draft decision, the ACCC considered that AMDQ/credit certificates fell within the ambit of the AA and that the associated revenues derived should be regulated. Specifically, the ACCC required GasNet to include revenues derived from AMDQ/credit certificates in the 'actual revenues' in cl. 4.2 of schedule 4 of GasNet's proposed AA, which would be counted towards its revenue requirement. To maintain an incentive on GasNet to continue administering AMDQ/credit certificates, the ACCC invited GasNet to propose any additional operating costs in response to the draft decision.

In response, GasNet noted the ACCC's implication that AMDQ/credit certificates were ancillary to the reference service. GasNet disputed this in terms of the definition of ancillary service under the code, and argued that AMDQ/credit certificates should not be regulated. It noted that revenues from AMDQ/credit certificates were particularly uncertain and that the setting of regulated tariffs for such services may act as a disincentive to their provision. GasNet also noted that the ACCC's proposal for GasNet to recover the cost of administering AMDQ/credit certificates would not provide an incentive for it to continue to provide this service.

Subsequent to receiving GasNet's response the ACCC provided GasNet an opportunity to consider whether AMDQ/credit certificates could be classified as a 'general' service under the code. The ACCC also sought clarification of GasNet's proposed allocation of AMDQ/credit certificates in the future. GasNet restated that AMDQ/credit certificates should not be regulated, but if the ACCC insisted on doing so, it should treat them as a negotiated service. It also provided the ACCC with a draft tender process for the allocation of AMDQ/credit certificates and indicated a willingness to formalise this.

The ACCC considered that regulating revenues from the sale of AMDQ/credit certificates was possible under the code however required the establishment of a separate tariff. In light of the scarcity of AMDQ/credit certificates any regulated tariff would not reflect the value placed on these instruments by market participants and would result in an inefficient and arbitrary allocation process. Furthermore, the MSO rules envisage VENCORP undertaking an auction in the case that demand for authorised MDQ exceeds its supply. The ACCC views the development of such a tender or auction process as desirable and something that would be undermined through the setting of a fixed tariff.

The ACCC also considered whether AMDQ/credit certificates could be classified as a rebatable service under the code given the uncertain nature of its demand and revenues. This would have allowed GasNet and users to reach a negotiated price (e.g. through a tender process) rather than have this set under GasNet's AA. Under the code, a rebatable service must be supplied in a market that is substantially different to that of the Reference Service. This definition qualifies what could be otherwise considered rebatable services and gives rise to doubt about whether AMDQ/credit certificates would satisfy the code definition of rebatable service.

In examining these issues, the ACCC encountered certain ambiguities in GasNet's processes and in the policy intent of AMDQ/credit certificates, which would be better

addressed through a review and potential amendments to the MSO rules. A broader review was undertaken by VENCorp in 2004 which resulted in a series of recommendations being made to the Victorian Government that would affect the nature of AMDQ/credit certificates. The ACCC understands that the implementation of these recommendations is still being considered, and the ACCC is of the view that it would be preferable to reconsider both the need and form of regulation of AMDQ/credit certificates following further consideration of VENCorp's recommendations or following a separate review of the MSO rules.

Cost allocation and tariff structures

GasNet proposed to simplify its methodology for allocating direct costs to both withdrawal and injection assets. The proposed methodology involves a greater averaging of costs across the PTS such that distance from the injection source determines the level of tariffs for different zones. This differs from GasNet's current methodology where specific tariff zones also reflect differences in the assets used to transport the gas to the tariff zone. GasNet submits that its proposed simplified cost allocation methodology is sufficiently cost reflective to satisfy the objectives of the code, and also draws an appropriate balance between cost reflectivity and other considerations.

GasNet also submits that the cost allocation method used in the AA2 period goes beyond the requirements of economic efficiency. GasNet submits that the costs which are directly attributable to a user should be allocated to that user, but that it is not clear what makes costs attributable to a user. GasNet considers that rigid application of the existing cost allocation methodology is not necessarily consistent with economic theory or the code.

The ACCC maintains that GasNet's proposed cost allocation methodology should provide tariffs that reflect the costs of each service and each user 'to the maximum extent that is commercially and technically reasonable'. In doing so, the ACCC considers that GasNet's current zone gate methodology for allocating costs better reflects differences in the cost of pipeline segments required to transport gas to different zones (or users) than GasNet's proposed volume-distance methodology which averages the cost of pipeline segments across all users. The ACCC acknowledges GasNet's argument that a rigid application of the current cost allocation methodology may not be appropriate in all circumstances. However, the ACCC notes that a number of modifications to this methodology have already been accepted by the ACCC where appropriate and these modifications have resulted in greater tariff averaging than what would be expected in a strictly cost reflective approach. In that sense, the existing methodology already attempts to strike an appropriate balance between cost reflectivity and practicality. Overall, the ACCC concludes that GasNet's proposed methodology amplifies any misallocations of costs attributable to a service and users, as the averaging of direct costs across all pipeline segments is less cost reflective across users and tariff zones. Three particular aspects of GasNet's tariff proposals are outlined below.

Postage stamp withdrawal tariff-V

GasNet proposed to apply a single rate for tariff-V (small) users across the PTS, so that all tariff-V users will pay the same postage-stamp tariff. GasNet further noted that this approach will not materially detract from efficient pricing since retail prices are averaged

across users at the retail level. GasNet also submitted that a postage stamp tariff will facilitate retail competition.

The ACCC considers that GasNet's proposed postage stamp rate for tariff-V users is not cost reflective relative to the code requirements (i.e. to the extent that is commercially and technically reasonable). The ACCC notes that a benefit of cost reflective pricing is that it facilitates efficient usage and investment decisions by users. Consequently the ACCC considers that it is appropriate for signals to be given to users (retailers) even if they do not pass them on to end users. The ACCC considers that, while a single tariff-V would be simpler (as GasNet and AGL maintain) no evidence was provided that tariff complexity is an undue burden. The ACCC also notes Origin Energy's observation that changing tariff structures also creates additional costs. The ACCC is also not convinced by GasNet's argument that the zonal tariff structure for V users is hindering retail competition or will increase the costs of new entrants. The AEMC recently considered potential barriers to retail competition in the Victorian gas market and states that:

A barrier to entry does not properly include a cost or other impediment that applies more or less equally to any party wanting to participate in the retail market, irrespective of whether it is an established retailer or a new retailer.⁴

The ACCC concurs with AEMC conclusion and considers that any administrative costs will be incurred by all existing and new entrants and as such are not a barrier to entry.

Injection tariff structure

GasNet proposed to charge the injection tariffs as a single flat rate over the peak period (being the winter months of June to September) instead of on the basis of the existing top ten peak days. GasNet suggested that this will improve predictability and transparency, since injection tariffs will be known in advance. GasNet also suggested that the very high level of the current injection tariffs falls disproportionately on those injectors who provide the injections required to balance the PTS during the current ten day period. In response to the draft decision, GasNet agrees that there is a need for a peak signal on the injection tariff, however, GasNet suggests that it is not clear that it should be a strong peak signal which is levied on the peak day.

In considering GasNet's argument that it is not clear that a strong peak signal needs to be levied on the peak day, the ACCC notes that if peak costs are spread over a longer period, those users who have high load factors (a constant injection profile) will pay more of the injection costs even though most of their use will occur at times when the pipeline is not constrained and there is spare capacity. The ACCC considers it is the peak days when price signals are required and the users injecting on those days should pay for the cost of using the pipeline at a peak time. The ACCC also considers it desirable to retain strong peak injection signals for transmission costs, to signal the cost of future congestion on the transmission system particularly when pipelines are relatively unconstrained. Accordingly, the ACCC maintains its view in the draft decision that all users that use the injection pipelines on the peak days should be required to contribute to

⁴ Australian Energy Market Commission, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria*, First Final Report, 19 December 2007, p. 112.

the costs of congestion in proportion to their contribution to the maximum capacity demanded from the system.

Prudent discounts

GasNet originally proposed not to re-apply its prudent discount for the Latrobe withdrawal zone. The ACCC received a number of submissions from interested parties objecting to the removal of the prudent discount, including a confidential submission from Australian Paper. Based on information received from Australian Paper regarding the Maryvale Mill, the ACCC finds that while bypass through the construction of another pipeline is uneconomic there is significant threat of bypass through a change in production processes. Evidence suggests that bypass of the PTS could occur if tariffs increase above existing levels. GasNet subsequently proposed a continuation of a prudent discount for the Latrobe zone, which will recover a proportion of indirect costs, thereby contributing to a reduction of indirect costs allocated to other users of the PTS. Accordingly, the ACCC considers the LaTrobe discount prudent in accordance with s. 8.43 of the code for the AA3 period.

GasNet proposed a prudent discount for its export tariff at the Culcairn withdrawal zone. The ACCC has reviewed further information on GasNet's proposed prudent discount at the Culcairn zone as part of this final decision including information as to authorised MDQ contracts pertaining to export withdrawals at Culcairn. The ACCC considers that based on the information provided, having considered s. 8.43(a) of the code (by-pass risk) that no prudent discount should be approved for Culcairn. Firstly, GasNet has entered into take-or-pay contracts providing certainty that its volume forecasts at Culcairn will be achieved. Secondly, GasNet has not demonstrated a credible by-pass risk exists at Culcairn by reference to other possible pipeline competition.

In response to the draft decision, GasNet proposes that the incremental costs of the Murray Valley pipeline should be deemed not to include the costs of pipeline usage up to Chiltern Valley and that it should be allowed to derive a tariff which reflects only these costs. For this final decision, the ACCC considers a prudent discount should be provided for the Murray Valley withdrawal zone reflective of largely an incremental cost tariff because in the long-run this may encourage further volume uptake, promote cost recovery of the Murray Valley lateral pipeline as well as increased contributions to common system costs (including from downstream pipeline usage).

Reference tariff path

GasNet proposed an increase in capex and opex coupled with lower volume forecasts. The recovery of these costs and the lower demand forecasts during the AA3 period implied a need for significant real increases in the average tariff over the AA3 period. GasNet proposed an initial average tariff of \$0.401/GJ 2008 increasing to \$0.460/GJ in 2012.

As a result of the ACCC's proposed amendments in the draft decision, GasNet's revenue requirement was reduced and volume forecasts were increased. This had the effect of reducing the initial tariff increase between 2007 and 2008 to approximately 16 per cent (from \$0.295/GJ to \$0.343/GJ), if GasNet maintains its proposed real increase of 2.8 per cent ($X = -2.8$) per year for the majority of its tariffs over the AA3 period. This initial

increase would be 22.5 per cent (to \$0.36/GJ) if a flat real tariff path ($X = 0$) over the AA3 period is adopted.

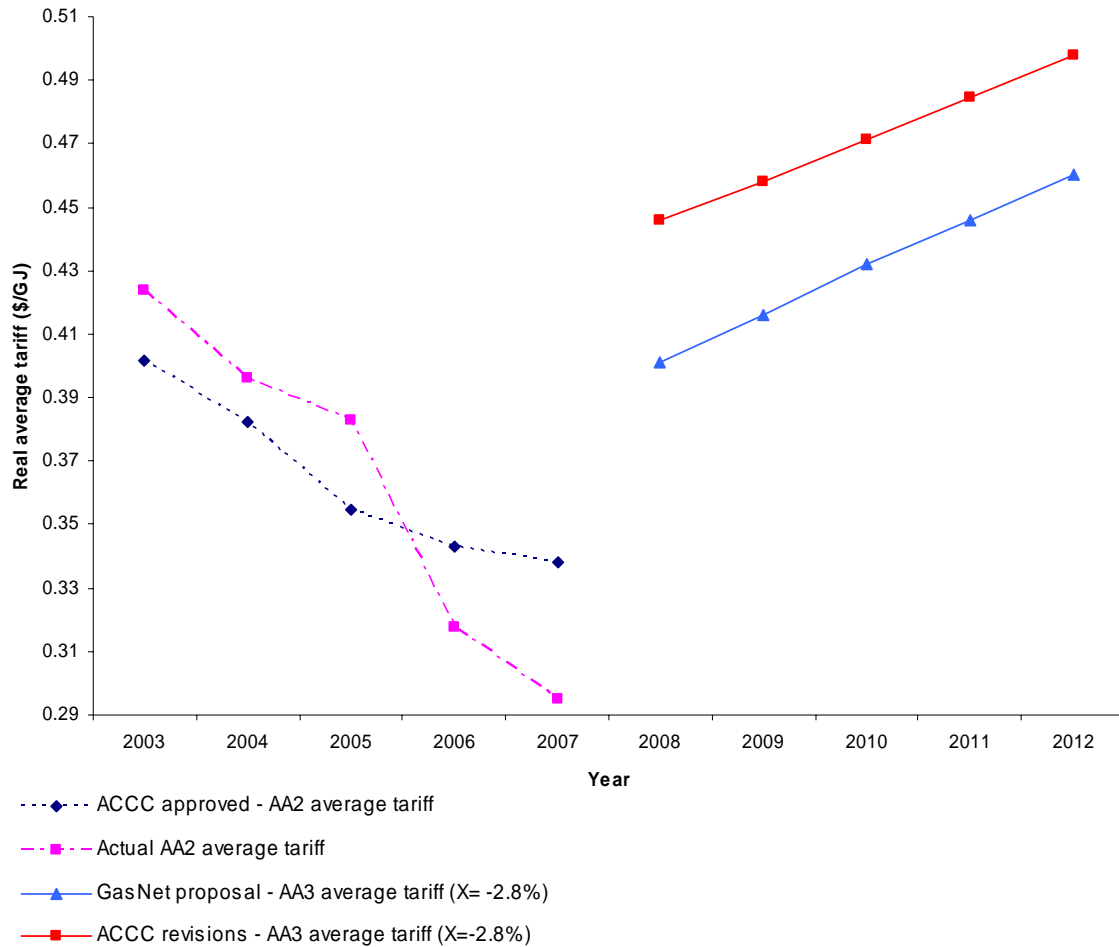
In its draft decision, the ACCC considered that whilst the step increase between the AA2 and AA3 periods is significant, an X factor of -2.8 per cent would result in the average tariff in 2008 being generally in line with the original forecast price path for the average tariff for 2007 of \$0.337/GJ. That is, in 2003 users would have expected an average tariff for 2007 of around \$0.337/GJ if the volume mix forecasts made at the start of the period had been met. Instead the actual average tariff for 2007 of \$0.295/GJ is the result of the balancing out of higher average payments made by users earlier in the AA2 period as a result of higher than forecast average tariffs. Accordingly, in the draft decision the ACCC considered the actual 2007 average tariff level of \$0.295/GJ was not indicative of the long term level.

Based on revisions to opex, capex and gas volumes in this final decision, however, the ACCC estimates that the average tariff for 2008 is \$0.446/GJ. The increase in the ACCC calculated average tariff in the final decision compared to the draft decision is a result of the following factors:

- approval of additional capex based on further information received from GasNet, including Northern zone, Warragul loop and Pakenham capex (an increase of nearly \$95 m compared to the draft decision, but which is still 45 per cent lower than GasNet's original capex proposal)
- an significant increase in the cost of debt driven by the large increase in the debt premium from the proposed 114bbp to 299bbp
- a reduction in the forecast volumes between the draft decision and the final decision to reflect updated VENCORP forecasts as per their 2007 Annual Planning Report.

Figure A.1 below sets out the average tariff movement for the AA3 period based on this final decision. It also shows GasNet's actual average tariff over the AA2 period and the ACCC approved initial AA2 forecast average tariff movement at the commencement of the AA2 period if the forecast tariff path had been followed in the absence of volume forecast error.

Figure A.1: Tariff path



Reference tariff variation policy

The ACCC notes GasNet has experienced volatility in volume outcomes during the AA2 period. The ACCC recognises GasNet’s objective to modify its average revenue yield control which is to reduce revenue at risk to volume outcomes largely out of its control. Gas demand (residential consumption) is sensitive to cold/hot weather as well as weather / other conditions impacting on demand by gas powered generation connected to the PTS.

GasNet proposed a revised price control formula that continued an average revenue yield approach for the AA3 period linking its revenue risk to only annual withdrawal volumes differing from forecast volumes. It proposed bounding its actual revenue risk by placing 5.5 per cent bounds on revenue variations as a result of annual withdrawal volumes differing to forecast. The ACCC considered that GasNet’s revised price control formula symmetrically bounds its likely revenue reward / risk, and proposed to approve its approach to normalise its revenue to cold weather, EDD (effective degree day) outcomes.

The ACCC maintains its position from the draft decision that GasNet must make a number of amendments to the schedule 4 price control formula, including the amendments below:

- remove Murray Valley volumes to prevent the undermining of the inclusion of the MVP lateral within the asset base under s. 8.16(a)(ii)(A)
- account for the fact that further expansions at Culcairn may be covered or uncovered.

As well the ACCC maintains its position on other amendments to limit individual tariff movements to CPI-X+2 and remove transmission refill volumes from the price control formula, which GasNet has not opposed.

In relation to the process that should apply for tariff variations, the ACCC has consulted with GasNet and changes have been agreed which are reflected in amendments required as part of this final decision. This will provide an appropriate timeframe for tariff variation approvals and abide with the processes envisaged by ss. 8.3B-H of the code.

Incentive mechanisms

GasNet proposed to amend its benefit sharing mechanism to require the regulator to use its discretion in applying negative carryover amounts. It proposed to require the regulator to use actual operating costs in 2011 as a basis for setting expenditure benchmarks for the AA4 period, rather than ‘take into account’ these actual costs as per the current arrangement. GasNet also proposes to remove fuel gas costs from the calculation of benefit sharing allowance.

In its draft decision, the ACCC considered that the removal of fuel gas costs is consistent with the intent of the incentive mechanism as these costs are largely uncontrollable by GasNet. The ACCC did not accept GasNet’s other proposed changes to the benefit sharing mechanism on the basis that the current mechanism already places a considerable weight on the use of actual expenditures as a basis for assessing forecasts. This feature also reinforced the need to automatically apply positive and negative carryover amounts in order to preserve the proper functioning of the mechanism. In its response GasNet considered that the possibility of the regulator applying negative carry-over amounts was a sufficient incentive.

For the final decision, the ACCC maintains its position that the introduction of discretion in the incentive mechanism would compromise the integrity of the mechanism and also introduce additional administrative burden without any benefit for users.

Services policy

GasNet proposed a services policy on the basis that the status quo remains in terms of the arrangements between GasNet and VENCORP and users. The Victorian Government has recently implemented legislation to remove VENCORP’s obligation to submit a revised AA under the code. As a consequence users will be required to enter into bilateral contracts for the gas transportation service with GasNet instead of VENCORP. Under these new arrangements, GasNet will provide gas transportation service directly to users as well as making the PTS available to VENCORP as required by the service envelope agreement (SEA).

As a result, the ACCC requires that GasNet revise its services policy to reflect that GasNet rather than VENCorp has the direct legal relationship with users, and will provide gas transportation services directly to users.

Terms and conditions

The ACCC considers that gas transportation agreements form part of the terms and conditions under s. 3.6 of the code. In particular, the transportation agreement provides terms and conditions on which GasNet will supply the tariffed transmission service to users and should therefore be included in GasNet's revised AA. For the AA2 period, VENCorp provided these agreements to users and an approved agreement was included in VENCorp's AA.

GasNet has indicated that it will propose a gas transportation agreement to users and has provided the ACCC with the principles to be included in a proposed agreement. The ACCC has reviewed these principles. The ACCC notes that affected parties have not had an opportunity to comment on GasNet's proposed agreement. Given that affected parties have not had an opportunity to comment on any proposal, the ACCC considers that the standard terms and conditions of the existing agreements should be included in the revised AA. GasNet has subsequently provided a 'term sheet' which outlines the principles that will apply to GasNet and users. The terms sheet includes, terms, payment, limitations, force majeure, termination and dispute resolution procedures.

Extensions and expansions policy

In its draft decision, the ACCC proposed amending GasNet's proposed expansions policy to allow for a fully informed coverage decision to be made on expansions at the Interconnect (Culcairn) at the time of proposal. GasNet had proposed that all expansions at Culcairn would be uncovered (subject to the formality of GasNet providing a notice). The ACCC proposed a revision to the AA that any such expansion proposal above 17 TJ/day be subject to ACCC approval prior to project commencement. GasNet considers there is enough available information to be satisfied now that future expansions would have to compete with other pipelines such that coverage would not be required. The ACCC considers, however, that it is possible that GasNet will have market power at the Interconnect when it chooses to expand. The ACCC notes its decision allows up to date information on market and other factors (e.g. pipeline ownership, conditions on competing pipelines) to be considered. The ACCC therefore maintains its amendment as required for this final decision.

1. Introduction

1.1. Access arrangement revisions

GasNet is currently subject to an access arrangement (AA) which was approved by the Australian Competition and Consumer Commission (ACCC) in 2002 for the Principal Transmission System (PTS) in Victoria.⁵ An AA describes the terms and conditions under which a service provider will make access to the services of the pipeline available to third parties. The AA2 period will end when the revisions approved by the ACCC come into effect.⁶

Chapter 2 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the code) specifies that the service provider of a gas pipeline covered by the code is required to propose revisions to an AA and submit them to the relevant regulator for approval by the revisions submission date.⁷

In assessing such proposed revisions to an AA, the code specifies that the relevant regulator must:

- inform interested parties that it has received the proposed revisions to the AA and the access arrangement information (AAI)
- publish a notice in a national daily newspaper which at least:
 - describes the covered pipeline to which the AA relates
 - states how copies of the documents may be obtained and
 - requests submissions by a date specified in the notice
- after considering submissions received, issue a draft decision that either proposes to approve the revisions or proposes not to approve the revisions and states the amendments (or nature of the amendments) that would have to be made to the revisions for the ACCC to approve them
- after issuing the draft decision, invite any further submissions
- after considering additional submissions, issue a final decision that either approves or does not approve the revisions (or amended revisions) and states the amendments (or nature of the amendments) which have to be made to the revisions (or amended revisions) in order for the ACCC to approve them and
- if the amendments are satisfactorily incorporated in a revised AA, issue a further final decision (referred to as a final approval) to approve the revised AA.

⁵ The Principal Transmission System is also commonly referred to as the GasNet system.

⁶ The current access arrangement period was scheduled to expire on 31 December 2007. On 31 October 2007 the ACCC extended the period for approving the revised access arrangement as permitted under s. 2.44 of the code. The ACCC published extensions on 31 October 2007, 21 December 2007 and 29 February 2008 and 29 April 2008.

⁷ In addition, a service provider may submit revisions at any time during the AA period. The assessment process for 'voluntary' revisions differs in a number of ways to that described.

If not, the ACCC must draft and approve its own AA addressing the specified amendments.

1.2. Consultative process

The code sets out a consultative process for the regulator to follow when assessing revisions to an AA.

On 30 April 2007 GasNet submitted to the ACCC its proposed revisions to the AA with accompanying AAI. These documents were made public via the Australian Energy Regulator (AER) website on 24 May 2007 and the public register held by the Code Registrar. After GasNet provided further supporting information, the ACCC published a notice in *The Australian* and released an issues paper on 24 May 2007 which both invited submissions from interested parties on the proposed revisions.

After considering submissions, the ACCC released its draft decision on 14 November 2007 which proposed not to approve GasNet's revisions in their current form and proposed 32 amendments to be made to the revisions.

Interested parties were invited to make written submissions on draft decision by 14 December 2007. After considering submissions, the ACCC has now issued its final decision on 1 May 2008. The public inquiry process is outlined below.

Submission of revised access arrangements	30 April 2007
Release of issues paper	28 May 2007
Due date for submissions on the issues paper	29 June 2007
Release of draft decision	14 November 2007
Due date for submissions on the draft decision	14 December 2007
Release of final decision	1 May 2008

Copies of the revisions application and associated documents are available (subject to confidentiality restrictions) from the AER website and from the Code Registrar. Copies of the draft decision and this final decision may also be obtained from the ACCC website.

1.3. Criteria for assessing revisions to access arrangements

The regulator may approve revisions to an AA only if it is satisfied that the AA as revised would contain the elements and satisfy the principles set out in ss. 3.1–3.20 of the code, which are summarised below. Revisions to an AA cannot be opposed solely because the AA as revised would not address a matter that s. 3 of the code does not require it to address. Subject to this, the relevant regulator has a broad discretion in accepting or opposing revisions to an AA.

An AA, or a revised AA, 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 tariff for a particular service and provides users with a right of access to the specific service at the reference tariff. Tariffs must be determined according to the reference tariff principles in s. 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 users' priorities 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.

Table 1.3.1 outlines the relevant chapters in this final decision where each of the elements specified above in terms of assessing GasNet's revised AA have been addressed.

Table 1.3.1: Final decision overview

<i>3.1-3.20 code principles</i>	<i>Final decision</i>
Services policy	Chapter 8.1
Reference tariff policy	Chapter 2.1: Reference tariff policy Chapter 2.2: Reference tariff methodology Chapter 6.3: Reference tariff variation policy Chapter 6.4: Reference tariff principles
Reference tariffs	Chapter 2.2: Reference tariff methodology Chapter 3.1: Roll forward of the capital base Chapter 3.2: New facilities investment Chapter 3.3: Forecast capital expenditure Chapter 3.4 Capital redundancy

	<p>Chapter 3.5: Depreciation</p> <p>Chapter 4: Rate of return</p> <p>Chapter 5.1: Non-capital costs</p> <p>Chapter 5.2: Pass-through events</p> <p>Chapter 5.3: Inflation</p> <p>Chapter: 5.4: Volumes</p> <p>Chapter 5.5: Revenue</p> <p>Chapter 6.1: Cost allocation and tariff structures</p> <p>Chapter 6.2: Reference tariff path</p> <p>Chapter 7.1: Incentive mechanisms</p> <p>Chapter 7.2:Key performance indicators</p>
Terms and conditions	Chapter 8.2
Capacity management policy	Chapter 8.3
Queuing policy	Chapter 8.4
Extensions and extensions policy	Chapter 8.5
Revisions submissions date and commencement date	Chapter 8.6: Review of an access arrangement

In considering whether a revised AA complies with the code, the ACCC must take into account the provisions of the AA as it currently stands and, pursuant to s. 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.

Appendix B of this final decision sets out the AAI that a service provider must disclose to interested parties (attachment A to the code).

1.4. The previous access arrangement assessment

The previous AA process was conducted in accordance with the requirements set out in the code and was based on information provided by GasNet and interested parties. All ACCC decision documents are available on the AER website.

GasNet submitted a proposed revised AA to the ACCC for the AA2 period for approval on 28 March 2002. The ensuing consultation and assessment process undertaken by the ACCC included:

- the release of the draft decision (under s. 2.13 of the code) on the proposed AA on 14 August 2002, in which the ACCC set out 35 proposed amendments to be made for the AA to be approved
- the release of the final decision (under s. 2.16 of the code) on 13 November 2002, with the ACCC set out 45 amendments to be made for the AA to be approved
- the release of a further final decision (under s. 2.19 of the code) in which, the ACCC, pursuant to s. 2.41(c) of the code, did not approve the revised AA submitted by GasNet on 6 December 2002 and 6 January 2003 and
- the release of the revised AA approved and drafted by the ACCC for GasNet (under s. 2.42 of the code).

GasNet subsequently lodged a merits review application with the Australian Competition Tribunal (Tribunal). On 23 December 2003 GasNet's AA was revised by order of the Tribunal. The Tribunal's orders and the revised AAs are available on the AER's website.

On 24 August 2004 GasNet proposed four separate revisions to its AA. The ACCC approved three of the four proposed revisions and the decision documents on 15 December 2004. Further, on 24 December 2005 GasNet provided an application under s. 8.21 of the code seeking an upfront binding approval from the ACCC that construction of the Corio loop satisfied the requirements of s. 8.16 of the code. On 6 June 2006 the ACCC published a final decision which approved the Corio loop under s. 8.21 of the code.

1.5. Regulatory framework

This assessment of the revised AA is subject to the code. Any subsequent scheduled revisions will be assessed under the National Gas Law and National Gas Rules to be introduced in 2008.

1.5.1. Relevant legislation

The main legislation and relevant documents regulating access to the PTS are:

- the code, under which transmission service providers are required to submit AAs and revised AA to the ACCC for approval
- the Market and System Operations Rules (MSO rules) and
- the *Gas Pipelines Access (South Australia) Act 1997*.

In accordance with the Natural Gas Pipelines Access Agreement, South Australia was the lead legislator in implementing the national gas access legislation.

1.5.2. Regulatory institutions

Code and appeals bodies for the PTS are:

- The ACCC—the regulator and the arbitrator
- The National Competition Council (NCC)—the code advisory body
- The Commonwealth Minister—the coverage decision maker
- The Federal Court of Australia—judicial review
- The Australian Competition Tribunal (Tribunal)—merits review.

1.5.3. The role of the AER

The ACCC has prepared this final decision with the assistance of the AER.⁸ The ACCC currently regulates natural gas transmission pipelines under the code except in Western Australia. However, governments have agreed that the regulation of natural gas transmission pipelines, along with natural gas distribution pipelines, will be undertaken by the AER from 2008.

1.5.4. Approach

Chapters two to eight of this final decision provide an outline of the ACCC's considerations and conclusions identified in the draft decision and on the responses by GasNet and other interested parties to the draft decision. As these chapters provide summaries of the ACCC's earlier assessment, the draft decision document should be referred to for the ACCC's full assessment.

The ACCC's final decision is set out in chapter ten.

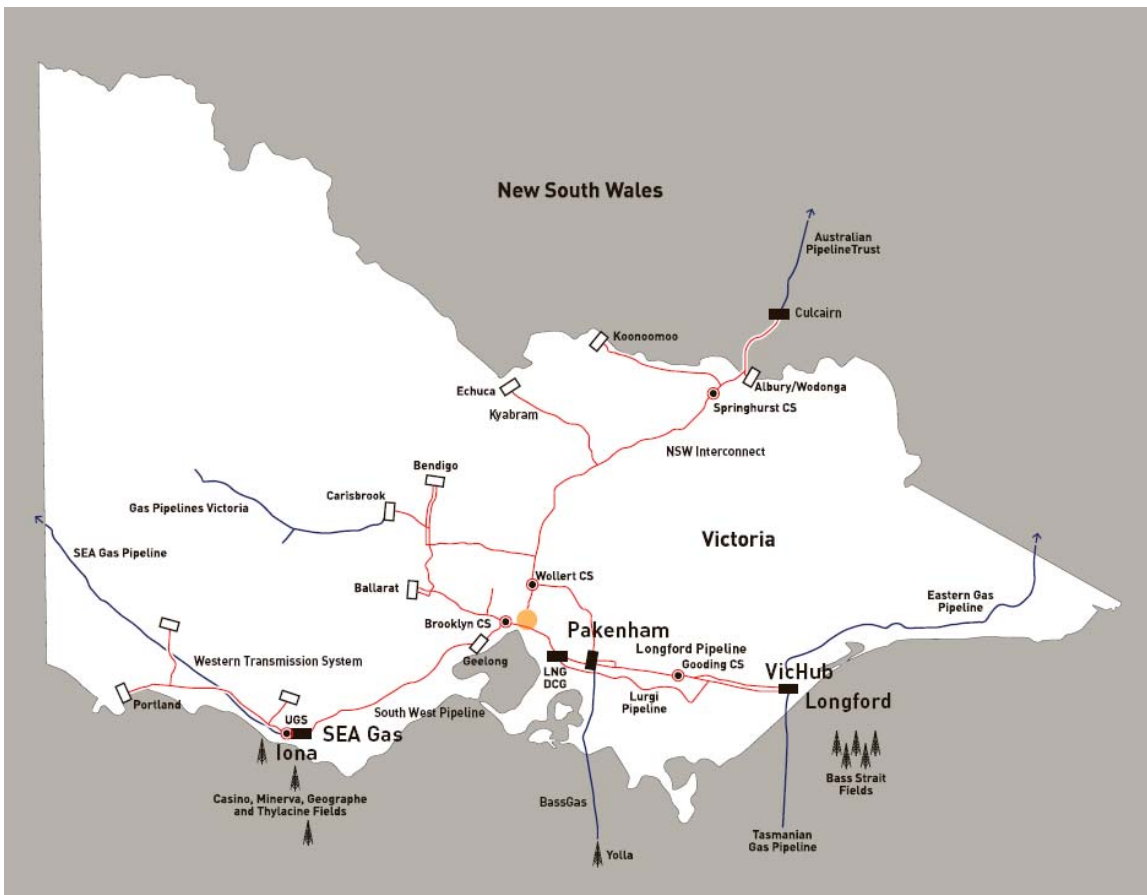
1.6. Background

1.6.1. The Principal Transmission System

The Principal Transmission System (PTS), also known as the GasNet system, is the primary system for the transmission of natural gas at high pressure in Victoria. GasNet is the owner of the PTS and VENCORP is the independent system operator of the PTS.

⁸ The relevant regulator of the code with respect to the PTS is the ACCC. All references in this final decision to the relevant regulator are to the ACCC. The AER will become the relevant regulator once proposed changes to legislation, which at the time of this final decision remains under consideration, are enacted.

Figure 1.6.1: Map of the PTS



Source: VENCORP, *Gas Annual Planning Report 2006*.

For the purpose of tariff recovery, the PTS is comprised of gas injection pipeline assets and gas withdrawal pipeline assets. Injection tariffs are charged for the costs attached to usage of injection pipeline assets. Withdrawal tariffs recover the costs attached to usage of the system for transmission of gas from injection pipelines to users, i.e. primarily those costs incurred in the usage of withdrawal pipelines. In some tariff zones, users receive a discount for withdrawing off an injection pipeline prior to the gas using all of the pipeline.

The PTS is not a traditional point-to-point transmission pipeline as there are a number of injection points. As set out in GasNet’s submission, the PTS has the following five main injection zones:

- Longford, comprising injection points at the site of the ESSO/BHP Billiton processing facility; VicHub (the interconnection with the Eastern Gas pipeline)
- Culcairn, the NSW interconnection with the Moomba-Sydney gas pipeline system
- Port Campbell, comprising the injection point for the Western Underground Gas Storage facility and local fields
- an interconnection with the SEA Gas pipeline and Minerva processing facility
- Dandenong, the site of the LNG facility and

- Pakenham injections, for gas sourced from the Yolla gas field.

Since the start of the AA2 period there has been an increase in the number of injection points. This coincides with an observable reduction in the reliance on Longford injections and the development of new gas fields and new gas production facilities. Table 1.6.1 sets out the change in gas sources for the PTS between 2003–06.

Table 1.6.1: Gas sources for the PTS

PJ %	Source of gas supply						
	Longford		BassGas ^a	Port Campbell		Culcairn	Dandenong LNG Facility
	Longford	VicHub		Iona	SEA Gas		
Annual							
Sep 02– Sep 03	89.9	4.3	n/a	5.8	n/a	–0.2	0.1
Sep 06– Sep 07	83.5	1.7	7.7	4.6	1.2	0.2	0.4
Peak							
2003	79.24		0.0		14.35	2.29	4.12
2007	76.10		4.1		16.20	0.2	3.3

Source: VENCORP, *Gas Annual Planning Report 2007*, section 2.4; VENCORP, *Gas Annual Planning Report 2003*, p. 13.

^a BassGas was commissioned in June 2006.

^b SEA Gas was commissioned in January 2004.

Whilst Longford injections remain the primary source of gas, supplies from other sources are increasing over time. GasNet forecasts this trend of gas supply, which places less reliance on the Longford injection zone, to continue in the AA3 period.

Gas injected into the PTS is primarily delivered into Victoria’s gas distribution system, however, some large customers are directly connected to the transmission network. A small amount of gas injected into the PTS is exported out of the system to:

- the separately owned Carisbrook to Horsham pipeline transmission pipeline in Victoria
- South Australia via the SEA Gas pipeline and
- NSW via Culcairn and the VicHub.

The PTS provides, along with distribution pipelines, a large part of the infrastructure necessary to facilitate both wholesale and retail competition in natural gas. As table 1.6.1 details, gas is increasingly sourced from a variety of fields. Diversity of ownership within these fields has been increasing along with the diversity of retail offerings to customers. The ACCC’s final decision and access pricing decisions on the PTS must be sensitive to potential impacts on competition in both the wholesale and retail gas market.

1.6.2. Allocation of responsibilities between GasNet and VENCORP

Under the code, both GasNet and VENCORP were service providers during the AA1 and AA2 periods. Their AAs share the responsibility between them for complying with the obligations imposed by the code.

Under the market carriage capacity management system operating in Victoria, users currently pay tariffs to both the system owner, GasNet, and the independent system operator, VENCORP. As the owner of the PTS, GasNet is responsible for the extensions and expansions policy in accordance with s. 3.16 of the code and VENCORP is responsible for the queuing policy in accordance with ss. 3.12–3.15 of the code. VENCORP's obligations in respect of queuing are contained in the MSO rules under the *Gas Industry Act 2001* (Vic).

The Victorian Government has accepted the recommendations of a statutory review of VENCORP's functions that VENCORP no longer be required to submit an AA under the national gas access regime. In its place, the review recommended VENCORP's costs and revenues be regulated on an annual basis by the AER under explicit provisions in the National Gas Law when it is enacted.

Under the Victorian Government's proposals, VENCORP's obligations in respect of the queuing policy for the PTS will remain under the MSO rules. It is expected that the rule making functions in respect of the MSO rules will transfer to the Australian Energy Market Commission.

Under the existing regulatory arrangements, GasNet makes the PTS available to allow VENCORP to operate the pipeline. VENCORP has a direct relationship and enters into gas transportation deeds with the users of the PTS. The MSO rules were recently amended such that VENCORP is no longer an intermediary between GasNet and the users of GasNet's transportation service. Instead, there is now a direct contractual relationship between GasNet and users.

In addition, recent Victorian legislative amendments are such that VENCORP is no longer required to submit an access arrangement under the national gas access regime. Instead it is anticipated that the AER will approve VENCORP's market fees on an annual basis based on recent changes to the MSO rules.⁹ Accordingly, this final decision only covers GasNet's proposed revisions and the processes for approving its revised AA.

⁹ VENCORP requested an extension of its revisions submissions date in early 2007 on the basis that the AER will approve the costs and revenues of VENCORP's reference services under the new regulatory arrangements. The ACCC approved this extension request on 28 March 2007.

2. Reference tariff method

Chapter 2 of the draft decision examined the basis on which GasNet's proposed reference tariffs are established. This included GasNet's reference tariff methodology and reference tariff policy.

2.1. Reference tariff policy

2.1.1. Introduction

Clause 4.3 of the proposed AA sets out a policy that describes the principles that are used to determine the proposed reference tariffs. This reference tariff policy describes the methodology used in deriving the reference tariff and the structure of the reference tariffs. It also sets out the information about the treatment of new facilities investment and redundant capital and describes the proposed incentive mechanism.

2.1.2. Response to draft decision

No submissions were received on this aspect of the draft decision.

2.1.3. Conclusion

As required under s. 3.5 of the code, GasNet has included a reference tariff policy in the proposed AA. The ACCC's assessment of each element of the reference tariff policy is provided in the relevant chapters of this final decision.

2.2. Reference tariff methodology

2.2.1. Introduction

Section 8 of the code sets out the general principles for a reference tariff and certain factors about which the relevant regulator must be satisfied before the reference tariffs and the reference tariff policy can be approved. The general principles are set out in ss. 8.1 and 8.2 of the code. Section 8.3 of the code states that, subject to requirements of that section and the s. 8.1 objectives, the method by which the reference tariff may vary within an AA period through implementation of the reference tariff policy is within the discretion of the service provider.

GasNet proposed to retain the cost of service approach to determine its total revenue requirement for the AA3 period.¹⁰ That is, total revenue is calculated to recover the costs associated with the rate of return on assets that form the capital base, depreciation of that capital base and non-capital costs incurred in delivering services.¹¹

¹⁰ GasNet, *Access Arrangement Submission 2008–12*, 14 May 2007, p. 13.

¹¹ *ibid.*, p. 15.

To vary its reference tariffs during the AA3 period, GasNet proposed to apply a combination of a reference tariff control formula approach (s. 8.3(c)) and a trigger event adjustment approach (s. 8.3(d)).¹² Specifically, in establishing the price path for the revised AA, GasNet has proposed that the initial reference tariffs at the commencement of the AA3 period be indexed in subsequent years by a CPI-X formula specified in cl. 4.1 of schedule 4 of the proposed AA. In addition to this annual adjustment, GasNet proposed that if there is a material change in new or existing taxes, insurance costs, regulatory costs, counterparty default, costs associated with a terrorism event or costs associated with an asbestos event, then this would be a specified event for the purposes of s. 8.3B of the code and the reference tariff may be adjusted by GasNet to pass-through such an amount to users.¹³

2.2.2. Response to the draft decision

No submissions were received on this aspect of the draft decision.

2.2.3. Conclusion

Section 8.4 of the code permits GasNet's retention of a cost of service approach to calculate its total revenue.

Section 8.3(e) of the code permits the adoption of a combination of a price path, reference tariff control formula and trigger event adjustment approaches. As such, GasNet's approach is consistent with the code. GasNet's proposals are considered in detail in the following chapters.

¹² *ibid*; GasNet's reference tariff control and trigger event adjustments are considered in detail in chapter 6.3 of the draft decision.

¹³ *ibid*.

3. Capital base

3.1. Roll forward of the capital base

3.1.1. Introduction

Section 8.9 of the code states that (for the cost of service methodology) the capital base at the commencement of each AA period after the first is determined as:

- the capital base at the start of the preceding AA period plus
- the new facilities investment (NFI) (or the recoverable portion) in the preceding AA period (adjusted as relevant as a consequence of s. 8.22 of the code to allow for the differences between actual and forecast new facilities investment) less
- depreciation for the preceding AA period less
- redundant capital identified prior to the start of the new AA period.

GasNet proposed the following roll-forward of its capital base to the commencement of the AA3 period in accordance with Table 3.1.1.

Table 3.1.1: Proposal—roll-forward of the capital base

Nominal \$ m	2003	2004	2005	2006	2007
Opening capital base	496.18	487.97	479.70	473.88	485.73
Depreciation allowance	-20.61	-21.60	-22.81	-23.92	-24.41
Capital expenditure	0.50	0.70	3.62	20.69	48.08
Disposals/redundancies	0.00	0.02	0.00	0.00	0.00
Inflation	11.90	12.64	13.37	15.08	14.97
Closing capital base	487.97	479.70	473.88	485.73	524.36

Source: GasNet, *AAI 2008–12*, p. 3; data from GasNet RAB model and PTRM.

GasNet used the 2003 opening value approved by the ACCC as part of the last access revision of \$494.1 m, adjusting this for actual capital expenditure and inflation for 2002 which were not known at the time it was determined. GasNet noted that it provided a best estimate of \$0.66 m for capex in 2002, whereas actual capex was \$0.31 m. Similarly, an inflation estimate of 0.54 per cent for the December quarter 2002 was used for the 2002 decision, whereas actual inflation for this quarter was 0.72 per cent. After correcting for these estimates, GasNet proposed an opening capital base of \$496.18 m.

GasNet’s proposed calculations also included the cost of interest during construction (IDC) on the basis that these costs should accompany capex reported under its as-commissioned approach. Also, consistent with this approach, expenditure incurred over the AA2 period on the Brooklyn Lara pipeline (i.e. the “Corio loop” augmentation) was not included in its roll-forward calculations given this project will be commissioned in AA3 period.¹⁴ GasNet submitted a revised cost estimate for

¹⁴ GasNet, *Submission*, p. 53.

this project of \$67.37 m (in 2006 dollars), which was \$3.67 m higher than that approved by the ACCC in 2006.

In its draft decision, while the ACCC generally accepted GasNet's proposed roll-forward calculations, it required the following adjustments to the 2007 closing value:

- removal of the value of return on capital over the AA2 period associated with the amount of capex in excess of that forecast for 2002, estimated by the ACCC to be \$6.91 m
- addition of the return on capital that was foregone over the AA2 period due to the underestimate of inflation for 2002, valued at \$0.34 m.

The ACCC also required GasNet to separate the value of expenditure incurred on the Brooklyn Lara pipeline (Corio loop) in the AA2 period and that forecast for the AA3 period, consistent with its decision to approve that project in 2006. The amounts to be capitalised for the AA2 period was \$45.51 m (\$ December 2006) and IDC of \$1.19 m. The ACCC noted that there was insufficient time to assess GasNet's revised cost estimate for this project, thus the remaining amount that was approved by the ACCC in 2006 (\$18.19 m¹⁵ and associated IDC of \$0.48 m) was to be recognised as forecast capex for the AA3 period.

3.1.2. Proposed amendments

Proposed amendment 01 (reproduced below) expressed the ACCC's draft decision noted above.

Proposed amendment 01

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 2.1 of its proposed revised access arrangement information to reflect table 3.1.4 of this draft decision.

Table 3.1.4 of the draft decision is reproduced below.

Table 3.1.4: Draft decision—roll-forward of the capital base

nominal \$ m	2003	2004	2005	2006	2007
Opening capital base^a	496.18	487.97	479.70	473.88	485.73
Depreciation allowance	-20.61	-21.60	-22.81	-23.92	-24.41
Capital expenditure ^b	0.50	0.70	3.57	20.36	94.77 ^c
Disposals/redundancies	0.00	(0.02)	0.00	0.00	0.00
Inflation	11.74	12.64	13.43	15.42	15.01
Closing capital base	487.80	479.69	473.89	485.74	571.09
Adjustment for 2002 capex overestimate					-6.91
Adjustment for 2002 inflation underestimate					0.34
Adjusted closing capital base					564.51

Source: ACCC analysis.

^a A minor discrepancy exists between GasNet's model and this summary roll-forward calculation.

¹⁵ That is, the initial approved amount (\$61.70 m) expressed in 2006 dollars of \$63.70 million, less \$45.51 m spent in AA2.

^b Includes IDC.

^c Includes expenditure associated with the Corio loop augmentation.

3.1.3. Response to the draft decision

GasNet states in its response to the draft decision that the amount of capex forecast to be spent in 2002 was \$0.57 m, not \$0.66 m as stated in its submission. It submits that the ACCC's calculation of the return on capital associated with this additional capex over the AA2 period is incorrect and is \$0.11 m, and that it considers this amount to be immaterial.

GasNet agreed with the ACCC's estimate of the additional return on capital associated with the estimate of inflation for 2002.

GasNet states that it is indifferent to when expenditure associated with the Brooklyn Lara pipeline is recognised, provided the associated IDC is calculated consistently. It notes that its claim of a 5.7 per cent increase in the cost of this project from that approved by the ACCC in 2006 is primarily due to increases in construction costs over the last two years. It notes that construction of the project was contracted through a tendering process and therefore the revised costs of the project do not exceed those which would be incurred by a prudent service provider. It also notes that the cost of this project would continue to satisfy s. 8.16(a)(ii)(B) of the code given that its claimed increases are insignificant compared to the net market benefits of the project identified by VENCORP (i.e. \$3.7 m compared to benefits of \$93.1 m). Attachment 1 to GasNet's response provides details on the current status and scope of the project. GasNet also provided confidential information to the ACCC relating to a tendering process for the project.

No other comments were received on this aspect of the draft decision.

3.1.4. Conclusion

The ACCC has reviewed the draft decision roll forward calculation and acknowledges that it had miscalculated the return on capital associated with the forecast capex for 2002. The ACCC also notes GasNet's revised value for actual capex of \$0.57 m. The ACCC confirms that GasNet's calculation of the return on capital associated with this overestimate is correct at \$0.11 m. While this amount is not substantial, the ACCC maintains that this amount should be removed from GasNet's capital base.

Similarly, the ACCC maintains the view in its draft decision that the \$0.34 m associated with the forecast inflation error for 2002 is of sufficient size to justify its inclusion in the capital base. By removing any costs or benefits of inaccurate forecasts it is expected that GasNet will not face any inappropriate incentives and therefore be more likely to provide accurate forecasts.

The information provided by GasNet regarding the Brooklyn Lara pipeline indicates that the project scope is substantially the same as that approved by the ACCC in

2006.¹⁶ The ACCC has reviewed the cost increases claimed by GasNet. The ACCC notes that these increases are primarily due to increased materials and labour costs, which are considered reasonable given the recent changes observed in materials prices and wages (see section 5.1.4 for a discussion on input prices). Further, the information provided by GasNet also substantiates that it has undertaken a competitive tendering process to select an engineering, procurement and construction contractor for the project as would be expected of a prudent service provider. In this context the ACCC considers that GasNet's revised cost estimate for the Brooklyn Lara pipeline of \$67.37 m and IDC of \$0.75 m (both in December 2006 dollars) is prudent and efficient. As per the approach adopted in the draft decision, the ACCC requires GasNet to capitalise \$47.27 m (and IDC of \$0.82 m) in rolling forward its capital base in 2007, and include the remaining \$21.0 m (IDC of \$0.07 m) as forecast capex for 2008.¹⁷

GasNet noted¹⁸ that refurbishment of the Gooding compressor station was not completed in the AA2 period and that 92.2 per cent of the total cost of the project had been incurred to December 2007, with the remaining 7.8 per cent to be spent by May 2008. As this project spans two AA periods, similar issues arise in recognising this expenditure as the Brooklyn Lara pipeline, namely that s. 8.20 of the code does not allow expenditure that has already been incurred to be recognised as forecast expenditure for the AA3 period, and therefore must be capitalised in the AA2 roll forward calculation. Based on information provided by GasNet, the amount to be recognised in the AA2 period is \$14.34 m (IDC of \$1.15 m) and in AA3 is \$1.22 m (IDC of \$0.10 m).¹⁹

Other adjustments relating to expenditure in the AA2 period are discussed in section 3.2.4.

As a result of these amendments, the ACCC has calculated a roll forward calculation for the final decision as set out in table 3.1.2. GasNet is required to amend its proposed revised AA and AAI to comply with these amendments.

¹⁶ GasNet, *Response to the Commission's Draft Decision on Proposed Access Arrangement for the Principal Transmission System*, (Submission in Response), December 2007, Attachment 1.

¹⁷ GasNet's method of calculating IDC is the value of expenditure which would be required to equalise, in net present value terms, the aggregated value of monthly expenditures and a single payment made at the end of the construction period. That is, GasNet assumes that IDC is calculated monthly and at a rate equivalent to its WACC.

¹⁸ GasNet, *Email to the AER*, 16 January 2008.

¹⁹ All expressed in 2006 dollars.

Table 3.1.2: Final decision—roll-forward of the capital base

nominal \$ m	2003	2004	2005	2006	2007
Opening capital base	496.18	487.97	479.70	473.88	476.34
Depreciation allowance	-20.61	-21.60	-22.81	-23.92	-24.41
Capital expenditure	0.50	0.70	3.57	10.97	92.54
Disposals/redundancies	0.00	-0.02	0.00	0.00	0.00
Inflation	11.74	12.64	13.43	15.42	14.09
Closing capital base	487.80	479.69	473.89	476.35	558.55
Adjustment for 2002 capex overestimate					-0.11
Adjustment for 2002 inflation underestimate					0.34
Adjusted closing capital base					558.78

Source: ACCC analysis.

Amendment 01

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 2.1 of its proposed revised access arrangement information to reflect table 3.1.2 of this final decision.

3.2. New facilities investment

3.2.1. Introduction

Sections 8.15 and 8.16 of the code allow the capital base to be increased where additional capital costs are incurred in constructing or acquiring new facilities for the purpose of providing services. GasNet proposed \$32.16 m of actual capex incurred during the AA2 period, to be rolled-in to the capital base on the grounds that the requirements of the code have been satisfied.²⁰ This contrasted with the \$47.72 m of forecast capex approved by the ACCC in 2002, which was reasonably expected to satisfy the requirements of the prudent investment test and the system integrity test.²¹ GasNet also submitted \$35.42 m of other non-forecast capex was also incurred during the AA2 period.²²

GasNet submitted all of the actual capex it has incurred was of a maintenance nature which did not increase or augment the capacity of the PTS and satisfies the requirements of the prudent investment test and the system integrity test.²³

The draft decision proposed to accept the majority of GasNet's actual capex over the AA2 period. The draft decision, however, proposed not to accept some of the costs related to the Iona cooler upgrade and all of the proposed acquisition costs related to GasNet as seller to the APA Group.

In proposing not to approve the capitalisation of acquisition costs in its draft decision, the ACCC considered the code defines new facilities investment as the capital costs incurred in constructing, developing or acquiring new facilities for the purpose of providing services. While a consequence of private ownership is subsequent merger and acquisition activity, the associated costs are not costs which are associated with the delivery of the reference service. The transaction costs of the buyer and seller would be taken into account by each party in arriving at the price that the parties are prepared to buy and sell the asset. The ACCC concluded that it would be no more appropriate to roll the transaction costs of the acquisition into the capital base as it would be to revalue the assets to reflect the purchase price.

The ACCC proposed to only approve \$0.6 m for the Iona cooler upgrade based on advice from Sleeman Consulting that the costs of this project should be lower than proposed given the scale of this project. The ACCC consideration of this issue is in section 3.3.4 of this final decision.

3.2.2. Proposed amendments

The proposed amendment 02 (reproduced below) expressed the ACCC's draft decision noted above.

²⁰ ACCC, *Final Decision: GasNet Australia access arrangement revisions for the Principal Transmission System*, 13 November 2002, p. 183.

²¹ GasNet, *Access Arrangement Submission 2008–12*, 14 May 2007 pp. 20 and 21.

²² *ibid.*, p. 22.

²³ *ibid.*, p. 24.

Proposed amendment 02

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 2.1 of its proposed revised access arrangement information to reflect table 3.2.3 of this draft decision for roll-in to the capital base.

Table 3.2.3 from the draft decision is reproduced below.

Table 3.2.3: Draft decision—AA2 approved capex

nominal \$ m ^(a)	Forecast	Actual	Draft decision	Difference
Forecast				
Gooding compressor refurbishment	22.21	16.03	16.03	0.00
Lurgi pipeline refurbishment	5.67	2.82	2.82	0.00
City gate upgrades and heaters	9.21	5.38	5.38	0.00
Wollert compressor station automation	2.86	2.76	2.76	0.00
Gas chromatographs	0.92	0.46	0.46	0.00
Other maintenance capex	5.97	4.70	4.70	0.00
Total forecast capex	46.84	32.16	32.16	0.00
Non-forecast				
Brooklyn compressor redevelopment	-	17.46	17.46	0.00
South Melbourne cut in	-	2.98	2.98	0.00
Wollert compressor station (miscellaneous)	-	2.15	2.15	0.00
Pig traps	-	0.72	0.72	0.00
Safety and security	-	0.79	0.96	0.17
Iona cooler upgrade	-	0.70	0.60	-0.10
Regulators work	-	0.42	0.42	0.00
Maximo	-	1.37	1.37	0.00
Corporate restructuring	-	8.84	0.00	-8.84
Total non-forecast capex		35.42	26.66	-8.77
Difference		67.58	58.82	-8.77

Source: GasNet, *Submission 2008–12*, tables 5.2 and 5.3, ACCC draft decision.

^(a)The draft decision, referred to these figures as \$ December 2006, however, these figures should have been expressed in nominal dollars.

3.2.3. Response to the draft decision

Apart from corporate restructuring costs, no submissions were received on GasNet's capex for the AA2 period.

3.2.4. Conclusion

3.2.4.1. Assessment of approved capex to be incurred during the AA2 period

(i) Gooding compressor

As noted in section 3.1.4, GasNet has provided the ACCC with further information indicating that, as at December 2007, it has incurred 92.2 per cent of the total cost of refurbishing the Gooding compressor station, with the remainder to be spent in 2008.

The ACCC considers that the cost of the project spent in the AA2 period of \$14.77 m satisfies s. 8.16 of the code and is to be included in the capital base.

(ii) *Refurbishment of Lurgi pipeline*

In its draft decision, the ACCC considered that \$2.82 m to refurbish the Lurgi pipeline satisfies s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$2.82 m satisfies s. 8.16 and is to be included in the capital base.

(iii) *City upgrades and heaters*

In its draft decision, the ACCC considered that \$5.38 m incurred in the AA2 period for city gate upgrades and heaters satisfied s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$5.38 m satisfies s. 8.16 and is to be included in the capital base.

(iv) *Wollert compressor station upgrade*

In its draft decision, the ACCC considered that \$2.76 m incurred in the AA2 period to automate the Wollert compressor station satisfied s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$2.76 m satisfies s. 8.16 of the code and is to be included in the capital base.

(v) *Gas chromatographs*

In its draft decision, the ACCC considered that \$0.46 m incurred in the AA2 period to install three gas chromatographs at Alansford, Brooklyn and Corio satisfied s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$0.46 m satisfies s. 8.16 of the code and is to be included in the capital base.

(vi) *Other maintenance capex*

In its draft decision, the ACCC considered that \$4.70 m incurred in the AA2 period for other maintenance capex satisfied s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$4.70 m satisfies s. 8.16 of the code and is to be included in the capital base.

3.2.4.2. Assessment of non-forecast capex incurred during the AA2 period

(i) *Brooklyn Lara pipeline*

As noted in section 3.1.4, the ACCC requires GasNet to recognise expenditure on the Brooklyn Lara pipeline to December 2007 (i.e. \$47.27 m, nominal) as actual capex for the AA2 period.

(ii) *Brooklyn compressor redevelopment*

In its draft decision, the ACCC considered that \$17.46 m incurred in the AA2 period to redevelop the Brooklyn compressor station satisfied s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$17.46 m satisfies s. 8.16 of the code and is to be included in the capital base.

(iii) *South Melbourne cut in*

In its draft decision, the ACCC considered that \$2.98 m incurred in the AA2 period to install two pig traps on the pipeline that connects the Dandenong to West Melbourne pipeline with the South Melbourne to Brooklyn pipeline satisfied s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$2.98 m satisfies s. 8.16 of the code and is to be included in the capital base.

(iv) *Wollert compressor station (miscellaneous)*

In its draft decision, the ACCC considered that \$2.15 m of works additional to the automation of the Wollert compressor station incurred in the AA2 period satisfied s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$2.15 m satisfies s. 8.16 and is to be included in the capital base.

(v) *Pig traps*

In its draft decision, the ACCC considered that \$0.72 m to install pig traps on the Bunyip to Pakenham line incurred in the AA2 period satisfied s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$0.72 m satisfies s. 8.16 of the code and is to be included in the capital base.

(vi) *Safety and security*

In its draft decision, the ACCC considered that \$0.955 m to install remote monitoring infrastructure and develop dossiers incurred in the AA2 period satisfied s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$0.955 m satisfies s. 8.16 of the code and is to be included in the capital base.

(vii) *Iona cooler upgrade*

GasNet has subsequently advised that this project has been delayed and is not expected to be completed until 2009. GasNet therefore proposes that this project be included as forecast capex to be incurred in 2009.²⁴ Accordingly, the ACCC has considered this project in chapter 3.3.

(viii) *Regulators work*

In its draft decision, the ACCC considered that \$0.42 m to upgrade backup regulators at the Dandenong terminal incurred in the AA2 period satisfied s. 8.16 of the code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$0.42 m satisfies s. 8.16 of the code and is to be included in the capital base.

(ix) *Maximo*

In its draft decision, the ACCC considered that \$1.37 m to upgrade GasNet's Maximo asset management system incurred in the AA2 period satisfied s. 8.16 of the

²⁴ GasNet, *Email to the AER*, 28 March 2008.

code and is to be included in the capital base. For this final decision, the ACCC reaffirms the draft decision that \$1.37 m satisfies s. 8.16 of the code and is to be included in the capital base.

(x) Corporate restructuring costs

GasNet submitted that it incurred in excess of \$10 m in relation to the takeover by the APA Group in 2006 and \$8.84 m is to be allocated to the regulated GasNet business.²⁵ In response to the draft decision GasNet submits that the APA Group has also incurred \$10 m in transactions costs as the buyer of the GasNet assets. GasNet now considers that the proposed \$8.84 m incurred in selling the assets to the APA group should be considered non-capital costs. GasNet also proposes that \$10 m of costs incurred by the APA Group as buyer of the regulated GasNet assets should be recovered as non-capital costs. The ACCC’s considerations of these proposals are provided in chapter 5.1 of this final decision.

3.2.5. Conclusion

Table 3.2.1 details the ACCC’s assessment of GasNet’s AA2 actual capex proposals against s. 8.16 of the code.

Table 3.2.1: Final decision—approved AA2 actual capex

nominal \$m	<i>Proposed</i>	<i>Draft decision</i>	<i>Final decision</i>	<i>Difference</i>
Forecast^(a)				
Gooding compressor refurbishment ^(b)	22.21	16.03	14.77	-1.26
Lurgi pipeline refurbishment	5.67	2.82	2.82	0.00
City gate upgrades and heaters	9.21	5.38	5.38	0.00
Wollert compressor station automation	2.86	2.76	2.76	0.00
Gas chromatographs	0.92	0.46	0.46	0.00
Other maintenance capex	5.97	4.70	4.70	0.00
Total forecast	46.84	32.16	30.89	-1.26
Non-forecast				
Brooklyn Lara pipeline	N/A	47.19	47.27	0.08
Brooklyn compressor redevelopment	17.46	17.46	17.46	0.00
South Melbourne cut in	2.98	2.98	2.98	0.00
Wollert compressor station (miscellaneous)	2.15	2.15	2.15	0.00
Pig traps	0.72	0.72	0.72	0.00
Safety and security	0.79	0.96	0.96	0.17
Iona cooler upgrade ^(c)	0.70	0.60	0.00	-0.70
Regulators work	0.42	0.42	0.42	0.00
Maximo	1.37	1.37	1.37	0.00
Corporate restructuring	8.84	0.00	0.00	-8.84
Total non-forecast	35.42	82.52	73.33	-9.29
Total actual capex	82.26	114.67	104.22	-10.55

^a values exclude IDC

^b \$1.26 m of expenditure on this project will be recognised as forecast capex for the AA3 period

^c This project is forecast, whereas, GasNet initially proposed this project as actual capex.

²⁵ GasNet, *Submission*, op. cit., p. 30.

Amendment 02

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 2.1 of the proposed revised access arrangement information to reflect table 3.2.1 of this final decision for roll-in to the capital base.

3.3. Forecast capital expenditure

3.3.1. Introduction

Section 8.20 of the code allows for reference tariffs to be determined on the basis of new facilities investment or capital expenditure (capex) approved by the relevant regulator which a service provider forecasts to occur during the AA period and demonstrates there is a reasonable expectation that the requirements in s. 8.16 of the code will be satisfied. GasNet proposed a substantial forecast capex program of \$334.08 m for the AA3 period.²⁶ This comprised \$245.91 m of augmentation capex, principally to address anticipated network constraints, and \$88.19 m of refurbishments/upgrades to the PTS. GasNet submitted that each capex proposal is reasonably expected to meet the requirements of s. 8.16 of the code.²⁷ Specifically:

- each capex proposal is reasonably expected to satisfy the requirements of the prudent investment test
- each augmentation proposal, with the exception of the Stonehaven compressor, is reasonably expected to satisfy the requirements of the system integrity test
- the Stonehaven compressor proposal is reasonably expected to satisfy the requirements of the system-wide benefits test²⁸ and
- each refurbishment/upgrade proposal is reasonably expected to satisfy the requirements of the system integrity test.

The draft decision concluded that the majority of GasNet's proposed augmentation capex should not be assessed against s. 8.16(a)(ii)(C) of the code as these proposals were not considered to be consistent with maintaining the safety and integrity of services. In contrast, the ACCC also concluded that the majority of GasNet's refurbishment/replacement proposals satisfied s. 8.16 of the code. However, the ACCC considered that some of the proposed refurbishment/replacement capex projects did not satisfy s. 8.16(a)(i) of the code.

3.3.2. Proposed amendments

Proposed amendment 03 (reproduced below) expressed the ACCC's draft decision noted above.

²⁶ GasNet, *Revised Access Arrangement 2003–07*, cl. 3.6; ACCC, *Final Decision: GasNet Australia 2002–07*, op. cit., p. 183.

²⁷ GasNet, *Submission*, op. cit., pp. 46–8.

²⁸ On 21 August 2007, GasNet provided further information relating to the Stonehaven compressor proposal: GasNet, *Email to the AER*, 21 August 2007.

Proposed amendment 03

Before the proposed revised access arrangement can be approved, GasNet must:

- amend cl. 3.6 of the proposed revised access arrangement information to reflect table 3.3.7 of this draft decision
 - demonstrate how the portion of the Northern zone necessary to address the anticipated breach of the minimum system pressure requirements and the Warragul loop are reasonably expected to satisfy the requirements of the economic feasibility test in s. 8.16(a)(ii)(A) of the code in order to include the amounts the ACCC considers are reasonably expected to satisfy the requirements of the prudent investment test in cl. 3.6 of the proposed revised access arrangement information
 - demonstrate how the proposed Pakenham loop is reasonably expected to satisfy the requirements of the system integrity test in s. 8.16(a)(ii)(C) of the code in order to include the amount the ACCC considers is reasonably expected to satisfy the requirements of the prudent investment test in cl. 3.6 of the proposed revised access arrangement information.
-

Table 3.3.7 of the draft decision is reproduced below.

Table 3.3.7: Draft decision—AA3 forecast capex

\$2006 Dec m	Proposal	s. 8.16(a) of the code requirements		Draft decision
		s. 8.16(a)(i)	s. 8.16(a)(ii)	
Augmentations				
Northern zone	79.03	79.03	Demonstrate against EFT	79.03
Sunbury loop	12.46	0.00	n/a—does not meet PIT	-12.46
Ballarat loop	29.03	0.00	n/a—does not meet PIT	-29.03
Warragul loop	4.84	4.43	Demonstrate against EFT	4.84
Pakenham loop	1.22	1.22	Demonstrate against SIT	1.22
Stonehaven compressor	26.19	0.00	n/a—does not meet PIT	-26.19
Carisbrook loop	24.05	0.00	n/a—does not meet PIT	-24.05
Brooklyn Lara (Corio) pipeline	63.71	18.19	18.19	-45.52
Brooklyn Wollert easements	5.37	0.00	n/a—does not meet PIT	-5.37
Total augmentations	245.90	102.87	18.19	-227.70
Refurbishments/upgrades				
Gas heating facilities	9.21	7.25	approved against SIT	-1.96
City gate works	6.68	6.18	approved against SIT	-0.50
Pipeline upgrades	9.65	7.65	approved against SIT	-2.00
Safety and security systems	4.25	2.93	approved against SIT	-1.32
Brooklyn compressor station	49.57	49.57	approved against SIT	0.00
Wollert compressor station	1.58	0.05	n/a—does not meet PIT	-1.53
Other compressor stations	2.96/2.91	1.29	approved against SIT	-1.62
Other	4.30	0.00	n/a—does not meet PIT	-4.30
Total refurbishments/upgrades	88.20	74.92	74.92	-13.23
Total capex	334.10	n/a	93.11	-241.00

Notes: PIT—prudent investment test in s. 8.16(a)(i) of the code.
EFT—economic feasibility test in s. 8.16(a)(ii)(A) of the code.
SBT—system-wide benefits test in s. 8.16(a)(ii)(B) of the code.
SIT—system integrity test in s. 8.16(a)(ii)(C) of the code.

3.3.3. Responses to the draft decision

VENCorp submits that it considers that the ACCC should reconsider how it takes into account anticipated constraints and potential breaches in minimum system pressure and the likely impacts on the safety and security of the PTS and future gas supplies in Victoria.²⁹ VENCorp also states that the *Victorian Gas Safety Act 1997*

²⁹ VENCorp, *Re: ACCC's Draft Determination of GasNet's Revised Access Arrangement*, (Submission in Response), December 2007, p. 2.

which requires VENCORP to operate the PTS in accordance with a safety case. This case considers gas demand as one of the key hazards as adequate pressures are required to control gas demand safely for Victorian consumers.³⁰

3.3.3.1. Assessment against the system integrity test

GasNet submits that the draft decision's interpretation and application of the system integrity test is incorrect and not appropriate in the circumstances.³¹

GasNet submits that it is possible for proposed capex to meet more than one of the tests in s. 8.16(a)(ii) of the code and that the regulator does not have the discretion to decide that a capex proposal must also demonstrate that it meets another one of the tests.³²

GasNet claims that its proposed augmentation capex should be assessed under the system integrity test on the basis of:

- maintaining minimum system pressures in the context of market carriage
- regulatory precedent and
- difficulties in identifying incremental users and usage for the purposes of applying the economic feasibility test.

GasNet also submits that the proposed augmentation capex meets the system-wide benefits test as the PTS is a single integrated pipeline system and augmentations which allow GasNet to continue to deliver gas across Victoria benefit all users.

3.3.3.2. Augmentation capex proposals

(i) Northern zone

GasNet submits that it has reviewed the alternative proposal put forward by Sleeman Consulting accepted by the ACCC in the draft decision and concludes that the expected cost differences between the two options are marginal as:

- Sleeman Consulting's overall costing is not materially different from GasNet's estimate
- fuel gas use is lower in the GasNet scenario as the two compressor stations would be required to operate less often than a single compressor station and
- operating costs (excluding fuel) are higher under the GasNet proposal as the operating costs associated with the Euroa compressor are higher than the operating costs associated with the longer loop (Sleeman Consulting) scenario.³³

³⁰ *ibid.*, p. 2.

³¹ GasNet, *Submission in Response*, *op. cit.*, p. 4.

³² *ibid.*

³³ GasNet, *Submission in Response*, *op. cit.*, p. 9.

GasNet submits that based upon its NPV analysis of the two options that the capex for the (Sleeman Consulting) loop option is approximately 5.5 per cent higher than the GasNet option over time.³⁴

GasNet also considers that there are other reasons not revealed by the NPV analysis that favour its option, which include:

- greater ability to import gas from Culcairn in a system emergency
- supports potentially greater growth on laterals, particularly the Echuca/Shepparton lateral, since the Euroa compressor can maintain maximum pressures into the inlet of the lateral and
- improves operational flexibility by providing better control of the linepack.³⁵

GasNet raises concerns that if the ACCC does not accept its submissions that it will not receive an opex allowance for the Euroa compressor in AA3 or future regulatory periods, and that there is a risk that if it proceeds with the project that the ACCC will not be rolled into the capital base in the next period.³⁶

In respect of the draft decision's conclusion that the economic feasibility test should be applied to a portion of the Northern zone investment, GasNet submits that if the economic feasibility test is applied that it is likely that a significant surcharge would be required on customers in the Echuca zone and this could lead to reduced consumption or lower demand growth. GasNet also states that it would have to consider whether the surcharge imposed an unacceptable risk profile on the investment, and therefore whether the expansion may not be justified at the regulated rate of return.³⁷

³⁴ *ibid.*, p. 10.

³⁵ *ibid.*

³⁶ *ibid.*

³⁷ *ibid.*, pp. 10-11.

GasNet notes that the draft decision has created two categories of investment for the purpose of the application of the 8.16 tests. Augmentation designed to maintain the AMDQ at Culcairn is deemed to pass the system integrity test, whereas augmentation designed to avoid a breach of minimum pressures on the Echuca lateral is required to pass the economic feasibility test. GasNet submits that the amount apportioned to the economic feasibility test is \$79.1 m less \$27 m (for the refurbishment of the Wollert compressor). Based upon gas flows GasNet submits that relevant gas flows for the 17 TJ/day of exports are the flows in Wodonga, North Hume, South Hume and Murray Valley zones, plus the exports, plus a portion of the flows into the Calder zone along the Kyneton lateral to Bendigo.³⁸

GasNet proposes that:

- \$27 m would be included in the forecast capital base under the system integrity test
- the portion associated with restoration of the 17 TJ/day of export capability would be also included in the forecast capital base under the system integrity test and
- the remaining amount associated with the Echuca lateral that the recoverable portion (based upon the incremental volumes within the Echuca zone in 2009) be included in the forecast capital base and the remaining portion be recovered by a surcharge (on a postage stamp basis over the life of the asset).³⁹

GasNet also proposes that the non capital costs be recovered in the same way as capex with the costs to operate the Wollert compressor deemed to be included in the general opex forecast. The surcharge would apply to all users in the Echuca zone as it is impossible to distinguish the incremental users from the existing users and that it will be reassessed at each revision (based upon approved volume forecasts, economic lives and the WACC).⁴⁰

(ii) Sunbury loop

GasNet submits that it accepts the ACCC's position in the draft decision that the Sunbury loop project should not be included as forecast capex. However it notes that if the installation of units 13 and 14 at the Brooklyn compressor station is not approved by the ACCC, then the proposed Sunbury loop will be required in 2012.⁴¹

(iii) Ballarat (Mt Franklin to Ballan loop)

GasNet submits that it accepts the ACCC's position in the draft decision that the Ballarat looping project should not be included as capex. However it notes that if the

³⁸ *ibid.*, p. 12.

³⁹ *ibid.*

⁴⁰ *ibid.*, pp. 12-13.

⁴¹ *ibid.*, p. 13.

installation of units 13 and 14 at the Brooklyn compressor station is not approved by the ACCC, then the proposed Ballarat loop will be required in 2010.⁴²

(iv) Warragul loop

GasNet submits that if it were to proceed under the economic feasibility test, GasNet would apply a surcharge to the whole Lurgi zone on a postage stamp basis.⁴³

GasNet states that it accepts the use of the term ‘unidentified costs’ rather than ‘contingency costs’ to describe this type of cost. However, it notes that a 20 per cent allowance is appropriate given that s. 8.20 of the code only requires that the forecast capital expenditure is *reasonably expected* to pass the requirements of the prudent investment test for new facilities investment. It submits that different variables apply to each new facility and insufficient design work has been conducted to narrow the range of variables.⁴⁴

(v) Pakenham loop

GasNet submits that operational velocities should not normally exceed 50 per cent of the maximum recommended velocity.⁴⁵ Therefore the forecast velocity of 22 m/s in 2009 is well in excess of the recommended operational velocity at 2,760 kPa of 12.5 m/s.⁴⁶

(vi) Stonehaven compressor

GasNet submits that:

- it has provided a cost/benefit analysis that demonstrates that the Stonehaven compressor is economically viable in 2012
- the analysis is sufficient to meet the requirements of the s. 8.16 tests of the code in terms of ‘reasonably expected’ to be met and
- there is no low cost alternative to Stonehaven, and hence a revenue provision in the tariffs is justified irrespective of if subsequent analysis shows an alternative investment is superior to Stonehaven.⁴⁷

GasNet states that by using a lower discount rate and allowing for competition benefits in VENCORP’s cost/benefit analysis, that the optimal timing for the Stonehaven compressor is at least 2012. It proposes that while VENCORP’s report only attempted a high level of analysis, the detail in this report is more than

⁴² *ibid.*, p. 13.

⁴³ *ibid.*, p. 14.

⁴⁴ *ibid.*

⁴⁵ E. Sashi Menon, *Gas Pipeline Hydraulics*, CRC Press, Boca Raton, Florida, 2005, p. 40.

⁴⁶ GasNet, *Submission in Response*, *op. cit.*, p. 15.

⁴⁷ *ibid.*, p. 16.

sufficient to justify a small revenue provision and approval of this project does not bind the regulator to roll the asset into the capital base.⁴⁸

GasNet also notes that the analysis conducted by Sleeman consulting excluded gas-fired power generation in its forecasts, while the VENCORP analysis included these loads and used forecasts based on Monte Carlo simulations of each day rather than just peak days.⁴⁹

GasNet submits that forecast capex only requires it to be reasonably expected to pass the requirements in s 8.16 for new facilities investment. However, it notes that the project must still pass the s. 8.16 tests in an *ex post* review at the next revision as to whether to roll the capex into the capital base.⁵⁰

GasNet states that as the proposed expenditure occurs in 2012, it would difficult to give same level detail and rigour when compared to a proposal for capex in 2008. However, the further out a project is forecast, the lower the impact on forecast revenues.⁵¹ GasNet further submits that if a superior alternative approach arises then the funds allocated to the Stonehaven project is equally applicable to that approach. This would include the alternative proposals suggested by Sleeman Consulting, as the PTS has operating boundaries which cannot be increased without additional compression or linepack.⁵²

GasNet further notes that VENCORP is undertaking a detailed market-benefits assessment which is due to be completed in February 2008. It proposes that the ACCC take the findings of this analysis into account in its final decision, even if it results in a delay in the issue of the final decision.⁵³

AGL submits that the ACCC should be mindful that if approvals are concentrated on refurbishment and replacement investment, that there is a risk that projects which has the effect of relieving pipeline congestion (particularly in the Otway basin) may be delayed and may have adverse consequences for retailers.⁵⁴ VENCORP in its submission confirmed that it proposes to undertake an economic assessment of the likely system-wide benefits associated with augmentations to the PTS to address the

⁴⁸ *ibid.*, pp. 16-17.

⁴⁹ *ibid.*

⁵⁰ *ibid.*, p. 17.

⁵¹ *ibid.*, pp. 17-18.

⁵² *ibid.* p. 18.

⁵³ *ibid.*

⁵⁴ AGL, *Re: GasNet Access Arrangement Revisions 2008–Draft Decision*, (Submission in Response), December 2007, p. 3.

ongoing needs of the system with the Stonehaven compressor being one of the alternatives considered.⁵⁵

AGL also notes the VENCORP 2007 Gas Annual Planning Report discusses how new sources of gas from the Otways will become available and that non-firm supply at Longford will decrease substantially in 2010. Therefore Stage 2 of the Corio loop in the form of a compressor station at Stonehaven may need to be brought forward. It supports the full market-benefits analysis being conducted by VENCORP.⁵⁶

Origin submits that the rejection of the proposed Stonehaven compressor under the prudent investment and system-wide benefits tests require further consideration. It notes the full market-benefits test being conducted by VENCORP and submits that its inclusion during the forthcoming AA period (subject to the analysis) will satisfy the tests under s. 8.16 of the code.⁵⁷

TRUenergy also submits that it supports the application of a full market-benefits test by VENCORP and that the ACCC can safely rely on the outcome of this analysis as it will:

- capture the market benefits by calculating the combined reliability, competition and total benefits in terms of unserved energy and
- choose the project that delivers the highest benefits to the market from the range of options considered in the test.⁵⁸

In response to the concerns raised by the ACCC about VENCORP's previous analysis TRUenergy submits that the following issues need to be factored into the analysis:

- increased gas demand required to facilitate additional gas-fired generation will increase the stress on the PTS in the next regulatory period
- increased Longford flows to NSW along the EGP arising from an increase in pipeline capacity through the use of mid-line compression that will reduce the availability of Longford gas in Victoria
- the benefits created by competition between Otway and Longford gas and
- supplies from Longford are more likely to be more expensive than supplies from Port Campbell.⁵⁹

⁵⁵ VENCORP, *Submission in Response*, op. cit., p. 3.

⁵⁶ *ibid.*

⁵⁷ Origin, *Draft Decision - GasNet Australia - Revised Access Arrangement 2008-12*, (Submission in Response), December 2007, p. 2.

⁵⁸ TRUenergy, *Revised Access Arrangement by GasNet Ltd for the Principal Transmission System - Draft Decision - 14 November 2008*, (Submission in Response), December 2007, p. 1.

⁵⁹ *ibid.*, pp. 2-3.

TRUenergy also considers that the VENCORP market benefit analysis was inaccurate as it used a higher discount rate (seven per cent) than the discount rate in the draft decision (6.19 per cent).⁶⁰

TRUenergy Gas Storage submits that the ACCC's decision not to accept further expansion of the SWP to provide sensible gas transmission capacity is denying the market increased price competition and security of supply.⁶¹ TRUenergy gas Storage also comments that the relocation of the Springhurst compressor to Stonehaven should be given urgent considerations as it submits that this compressor is rarely used given insufficient capacity on the Bathurst-Orange-Lithgow pipeline to supply gas to the compressor.

TRUenergy proposes that there are sufficient incentives (VENCORP analysis, irregular price signals and loss of pressure due to gas being transported through the EGP) to accelerate the commissioning of the Stonehaven compressor to winter 2010 at the latest, and that 2012-2013 is too late.⁶²

(vii) Carisbrook loop

GasNet notes the agreement between VENCORP and Sleeman as to unusual nature of gas flows and pressures. However, it points out there is a disagreement as to the cause and consequences of the fluctuations.⁶³

GasNet submits that it remains of the view that the unusual fluctuations are a cause for concern.⁶⁴

(viii) Brooklyn Lara (Corio) pipeline

GasNet submits that it is indifferent to the mechanism used to roll the asset into the capital base, provided the interest during construction is calculated consistently.⁶⁵

GasNet proposes that due to higher construction costs, the revised cost of the project is now \$69.0 m (nominal). It attributes this increase in costs in the past two years where it conducted a tender in order to select a preferred contractor (between three bidders). It notes that this is a six per cent increase on the approved forecast amount of \$63.7 m (Dec 2006 dollars) and is insignificant when compared to the market benefits of \$93.1 m.⁶⁶

⁶⁰ *ibid.*, p. 3.

⁶¹ TRUenergy Gas Storage, *TRUenergy Gas Storage Submission - GasNet Revised Access Arrangement for the Principal Transmission System - 14 November 2008 Draft Decision*, (Submission in Response), December 2007, p. 1.

⁶² *ibid.*, pp. 1-5.

⁶³ GasNet, *Submission in Response, op. cit.*, p. 19.

⁶⁴ *ibid.*

⁶⁵ *ibid.*, p. 2.

⁶⁶ *ibid.*

(ix) Acquisition of easements for the Brooklyn-Wollert loop

GasNet notes that VENCORP is carrying out further work on the benefits of the early acquisition of easements. It proposes that if the analysis supports the need for the loop in the future then the acquisition of the easement in 2010 is justified.⁶⁷

GasNet proposes that in conjunction with the Corio loop that the project will provide a high pressure, high capacity pipeline connecting the Southwest pipeline, the Brooklyn and Wollert compressors, and Dandenong. Subsequently it will enable high volume interchanges between the East and the West of the system, improved supply to metropolitan areas and increased linepack. The anticipated cost of the pipeline is \$117 m.⁶⁸

GasNet states that had the pipeline been constructed before rezoning and subsequent development of Craigeburn and surrounding areas ten years ago, the pipeline route would have been 10 kilometres shorter. GasNet considers that if urban encroachment continues then the cost of the Brooklyn-Wollert loop will be \$20m higher. This justifies the early acquisition of an easement in 2010 at a cost of between \$11 m (for construction in 2020) and \$14.8 m (for construction in 2015).⁶⁹

GasNet submits that this is its first proposal for early acquisition of an easement and notes that VENCORP's Vision 2030 report highlighted the problem of providing infrastructure in a growing city.⁷⁰ GasNet notes that VENCORP is in the process of preparing a report on the benefits of early acquisition of the easement within a 'real options' analytical framework.⁷¹

GasNet proposes that the cost estimate for acquiring 33.5 kilometres of easement and a pipeline licence is \$5.37 m, which is approximately 4.6 per cent of the total cost compared to the owner's costs of 4.2 per cent of the Corio loop.⁷²

GasNet submits that placing the acquisition of the easements under the speculative investment fund would not be appropriate as users would ultimately bear the higher cost to acquire the easements in the future provided they meet the tests in s. 8.16(a) at the relevant time.⁷³ GasNet proposes that it is appropriate to charge users for the cost of early acquisition through the reference tariff as the users would be the ultimate beneficiaries of the early investment. Further, GasNet considers it does not

⁶⁷ *ibid.*, p. 20.

⁶⁸ *ibid.*, p. 20.

⁶⁹ *ibid.*, p. 21.

⁷⁰ *ibid.*

⁷¹ *ibid.*

⁷² *ibid.*

⁷³ *ibid.*

expose any individual user to the same level of risk as applying the whole speculative risk to one company.⁷⁴

GasNet also notes that the concept of early acquisition of sites and easements has been accepted by the AER in its final decision in relation to Powerlink's revenue cap as it was good practice to acquire some easements before they required augmentation if it is likely to result in lower costs to customers in the long-term.⁷⁵

VENCorp submits that following on from the Vision 2030 document, that it is embarking on a sites and easements' review, which is designed to determine what is the current availability of easements, where easements will be required, and what are the estimated costs and timing for acquiring potential easements and sites will be.⁷⁶ VENCorp also advises that it is currently analysing the economic feasibility of acquiring easements for the Brooklyn-Wollert loop using real-options theory as the basis for determining the likely need and timing.⁷⁷

3.3.3.3. Refurbishment/upgrade capital expenditure

(i) Gas heating facilities

GasNet accepts that the need for the Wandong gas chromatograph has not been identified by VENCorp. GasNet states that it will withdraw this proposal on the basis that if VENCorp subsequently requires a chromatograph this will constitute a Regulatory Event for the purposes of the AA.⁷⁸

GasNet submits that Sleeman Consulting's description of the activities covered by owner's costs did not include the design function (a critical function for gas heaters). It notes that each heater facility is a one-off design which must be individually tailored according to purpose and regulator configurations at each site.⁷⁹ It therefore submits that the allowance of 15 to 17 per cent is reasonable and complies with s. 8.16(a) of the code.⁸⁰

GasNet accepts the term 'unidentified costs' and restates that a 20 per cent allowance for 'unidentified costs' is appropriate given that s. 8.20 of the code only requires that the forecast capital expenditure "is reasonably expected to pass the requirements in s. 8.16(a) when the New facilities Investment is expected to occur".⁸¹

⁷⁴ *ibid.*, p. 22.

⁷⁵ *ibid.*

⁷⁶ VENCorp, *Submission in Response*, *op. cit.*, p. 2.

⁷⁷ *ibid.*

⁷⁸ GasNet, *Submission in Response*, *op. cit.*, p. 23.

⁷⁹ *ibid.*

⁸⁰ *ibid.*

⁸¹ *ibid.*

(ii) City gate works

GasNet submits that it accepts the use of the term ‘unidentified costs’ but it also submits that the 20 per cent allowance is reasonable and complies with s. 8.16 (a)(i) of the code.⁸²

(iii) Pipeline upgrades

GasNet submits that an allowance of \$2.0 m over five years (\$0.4 m per annum) is reasonable and that Sleeman Consulting has indicated that making a provision for this amount is reasonable. GasNet accepts that the specific works to be undertaken have not been identified. However it expects that some yet to be identified work will arise during the course of risk assessment.⁸³

GasNet notes that s. 8.20 of the code requires that forecast capex be allowed if it is reasonably expected to pass the tests in s. 8.16(a). It notes that it is not uncommon for regulators to approve amounts for unidentified capex under a ‘business-as-usual’ heading or based on historical experience.⁸⁴

(iv) Safety and security systems

GasNet submits that s. 8.20 of the code requires that forecast capex be allowed if it is reasonably expected to pass the tests in s. 8.16(a). It notes that the code does not require that a specific facility be identified and justified before the event and the work flowing from the hazardous area review fits this description.⁸⁵

(v) Brooklyn compressor station

GasNet makes no comment in its submission on the refurbishment of the Brooklyn compressor station.

(vi) Wollert compressor station

GasNet submits that it accepts the draft decision’s approach.⁸⁶

(vii) Gooding compressor station

GasNet has provided the ACCC with information indicating that, as at December 2007, it has incurred 92.2 per cent of the total cost of refurbishing the Gooding compressor station, with the remainder to be spent in 2008. The total cost of the project forecast by GasNet is \$15.56 m.

⁸² GasNet, *Submission in Response*, op. cit., p. 24.

⁸³ *ibid.*

⁸⁴ *ibid.*

⁸⁵ *ibid.*, p. 25.

⁸⁶ *ibid.*

(viii) *Other compressor station upgrades*

GasNet notes that not all controls were installed in 2001 and that some controls were installed in 1999. Therefore it submits that the life of the units at replacement will vary between 11 and 13 years.⁸⁷

GasNet states that a near miss occurred in 2005 when a field device failure led to the shutdown of the Iona city gate (sole supply to the Western system). It notes that this prevented that operation of both of the compressors and city gate until intervention occurred in Dandenong through remote diagnostics. It submits that had the remote unit failed or the personnel not been available this would certainly lead to significant outages.⁸⁸

Finally, GasNet submits that where a control system is required to interface with new technology (such as SCADA control systems, personal computers, etc), the life of any control system is becoming significantly shorter.⁸⁹

(ix) *Other refurbishments and upgrades*

GasNet submits that its proposed expenditure of 0.15 per cent of the capital base each year for various unidentified projects is a reasonable expectation.⁹⁰ GasNet states that the ACCC approved minor capex of \$5.56 m and that it accepted this unidentified minor maintenance capex at the 2002 revision.⁹¹

GasNet outlines that the minor expenditure includes:

- expansion of office space (\$1.14 m) and maintenance of buildings
- (\$0.64 m) upgrades and replacements of corporate IT hardware and software communication, and data acquisition systems (\$0.86 m)
- replacement of odorant pumps at Longford (\$0.22 m)
- replacement of two chromatographs at the Dandenong City Gate and Terminal station (\$0.25 m) and the installation of five Welker sample probes (\$0.08 m)
- removal and treatment of asbestos (\$0.2 m)

⁸⁷ *ibid.*, p. 26.

⁸⁸ *ibid.*

⁸⁹ *ibid.*

⁹⁰ *ibid.*

⁹¹ *ibid.*

- replacement of five remote terminal units (\$0.51 m)
- acquisition of test equipment for pressure calibration (\$0.2 m) and
- replacement of the GasMan radio system (\$0.2 m).⁹²

3.3.4. Conclusion

3.3.4.1. Assessment against the system integrity test

The ACCC recognises that capex proposals may meet more than one of the s. 8.16(a) tests. In considering GasNet's capex proposals, the code requires that the ACCC be satisfied that GasNet's proposals meet one or a combination of these tests. The ACCC concluded in the draft decision that GasNet's proposed augmentation capex to address anticipated minimum system pressures did not satisfy the system integrity test and invited GasNet to resubmit these proposals under the economic feasibility test.

(i) *Maintaining minimum system pressures in the context of market carriage*

GasNet submits that the objective of a market carriage system is to use market signals rather than firm contractual rights to allocate gas/capacity on a pipeline. In particular, GasNet states that:

- shippers are not required to reserve specified capacity under long-term contracts in order to ship the gas through the market carriage system (instead, they can request various amounts of gas on any given day);
- subject to emergency curtailment powers, VENCORP will accept all gas for delivery and rely instead on market signals to relieve potential constraints; and
- VENCORP operates a spot market into which participants can bid on gas supply and through which all gas imbalances are taken to be bought and sold.⁹³

GasNet submits that a related component of providing safe and secure services to VENCORP is the requirement that access to such services be provided to all users and VENCORP's curtailment powers are limited to emergencies and threats to system security. GasNet also submits the Market System Operation (MSO) rules and the market carriage system are based on the premise that there will be sufficient capacity to meet demand at the gas wholesale market price.⁹⁴

GasNet submits that as the market carriage system is designed to give access in order to meet load and demand requirements, the capital expenditure must be implemented in order for the market carriage system to work as intended and in accordance with the market objective (with minimum pressure levels maintained). As such the augmentation is necessary to maintain the integrity of services in the market carriage system.⁹⁵

⁹² GasNet, *Submission*, op. cit., pp. 44 and 45. The ACCC notes the total of these upgrades (\$0.99 m+\$1.62 m+\$0.30 m) is \$2.91 m, which is marginally less than GasNet's proposal.

⁹³ GasNet, *Submission in Response*, op. cit., pp. 5-6.

⁹⁴ *ibid.*, p. 6.

⁹⁵ *ibid.*

GasNet notes that for contract carriage systems, the service provider can enter into a contract to underpin the cost of capital required to provide the capacity in excess of existing contracted capacity. However, in the market carriage system there is no mechanism (commercial or regulatory) which requires users to make a commitment to contribute to the costs (before or after the investment is undertaken).⁹⁶

The ACCC does not accept that it follows that the market carriage system and MSO rules require that there be sufficient capacity to accommodate all gas demand. As GasNet has noted, VENCorp will accept all gas for delivery subject to the requirement of maintaining system security and safety as required by the MSO rules. In the event that demand exceeds the capacity on parts of the network and there is a threat to system security and safety, VENCorp as the operator of the PTS, is required to control the operation and security of the PTS. This includes reducing users' supply back to their AMDQ/credit allocation (this requires operating the system to ensure there is no minimum pressure breach). In particular, VENCorp is required by the MSO rules to control the operation and security of the PTS in accordance with its *System Security Guidelines*. VENCorp also publishes *Gas Load Curtailment and Gas rationing and Recovery Guidelines*, which provide a priority-order for interrupting users' in circumstances where demand is greater than system capacity on parts of the PTS. In particular, the Guidelines indicate that users whose demand exceeds their AMDQ/credit allocation will be curtailed to the AMDQ/credit allocation, and users who do not have AMDQ/credit will also be curtailed where there is excess demand on the PTS. These Guidelines place essential services last in the order of curtailment and a minimum level of gas consumption is permitted on the basis of safety considerations.⁹⁷

In response to VENCorp's view that the ACCC should reconsider how it takes into account anticipated constraints and the likely impacts on safety and security of the PTS, the ACCC notes that VENCorp has previously commented that under the market carriage capacity management system, in the event that there are network constraints:

- the market resolves the constraints, avoids unnecessary interruption and assigns costs by valuing imbalances and congestion relieving gas at the underlying market price
- unauthorised users are curtailed first if interruption is needed.⁹⁸

Accordingly, the ACCC notes that under the market carriage system, users who access the PTS during peak periods will incur some of the costs of congestion, thereby modifying users demand to facilitate balancing demand and supply on the PTS. In the event that there is a demand imbalance, users will be interruptible in accordance with VENCorp's guidelines as discussed above.

⁹⁶ *ibid.*

⁹⁷ VENCorp, *Gas Load Curtailment and Gas rationing and Recovery Guidelines: issue 7*, March 2003.

⁹⁸ VENCorp, *Submission to COAG Energy Market Review Panel in Response to Issues Raised in Institute of Public Affairs*, submission dated 21 November 2002, 3 December 2002.

(ii) **Regulatory precedent**

GasNet submits that regulatory precedent established by State Regulators' supports the view that the system integrity test should be applied to augmentation capex. These regulatory decisions include:

- the ESCoSA draft and final decisions' for the Envestra gas distribution network
- the ESCV's recent draft decision on gas distribution networks and
- the IPART's decisions in 2000 and 2005 on the Sydney 'primary loop' for the Alinta AGN Limited's gas distribution network.⁹⁹

The ACCC notes that the approved forecast capex in the ESCoSA decision was tested under security of supply considerations and ESCoSA noted that:

Envestra's explanation of this category stresses the objective of reducing the risk of outages some of the projects also have other outcomes and benefits, such as increasing capacity and accessibility for certain areas.¹⁰⁰

The ACCC notes that ESCoSA does not specify which of the s. 8.16(a) tests have been applied. The ACCC notes that the primary purpose of this proposed capex is to reduce the risk of outages but at the same time will also increase capacity. The draft decision accepted capex that is primarily required to refurbish and upgrade compressor stations but at the same time will also increase the capacity of the network under the system integrity test. This is in contrast to GasNet's proposed augmentation capex, which is solely for the purpose of increasing system capacity due to increased demand. Similarly, the ACCC notes that IPART does not specify which of the s. 8.16(a) tests have been applied in its decisions'. However, the ACCC notes the IPART decision considered that the building of the primary loop was not for the purpose of expansion and/or growth but rather system reinforcement.¹⁰¹

In the ESCV's draft decision, the majority of the augmentation for the gas distribution networks in Victoria involved reinforcement and replacement of the existing network. The main example of capex which was required to meet future demand, which the ESCV's decision notes:

Multinet's forecast augmentation expenditure includes an allowance for the 'Lilydale Pipeline' project. This project has been identified as a key project to meet future demand and mitigate supply risk to meet forecast load growth in the next ten years.¹⁰²

The ESCV also does not specify in its decision which of the 8.16(a) tests have been applied in approving this capex. The ACCC notes that both SP AusNet and Envestra's approved augmentation capex involved mains reinforcement,

⁹⁹ GasNet, *Submission in Response*, op. cit., pp. 6-7.

¹⁰⁰ ESCOSA, *Proposed Revision to the Access Arrangement for the South Australian Gas Distribution System*, Draft Decision, March 2006 p 121-122, and Final Decision, 30 June 2006, pg 113.

¹⁰¹ *ibid.*, pp. 106-107.

¹⁰² ESCV, *Gas Access Arrangement Review 2008-2012*, Draft Decision, August 2007, p. 293.

reinforcement of supply and replacement expenditure. Specifically, the ESCV's decision states that of the augmentations proposed by SP AusNet, that '*many were safety or maintenance/replacement related.*'¹⁰³ The ACCC notes that one of the augmentations proposed by Envestra was for the purpose of meeting demand. In particular the proposed project involved the connection of a tariff D customer and was rejected as the ESCV expected that the customer would '*make a significant contribution to the project cost.*'¹⁰⁴

Accordingly, the ACCC considers that the regulatory precedents by ESCoSA and IPART noted in GasNet's submission do not support the application of the system integrity test to capex which is primarily for the purposes of expanding the network to meet increased demand. It is also noted that there is no evidence to suggest that the State Regulators' have accepted augmentation capex under the system integrity test.

(iii) Application of the economic feasibility test

GasNet's submits that unlike contract carriage pipelines, it does not contract directly with users in relation to the reservation of capacity on its pipelines. That is, it is not possible to differentiate between different users of a particular section of pipeline and therefore charge different tariffs (or a surcharge) in relation to use.¹⁰⁵

GasNet notes that it is not possible to differentiate the incremental volumes from the existing volume within a tariff zone and therefore identify the incremental demand. This is due to the fact that it does not have a direct contractual relationship with users and because increased demand largely relates to incremental demand in established areas rather than new developments.¹⁰⁶

The ACCC accepts that it is difficult to identify incremental users and incremental usage, and acknowledges that a number of assumptions are required. The ACCC notes that GasNet has foreshadowed an approach to forecasting incremental volumes in the event that the ACCC requires the application of the economic feasibility test. GasNet has also indicated that it would assume all users in a tariff zone would be incremental users. In particular, GasNet's provided a proposed approach (methodology and assumptions) for the recovery of investments under the economic feasibility test for the Warragul loop. In addition, for the Warragul loop, GasNet states it would likely seek a surcharge for the Lurgi zone.¹⁰⁷

The ACCC has reviewed GasNet's proposed assumptions and methodology for the application of the economic feasibility test for the recovery of the Warragul loop and considers that GasNet's proposed approach is reasonable. In respect of the Northern

¹⁰³ *ibid.*, p. 291.

¹⁰⁴ *ibid.*, p. 298.

¹⁰⁵ *ibid.* p. 7.

¹⁰⁶ *ibid.*, pp. 7-8.

¹⁰⁷ GasNet, *Submission*, *op. cit.*, p. 14.

zone, the ACCC considers that that GasNet's proposed capex is reasonably expected to satisfy the system integrity test of the code.

(iv) Application of the system wide benefits test

GasNet submits that the proposed augmentation capex meets the system-wide benefits test as the PTS is a single integrated pipeline system and augmentations which allow GasNet to continue to deliver gas across Victoria benefit all users.¹⁰⁸

In assessing proposals against the system-wide benefits test, the code requires that the new facility has system-wide benefits that in the Regulators' opinion justify a tariff increase for all users. The ACCC has previously indicated that where the costs to be recovered are substantial, the benefits must also be substantial.¹⁰⁹

GasNet's initial application did not propose that its augmentation capex (with the exception of the Stonehaven compressor proposal) is expected to satisfy the system-wide benefits test. The ACCC considers that it is unlikely that GasNet's capex in the Northern zones and Lurgi zones (Warragul loop) will provide system-wide benefits justifying a tariff increase for all users as these investments are limited to addressing capacity constraints on limited parts of the network. Further, the Interconnect was included in the capital base under the system-wide benefits test on the assumption that imports into the PTS would improve the security of supply for Victorian PTS users. However, the proposed investment in the Northern zone will enable gas to be exported from the PTS through the NSW Interconnect and as GasNet notes it is likely that there will be exports in the AA3 period, thereby limiting the potential benefits associated with security of supply for Victorian users during the winter peak period. To the extent that security of supply improves for country NSW users, these benefits will be limited to these users.

The ACCC also notes that GasNet has not provided information as to the nature of these benefits and an estimate of any benefits it considers to be system-wide and as a consequence, the ACCC has no information to form a basis on assessing whether any benefits would be of such a magnitude to justify a tariff increase for all users in accordance with s. 8.16(a)(ii)(B) of the code.

3.3.4.2. Augmentation capex proposals

(i) Northern zone

In response to the draft decision, GasNet has provided analysis that the cost of the option identified by Sleeman Consulting to augment the Northern zone, in terms of net present value, is more expensive than the option proposed by GasNet.¹¹⁰ VENCORP also provided further analysis regarding the timing of costs associated with these options.¹¹¹ These options are outlined in table 3.3 1.

¹⁰⁸ GasNet, *Submission in Response*, p. 5.

¹⁰⁹ ACCC, *Final Decision: GasNet Australia – Major System Augmentation – Corio Loop*, 6 June 2006, p. 33.

¹¹⁰ GasNet, *Submission in Response*, op. cit., pp. 9-10.

¹¹¹ VENCORP, *Network Planning Report – T003 Northern System Withdrawal Zone*, Addendum 2, 8 January 2008.

Table 3.3.1: Northern zone cost comparison between GasNet and Sleeman Consulting option

\$ m	<i>GasNet</i>	<i>Sleeman Consulting</i>
Expansion of Wollert compressor station	39.6	39.6
Pipeline looping (LV3 loop)	14.6	-
Pipeline looping (LV3 to Wandong loop)	16.8	-
Pipeline looping (Wandong to LV5 loop)	8.1	-
Pipeline looping (LV5 loop)	-	39.5
Development of Euroa compressor	24.9	24.9
Total capital costs (2008 to 2023)	104	104
Total capital costs (2008 NPV)	48.6	50.8
Operational costs (Fuel gas)	4.7	5.6
Operational costs (Compressor)	7.5	2.7
Operational costs (Pipeline)	0.4	1.0
Total operational costs (2008 to 2023)	12.6	9.3
Total operational costs (2008 NPV)	7.8	5.4
Total costs (2008 NPV)	56.4	56.2

Source: Calculations based on GasNet's submission and model submitted 15 January 2008.¹¹²

The ACCC has reviewed GasNet's analysis and assumptions of each option and concludes that the cost differences between these options, in NPV terms, is much closer than assumed by GasNet. Specifically, Table 3.3.1 indicates that the difference between the NPV of these options are within 1 per cent rather than 5.5 per cent as assumed by GasNet. However, given the cost differences between GasNet's option and the Sleeman option are minimal and there are additional benefits associated GasNet's preferred option in terms of greater operational flexibility as noted by GasNet, the ACCC accepts that GasNet's preferred option is likely to satisfy the requirements of the code¹¹³ In particular, the ACCC is satisfied that the proposed \$79.1 m along with GasNet's proposed option is expected to satisfy the requirements of s. 8.16(a)(i) of the code.

In assessing this proposal against s. 8.16(a)(ii) of the code, the draft decision considered that GasNet had not provided a sufficient case to justify assessing this investment entirely under the system integrity test. In this regard, the ACCC considered that this proposal will first restore the export capability of authorised MDQ and second address the anticipated breach of the minimum system pressure requirements at Shepparton on the Echuca lateral. As detailed in the draft decision, in relation to the anticipated breach of the minimum system pressure requirements, the ACCC considered it more appropriate to assess this proposal against the economic feasibility test. In relation to the restoration of the capability to export 17 TJ/day of authorised MDQ across the Interconnect, the ACCC considered that this will be necessary to maintain the integrity of services. Accordingly, assessment

¹¹² The ACCC notes that the figures in GasNet's response differ from those in the above analysis as \$8.1 m in the GasNet option was omitted from its original analysis. GasNet notes that the capex timings have been confirmed by VENCORP system planning.

¹¹³ GasNet, *Submission in Response*, op. cit., p. 10.

against the system integrity test for this portion of the Northern zone augmentation was considered appropriate.

After further advice from VENCORP and discussion with GasNet, the ACCC notes that to address the anticipated minimum pressure breach at Shepparton in 2010 requires either upgrading the compressor at Wollert or installing a new compressor station at Euroa. However, GasNet has submitted that the Wollert compressor station would require refurbishment even in the absence of a need to augment the Northern zone. Whilst, GasNet states the Wollert compressor station will need replacement because it is at the end of its economic life, the ACCC accepts this is refurbishment expenditure given that it is necessary to install dry seal compressors to maintain the quality of the service.¹¹⁴ As it is necessary to refurbish the Wollert compressor station in the absence of any anticipated pressure breach at Shepparton, the ACCC considers that this expenditure is consistent with maintaining the service potential of existing facilities as they age and deteriorate as well as maintaining gas quality and is reasonably expected to satisfy the system integrity test. The ACCC therefore considers that the economic feasibility test should not be applied to the portion of the Northern zone investment related to addressing the network constraint on the Echuca lateral to users in the Echuca zone.

As noted above, the ACCC audited the methodology and assumptions used in GasNet's updated analysis to justify the installation of the Euroa compressor instead of additional looping from line valve 3 to line valve 5 and consider these to be reasonable. As a result, the ACCC considers that the remaining costs (which include the Euroa compressor and looping from Wollert to line valve 3) are related to restoring the export capacity and in accordance with the draft decision these investments should be assessed under the system integrity test.

Accordingly, the ACCC considers that \$79.1 m, which includes the Euroa compressor is reasonably expected to satisfy the system integrity test in s. 8.16(a)(ii) of the code.

(ii) Sunbury loop

The ACCC considers that the proposed \$12.46 m to augment the Sunbury lateral is not reasonably expected to satisfy the requirements of the prudent investment test in s. 8.16(a)(i) of the code.

Given that the ACCC has approved the refurbishment of the Brooklyn compressor station, which enables the Sunbury loop to be deferred until after the AA3 period, it considers that the forecast capex \$12.46 m to augment the Sunbury lateral does not satisfy the prudent investment test in s. 8.16(i)(a) of the code.

¹¹⁴ VENCORP, *Email to the AER*, 22 February 2008.

GasNet has previously submitted that it is necessary to upgrade the Wollert compressor station by replacing wet seals with dry seals. The ACCC has accepted GasNet's refurbishment program to replace wet seals with dry seals to prevent the ingress of oil into the gas and therefore considers that these investments are necessary to maintain the quality of the service.

(iii) Ballarat (Mt Franklin to Ballan loop)

The draft decision considered that the proposed \$29.03m to duplicate a portion of the Mt Franklin to Ballan pipeline is not reasonably expected to satisfy the requirements of the prudent investment test in s. 8.16(i)(a) of the code.

Given that the ACCC has approved the refurbishment of the Brooklyn compressor station, which enables the Ballarat loop to be deferred until after the AA3 period, it considers that the forecast capex \$29.03 m to augment the Sunbury lateral does not satisfy the prudent investment test in s. 8.16(i)(a) of the code.

(iv) Warragul loop

GasNet proposed \$4.84 m to duplicate 4.8 km of the 100 mm Warragul pipeline with a 150 mm pipeline, which included a 20 per cent contingency allowance for cost uncertainty. In its draft decision, the ACCC considered that a 20 per cent contingency allowance for costs uncertainty is not reasonably expected to satisfy the requirements of the prudent investment test. The ACCC also considered that GasNet's proposed cost of \$4.84 m may appear to be excessive due to a number of factors such as the route the pipeline is expected to take.

GasNet in response to the draft decision accepts the term unidentified costs to describe its contingency allowance. The ACCC notes that there is some uncertainty as GasNet has stated that sufficient design work has not been completed and as the facility will not be constructed for some years, it is difficult to estimate all cost elements. The ACCC accepts that there is likely to be some uncertainty as GasNet states and has provided an allowance of 10 per cent to reflect this uncertainty. Sleeman Consulting recommends that an allowance 20 per cent is likely to bias the cost estimate upwards such that the forecast of costs are more likely to be overstated than understated. Accordingly, the ACCC does not consider that a 20 per cent allowance for unidentified costs is reasonably expected to provide GasNet with an allowance that reflects a service provider acting efficiently, in accordance with good industry practice to achieve the lowest sustainable cost of providing services (s. 8.16(a)(i) of the code).

Further, the ACCC notes that if GasNet's actual capex exceeds its forecast capex it will have the opportunity to roll these costs into the capital base as a part of the *ex post* review at its next revision.

In response to the draft decision, GasNet provided further analysis that suggests that \$0.22 m is reasonably expected to satisfy the economic feasibility test. In particular, GasNet submits that \$0.22 m of the Warragul loop costs should be included as forecast capex and is to be recovered from users in the Lurgi zone at the prevailing tariff. The ACCC has reviewed the methodology and assumptions used by GasNet to calculate the amount of capex that is expected to meet the requirements of the economic feasibility test (i.e. the recoverable capital amount) to be recovered from Lurgi zone users.^{115 116}

¹¹⁵ GasNet assumes a growth rate of 0.7 per cent over the life other asset based on the latest VENCORP forecast and incremental operating costs of 2115 per km and has applied the prevailing injection and withdrawal tariffs.

While the ACCC agrees with the methodology and the cost inputs to calculate the recoverable capital amount, the ACCC notes that given the requirement to re-calculate the prevailing withdrawal and injection tariffs to the Lurgi zone users, the recoverable portion may change. Accordingly, the ACCC will require GasNet to re-calculate the recoverable portion of capex following the final decision based on the approved Lurgi tariffs. The ACCC also notes that as the recoverable portion does not cover the cost of the investment, GasNet has the option under s. 8.25 to seek approval from the regulator to levy a surcharge to recover this shortfall.

The ACCC considers that \$4.43 m is reasonably expected to satisfy the requirements of the prudent investment test in s. 8.16(a)(i) of the code.¹¹⁷ The ACCC requires GasNet to re-calculate the recoverable portion of capex that is reasonably likely to satisfy s. 8.16(a)(ii)(A) of the code, following the final decision approval of Lurgi tariffs. The recoverable portion will be included in GasNet's forecast capex over the AA3 period.

(v) *Pakenham loop*

The ACCC notes GasNet's view that high gas velocities can lead to excessive noise and vibration, and pressure cycling in the pipeline leading to fatigue and the possibility of failure of pipeline welds as well as damage to instrumentation and meters¹¹⁸. On the basis that there are potential problems of peak gas flows in the pipeline being more than half of the specified maximum flow velocity, the ACCC considers that the proposal is required to maintain the safety and integrity of services.¹¹⁹

In accordance with the draft decision, given that the GasNet estimate is within 5 per cent of the Sleeman Consulting estimate, the ACCC considers that \$1.22 m is reasonably expected to satisfy the prudent investment and system integrity tests in s. 8.16 of the code.

(vi) *Stonehaven compressor*

As the next staged development to supplement the construction of the Corio loop, GasNet proposed \$26.19 m to install a compressor at Stonehaven to increase the capacity of the PTS by 65 TJ.

In support of this proposal GasNet refers to a cost-benefit analysis undertaken by VENCORP which suggests that while the timing of this proposal is uncertain, the

¹¹⁶ GasNet, *Submission in Response*, p. 14.

¹¹⁷ The 10 per cent provision for unidentified costs is an allowance for costs incurred by GasNet which Sleeman Consulting has not identified: see Sleeman Consulting, *op. cit.*, pp. 29 and 30. The ACCC considers this is consistent with the requirements of the prudent investment test.

¹¹⁸ GasNet, *Submission in Response*, *op. cit.*, p. 15.

¹¹⁹ GasNet notes in a standard engineering text for pipeline design that flow velocities in excess of half the specified maximum may cause metal fatigue from excessive vibrations. Therefore 22m/s in 2009 is well in excess of the acceptable velocity for the Pakenham pipeline for peak flows which is 12.5m/s. GasNet, *Submission in Response*, *op. cit.*, p. 15.

highest cost-benefit may be achieved if this project is completed prior to winter 2013.

The ACCC maintains its view in the draft decision that based on the information available the ACCC is not convinced that the cost-benefit analysis provided by GasNet demonstrates that the installation of additional compression on the SWP at Stonehaven is the most appropriate investment. GasNet in part relies on the cost-benefit analysis undertaken by VENCorp that the most appropriate option and optimal timing for the Stonehaven compressor is likely to be 2012. The ACCC noted in the draft decision that VENCorp's cost-benefit analysis is only indicative and further analysis may produce different results. Further, the ACCC also audited this analysis and observed that the timing of this investment is sensitive to the assumed level of involuntary load curtailments. VENCorp has indicated in its submission that it intends to undertake further modelling, which is also to include a review of other options as well as the Stonehaven compressor option.

Whilst, GasNet has previously noted that the VENCorp analysis does not include competition benefits, VENCorp has advised that it intends to estimate any competition benefits in its further modelling. However, VENCorp has also advised that due to the complexity associated with calculating competition benefits and recent announcements such as the *Interim Report for the Garnaut Climate Change Review*, it is reassessing its GPG forecasts and requires more time to complete its analysis.¹²⁰

Given the uncertainty regarding the most appropriate investment option and the timing of this option, the ACCC does not agree with GasNet that the Stonehaven compressor proposals can be reasonably expected to be met under s. 8.16 of the code. Further, the ACCC does not agree with GasNet's view that there is no low cost option to Stonehaven such that a revenue provision in the tariffs is justified irrespective of whether subsequent analysis demonstrates an alternative option is superior. As VENCorp has previously noted a more detailed assessment of the Stonehaven compressor would consider demand-side options and the possibility of looping the existing Longford or SWP pipelines which have not been considered. In addition, as the ACCC has previously noted the timing of any proposal is sensitive to the level of assumed benefits and as VENCorp notes it requires additional time to conduct its analysis to ensure its results are robust. Accordingly, the ACCC considers that there is considerable uncertainty as to the optimal timing of any proposal within and between AA periods.

GasNet submits that by using a lower discount rate and allowing for competition benefits in VENCorp's cost-benefit analysis that the optimal timing for the Stonehaven compressor is at least 2012. Whilst, the ACCC accepts that it is appropriate to apply GasNet's real WACC to discount the costs and benefits of any proposal, there is considerable uncertainty regarding the magnitude and the timing of any benefits. Moreover, whilst the timing of the Stonehaven compressor is uncertain, the ACCC is not convinced that the Stonehaven compressor is the most prudent investment given that VENCorp has identified other options.

¹²⁰ VENCorp: *Letter to the AER*, 29 February 2008.

GasNet also submits that as the proposed capex is expected to occur in 2012, it would be difficult to apply the same level of detail and rigour compared to a proposal in 2008 and the further out a project is forecast, the lower the impact on forecast revenue. Whilst, the ACCC acknowledges that there is more uncertainty associated with potential projects towards the end of the AA period, the ACCC is not convinced based on the information available that the Stonehaven compressor is prudent in terms of the most appropriate option or 2012 reflects the most appropriate timing.

In response to GasNet's view that if a superior alternative arises, the funds allocated to the Stonehaven project is equally applicable to the alternative project, the ACCC based on the information available considers that there is considerable uncertainty as to whether any alternative or the Stonehaven project will be required in the AA3 period.

GasNet and other interested parties note that VENCORP is conducting a market benefits analysis to determine whether the installation of the Stonehaven compressor is prudent and the ACCC should be guided by this analysis.¹²¹ However, to date VENCORP has not formed a view whether it would be prudent amongst all available options to install the Stonehaven compressor in the AA3 period and whether the optimal timing is within the AA3 period.

The ACCC agrees that the issues raised by TRUenergy in terms of VENCORP's previous analysis are relevant considerations and the ACCC understands that these factors are being considered in VENCORP's revised analysis (e.g. impact of GPG's and intra basin competition between supplies from Longford and Port Campbell). Origin Energy submits that the ACCC has not approved the Stonehaven compressor on the basis that the ACCC does not consider this project to reasonably meet the requirements of the prudent investment and system-wide benefits test. However, in its draft decision, the ACCC has not considered the proposal against the system-wide benefits test as it considered that the project was not likely to meet s. 8.16(a)(i) of the code. The ACCC notes TRUenergy Gas Storage view that consideration should be given to transferring the Springhurst compressor to Stonehaven and considers that this is an operational matter for GasNet and VENCORP to assess.

The ACCC notes that the code provides GasNet with the opportunity to seek a binding approval from the Regulator at any time during the AA period.

Based on the information currently available, the ACCC considers the proposed \$26.19 m Stonehaven compressor is not reasonably expected to satisfy the requirements of the prudent investment test in s. 8.16(a)(i) of the code.

¹²¹ GasNet, *Submission in Response*, op. cit., p. 18, AGL, *Submission in Response*, op. cit., p. 3, Origin, *Submission in Response*, op. cit., p. 2, and TRUenergy, *Submission in Response*, op. cit., p. 1.

(vii) Carisbrook loop

The draft decision noted that the supporting planning report for this proposal has been provided by GasNet and not VENCORP.¹²² Modelling undertaken by Sleeman Consulting suggested that if the proposed Northern zone augmentation is undertaken there does not appear to be a case for a constraint arising at Carisbrook.¹²³ VENCORP confirmed Sleeman Consulting's conclusions. In particular, VENCORP advised that the gas flow assumptions adopted in GasNet's analysis resulting in an anticipated constraint in winter 2010 are unlikely to occur in the timeframe suggested by GasNet.¹²⁴

The ACCC considers that GasNet has not provided sufficient information to suggest that the fluctuations in the pipeline are not manageable subsequent to the augmentations to the Northern loop. It therefore considers the proposed \$24.05 m Carisbrook loop is not reasonably expected to satisfy the requirements of the prudent investment test in s. 8.16(a)(i) of the code.

(viii) Brooklyn Lara (Corio) pipeline

The ACCC approved \$63.71 m for the Brooklyn-Lara (Corio) loop pipeline in June 2006 under s. 8.21 of the code. In its draft decision, the ACCC considered that further information provided by GasNet demonstrated that construction of the Corio loop has been undertaken in accordance with the ACCC's approval.

The ACCC considers that the additional capex proposed by GasNet is reasonably likely to satisfy the requirements of s. 8.16 of the code such that remaining \$21.01 m of the approved capex for the Brooklyn Lara pipeline is to be included in forecast capex for the AA3 period (refer to section 3.1.4 of this final decision).

(ix) Acquisition of easements for the Brooklyn-Wollert loop

The ACCC considered in the draft decision that GasNet did not demonstrate a satisfactory need for the development of this high pressure pipeline link or substantiated the likelihood of urban encroachment. The ACCC considered that if GasNet demonstrated it was necessary that there may be scope for this proposal to be included in the speculative investment fund in accordance with cl. 4.5 of the proposed AA. Capital costs which are included in the speculative investment fund may be added to the capital base at a later date when the requirements of s. 8.16 of the code are satisfied.

In response to the draft decision, GasNet notes that VENCORP is conducting analysis that the acquisition of the easements is required in AA3.¹²⁵ VENCORP has advised the ACCC that the timing of the acquisition of easements will depend on whether the Stonehaven compressor is required during the AA3 period. Therefore, the ACCC

¹²² TRUenergy made a similar comment: see TRUenergy, op. cit., p. 13.

¹²³ Sleeman Consulting, op. cit., p. 34.

¹²⁴ VENCORP advises this is due to a non-return valve at Carisbrook on the inlet to the Horsham pipeline: see Sleeman Consulting, op. cit., p. 33.

¹²⁵ GasNet, *Submission in Response*, op. cit., p. 20.

considers that it would be appropriate for the regulator to consider the proposed acquisition of easements with the Stonehaven compressor proposal. As the ACCC is not convinced that the Stonehaven compressor proposal is prudent and any further analysis by VENCORP on both the Stonehaven compressor and acquisition of easements will not be available until June 2008, the ACCC does not consider the acquisition of easements to reasonably be expected to satisfy s. 8.16(a)(i) of the code.¹²⁶

The ACCC also considers that GasNet has not demonstrated how including this investment in the speculative investment fund would result in materially higher costs for users. Further, the ACCC notes that whilst, the AER has approved the acquisition of easements in the Powerlink revenue cap final decision, under the National Electricity Rules, there is no corresponding provision for a speculative investment fund.

Accordingly, based on the information currently available, the ACCC considers the proposed \$5.37 m to acquire easements is not reasonably expected to satisfy the requirements of s. 8.16(a)(i) of the code.

3.3.4.3. Refurbishment/upgrade capital expenditure

(i) *Gas heating facilities*

Given the further information provided by GasNet¹²⁷, the ACCC considers that an allowance for the design function in owner's costs is prudent. However, as discussed above, it considers that a 20 per cent allowance for unidentified costs is not reasonably expected to satisfy the requirements of s. 8.16(a)(i) of the code.

The ACCC considers that after adjusting for higher owner's costs, that \$7.74 m to install the proposed gas heating facilities is reasonably expected to satisfy the requirements of the s. 8.16(a)(i) of the code. The ACCC also considers the purpose of this proposal is consistent with maintaining the service potential of existing facilities as they age and deteriorate and is reasonably expected to satisfy the system integrity test in s. 8.16(a)(ii)(C) of the code.

(ii) *City gate works*

As discussed above, the ACCC considers that an allowance of 10 per cent for 'unidentified costs' is reasonably expected to satisfy s. 8.16(a)(i) of the code.

Accordingly, \$6.18 m is reasonably expected to satisfy s. 8.16(a)(i) of the code. The ACCC also considers that this proposal is reasonably expected to satisfy the system integrity test in s. 8.16(a)(ii)(C) of the code.

(iii) *Pipeline upgrades*

GasNet proposed \$9.65 m for pipeline upgrades, including an allowance for any necessary works associated with pipeline risk assessments. The draft decision

¹²⁶ VENCORP, *Letter to the ACCC*, 22 February 2008.

¹²⁷ GasNet, *Submission in Response*, op. cit., p. 23.

proposed not to approve GasNet's proposed allowance for unidentified works. Notwithstanding the fact that any additional works have not been identified following pipeline risk assessments, the ACCC has reconsidered its position in the draft decision and accepts that there is likely to be additional capex that will be identified following pipeline risk assessments.

In particular, the ACCC considers as there is likely to be additional capex requirements as a result of these pipeline risk assessments in the absence of any further information, an allowance of \$0.4 m per annum is reasonably likely to satisfy s. 8.16(a)(i) of the code.

Accordingly, the ACCC considers that \$9.65m for this proposal is reasonably expected to satisfy the requirements of s. 8.16(a)(i) of the code. The ACCC also considers that the purpose of this proposal is consistent with maintaining the service potential of existing facilities as they age and deteriorate and is reasonably expected to satisfy the requirements of the system integrity test in s. 8.16(a)(ii)(C) of the code.

(iv) *Safety and security systems*

GasNet proposed \$2.93 m for safety and security systems, including an allowance for the replacement and upgrade of unidentified electrical equipment. The draft decision proposed to not approve GasNet's allowance for unidentified electrical equipment. Notwithstanding the fact that any additional replacements and upgrades have not been identified following pipeline risk assessments, the ACCC has reconsidered its position in the draft decision and accepts that in safety review processes, a prudent service provider is likely to make an allowance for the replacement or upgrade of unidentified electrical equipment.¹²⁸ The ACCC now considers that \$1.32 m for security upgrades and the replacement of electrical equipment is reasonably expected to satisfy the requirements of s. 8.16(a)(i) of the code.

Accordingly, the ACCC considers \$2.93 m is reasonably expected to satisfy the requirements of s. 8.16 of the code.

(v) *Brooklyn compressor station*

The ACCC has not received any further submissions in response to the draft decision on the refurbishment of the Brooklyn compressor station. Accordingly, the ACCC considers that the proposed \$49.57 m is reasonably likely to satisfy s. 8.16 of the code.

(vi) *Wollert compressor station*

In its draft decision, the ACCC considered that \$1.53 m for the fuel gas system is unnecessary given the cost of a fuel gas skid inclusive of heating is already included in the \$39.56 m redevelopment cost.

¹²⁸ *ibid.*, p. 25.

Given that GasNet accepts the ACCC's draft decision¹²⁹, the ACCC considers \$0.05 m for fencing upgrades additional to the redevelopment of the Wollert compressor station is reasonably expected to satisfy s. 8.16 of the code.

(vii) *Gooding compressor station*

The ACCC accepts that \$15.56 m for refurbishment of the Gooding compressor station is reasonably expected to meet the requirements of s. 8.16(a)(i) of the code. As discussed in section 3.1.4 of this decision, the ACCC requires GasNet to treat \$14.34 m of expenditure on this project as approved capex for the AA2 period. The remaining \$1.22 m is to be recognised as forecast expenditure for the AA3 period.

(viii) *Other compressor station upgrades*

The ACCC considers that GasNet, in its response to the draft decision on the existing control system at Iona,¹³⁰ has indicated that there is a possibility that existing control systems may not be serviceable. Accordingly, based on the information available, the ACCC considers that \$2.96 m is reasonably expected to satisfy s. 8.16 of the code.

(ix) *Other refurbishments and upgrades*

GasNet proposes that \$4.30 m is necessary for other refurbishments and upgrades during AA3.

Based on the further information provided by GasNet identifying other refurbishments and upgrades, the ACCC considers that \$4.30 m of other refurbishments and upgrades as detailed in GasNet's response to the draft decision, are reasonably expected to meet the requirements of s. 8.16 of the code.¹³¹

(x) *Iona cooler upgrade*

GasNet submitted \$0.70 m is required to install a new compressor station cooler at Iona by winter 2007 to address a potential breach in the minimum system pressure requirements at Portland and Hamilton.¹³² The draft decision noted that the proposed \$0.70 m included owners' costs and contingency provisions of 15 and 20 per cent respectively and that for a project of this size, an owner's cost provision of 10 per cent and an allowance for 10 per cent for unidentified costs is sufficient to provide a cost estimate which is equally likely to provide an over or under-forecast. Accordingly, the ACCC considered that \$0.60 m to install a cooler at the Iona compressor station during the AA2 period is prudent satisfies s. 8.16 of the code.

The ACCC has reconsidered its draft decision, given that the difference between GasNet's proposed capex of \$0.7 m and the proposed draft decision amount is

¹²⁹ *ibid.*

¹³⁰ *ibid.*, p. 26.

¹³¹ *ibid.*, pp. 26-28.

¹³² GasNet, *Submission*, *op. cit.*, p. 29.

\$0.6 m. For the purpose of this final decision, the ACCC considers that \$0.7 m is reasonably expected to meet the requirements s. 8.16 of the code.

3.3.5. Conclusion

The ACCC has decided that \$101.26 m of the proposed \$245.90 m of augmentations and \$84.66 m of the proposed \$88.20 m of refurbishments/upgrades are reasonably expected to satisfy the requirements of s. 8.16 of the code. Broadly these reductions are principally due to GasNet not having demonstrated a justifiable need for a capex proposal.

The ACCC also notes cl. 4.4 of the proposed AA provides GasNet may at any time during the AA3 period submit revisions to increase the capital base to recognise capex which can be demonstrated to satisfy the requirements of s. 8.16 of the code.

Table 3.3.2 details the ACCC's assessment of GasNet's capex proposals for the AA3 period against s. 8.16 of the code.

Table 3.3.2: Final decision—AA3 forecast capex

\$2006 Dec m	<i>Proposal</i>	<i>Final Decision</i>		<i>Difference</i>
		<i>s. 8.16(a) of the code requirements</i>	<i>s. 8.16(a)(ii)</i>	
Augmentations				
Northern zone	79.03	79.03	Approved against SIT	0.00
Sunbury loop	12.46	0.00	n/a—does not meet PIT	-12.46
Ballarat loop	29.03	0.00	n/a—does not meet PIT	-29.03
Warragul loop	4.84	0.00 ^(a)	Approved against EFT	0.00 ^(a)
Pakenham loop	1.22	1.22	Approved against SIT	0.00
Stonehaven compressor	26.19	0.00	n/a—does not meet PIT	-26.19
Carisbrook loop	24.05	0.00	n/a—does not meet PIT	-24.05
Brooklyn Lara (Corio) pipeline	63.71	21.01	Approved against SBT	-42.70
Brooklyn Wollert easements	5.37	0.00	n/a—does not meet PIT	0.00
Total augmentations	245.90	101.26	N/A	-144.64
Refurbishments/upgrades				
Gooding compressor station	1.22	1.22	Approved against SIT	0.00
Gas heating facilities	9.21	7.74	Approved against SIT	-1.47
City gate works	6.68	6.18	Approved against SIT	-0.50
Pipeline upgrades	9.65	9.65	Approved against SIT	0.00
Safety and security systems	4.25	4.25	Approved against SIT	0.00
Brooklyn compressor station	49.57	49.57	Approved against SIT	0.00
Wollert compressor station	1.58	0.005	Approved against SIT	-1.57
Other compressor stations	2.91	2.91	Approved against SIT	0.00
Other	4.30	4.30	Approved against SIT	0.00
Iona cooler upgrade	0.70	0.70	Approved against SIT	0.00
Total refurbishments/upgrades	90.07	86.53	N/A	-3.55
Total capex	335.97	187.19	N/A	-148.19

Notes: PIT—prudent investment test in s. 8.16(a)(i) of the code.
EFT—economic feasibility test in s. 8.16(a)(ii)(A) of the code.
SBT—system-wide benefits test in s. 8.16(a)(ii)(B) of the code.
SIT—system integrity test in s. 8.16(a)(ii)(C) of the code.
^(a) Amount subject to application of economic feasibility test using recalculated tariffs after new parameters used (i.e. WACC and volume forecasts)

Amendment 03

Before the proposed revised access arrangement can be approved, GasNet must:

- amend cl. 3.6 of the proposed revised access arrangement information to reflect table 3.3.2 of this final decision.
-

3.4. Capital redundancy

3.4.1. Introduction

GasNet proposed to amend clause 4.6 of its AA to identify partially redundant assets as those that “have a *significantly* reduced contribution to the provision of the Tariffed Transmission Service”¹³³ [emphasis added]. In its draft decision, the ACCC did not approve this proposed amendment. It considered that distinguishing the extent of reduction in an asset’s contribution to the provision of a service would introduce ambiguity and reduce the incentive on GasNet to manage the risk of redundancy.

3.4.2. Proposed amendments

Proposed amendment 04 (reproduced below) expressed the ACCC’s draft decision noted above.

Proposed amendment 04

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 4.6 of the proposed revised access arrangement and retain the definition of partially redundant assets as it appears in the second access arrangement.

3.4.3. Response to the draft decision

GasNet indicates that, while it did not necessarily agree with the analysis in the draft decision, it no longer proposes to amend its capital redundancy policy.

No other comments were received on this aspect of the draft decision.

3.4.4. Conclusion

The ACCC reaffirms its draft decision not to approve any amendments to GasNet’s capital redundancy policy.

Amendment 04

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 4.6 of the proposed revised access arrangement and retain the definition of partially redundant assets as it appears in the second access arrangement.

¹³³ GasNet, *Proposed access arrangement*, p. 6.

3.5. Depreciation

3.5.1. Introduction

For AA3, GasNet proposed the economic lives of the assets in table 3.5.1 be equal to their technical lives, with the exception of pipeline assets.¹³⁴

Table 3.5.1: Technical life per asset category

<i>Asset category</i>	AA2	AA3
Compressor stations	30	30
Heaters	20	20
Regulators	30	30
Pipelines	60	60
Telemetry	5	10
Buildings	60	60
Land	n/a	n/a
Office equipment	5	5

Source: GasNet, *Proposed AAI*, p. 6; GasNet, *AAI 2002–07*, p. 6.

GasNet proposed that the economic life of new pipelines be set at 55 years.¹³⁵ Table 3.5.2 illustrates the different lives per pipeline group used in AA2 and those GasNet proposes for AA3.

Table 3.5.2: Current and proposed economic lives for pipeline groups

<i>Pipeline group</i>	AA2	AA3
Longford	2023	2023
SWP	2052	2052
Murray Valley	2033	2054
Lurgi	2016	2033
Other existing pipelines	2033	2033
New pipelines	55 years	55 years

Source: GasNet, *Proposed AAI*, p. 6; GasNet, *AAI 2002–07*, p. 7.

GasNet's proposals and justifications for particular pipeline segments were as follows:

- depreciate the Longford pipeline completely by 2023 as per the economic life approved in AA2, stating that there was no new information to suggest this was inappropriate
- depreciate the Southwest Pipeline (SWP) over a period of 50 years, consistent with the approach approved for AA2
- extend the economic life of the Murray Valley pipeline to 2054, which is its full economic life

¹³⁴ GasNet, *Submission*, op. cit., p. 61.

¹³⁵ *ibid.*

- extend the economic life of the Lurgi Pipeline to 55 years, ending in 2033, as per other existing pipelines.

Table 3.5.3 outlines GasNet's proposed depreciation allowance.

Table 3.5.3: Proposal—depreciation allowance by asset category

2006 Dec \$ m	2008	2009	2010	2011	2012
Pipelines	15.4	16.3	17.1	17.7	17.8
Compressors	4.7	6.6	8.1	8.2	8.9
City gates and field regulators	1.2	1.5	1.5	1.5	1.5
Odourisation	0.0	0.0	0.0	0.0	0.0
Gas quality	0.1	0.1	0.1	0.1	0.2
General land and building	0.8	0.8	0.8	0.5	0.5
Other	0.4	0.5	0.5	0.5	0.5
Total	22.5	25.9	28.1	28.7	29.4

Source: GasNet, *Proposed AAI*, p. 7 (converted to 2006 Dec \$).

In its draft decision, the ACCC approved GasNet's proposed changes to the lives of the Lurgi and Murray Valley pipelines. However, the ACCC did not approve the proposed economic life of the Longford pipeline. For the AA2 period, the ACCC approved a shorter economic life for the Longford pipeline as being in the legitimate business interests of GasNet under s. 2.24(a) of the code. In its draft decision for the AA3 period, the ACCC considered that, contrary to GasNet's claim, there were several sources of new information which supported extending the economic life of the pipeline (by 7 years) to its full technical life. This new information regarded gas produced from the Gippsland basin (which is transported via the Longford pipeline) and included:

- observed production levels from the Gippsland basin being well below those assumed in the analysis leading to the ACCC's 2002 decision, implying a longer production life of the basin and therefore of the pipeline
- a study by ABARE indicating that production from the basin would be around 250PJ in 2030¹³⁶
- announcements by Esso Australia that it expects production from the basin to continue for approximately another 30 years (i.e. to 2037)¹³⁷, and that it will undertake further comprehensive testing of the basin following recent discoveries¹³⁸

¹³⁶ Clara Cuevas-Cumbria and Damien Rewove, *Australian Energy: National and State Projections to 2029-30*, ABARE Research Report 06.26, 30 December 2006, p. 41-42.

¹³⁷ http://www.exxonmobil.com/Australia-English/PA/Newsroom/NewsReleases/AU_NR_MR_2007_Technology_Extends_BassStrait.asp

¹³⁸ http://www.exxonmobil.com/Australia-English/PA/Newsroom/NewsReleases/AU_NR_MR_2007_New_Gippsland_Basin_Gas.asp

- general increases in the amounts of proved and probable reserves of the basin (e.g. of 53.9 per cent since 2005).¹³⁹

In addition, the ACCC considered that the Longford pipeline's use would potentially extend beyond exhaustion of offshore supply sources because of its role in supplying large users and distribution systems in eastern Victoria.

Under section 8.33(c) of the code, the ACCC did not accept GasNet's proposed depreciation of the Longford pipeline as being reflective of changes to the expected economic life of that asset. On this basis the ACCC considered that the economic life should be increased to 60 years (ending in 2029).

3.5.2. Proposed amendments

Proposed amendment 05 (reproduced below) expressed the ACCC's draft decision noted above.

Proposed amendment 05

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.3.3 of the proposed revised access arrangement to reflect table 3.5.6 of this draft decision.

Table 3.5.6 of the draft decision is reproduced below.

Table 3.5.6: Draft decision—depreciation allowance by asset category

2006 Dec \$ m	2008	2009	2010	2011	2012
Pipelines	15.83	16.14	16.18	16.20	16.21
Compressors	4.71	5.43	5.73	5.91	6.11
City gates and field regulators	1.13	1.35	1.38	1.37	1.33
Odourisation	0.01	0.01	0.01	0.01	0.01
Gas quality	0.09	0.10	0.09	0.09	0.09
General land and building	0.72	0.72	0.67	0.31	0.23
Other	0.20	0.20	0.20	0.20	0.20
Total	22.71	23.95	24.26	24.09	24.18

Source: ACCC analysis.

3.5.3. Response to the draft decision

In its response GasNet states that the current economic life of the Longford pipeline should be retained, ending in 2023. Overall it maintains the view that there has been no material change in circumstances since the ACCC approved this economic life in 2002.

GasNet makes several observations regarding the information presented by the ACCC, as well as other factors affecting the depletion of the Gippsland basin:

¹³⁹ *Energy Quarterly Report* May 2007, p. 22.

- the report by Saturn Resources (that GasNet submitted as part of the AA2 revisions) was a probabilistic assessment of a range of factors affecting the economic life of the Longford pipeline, whereas the studies quoted by the ACCC were deterministic assessments and therefore limited by their assumptions
- the report by ABARE presumes that the price of coal seam methane (which represents an alternative supply source) will be delivered for less than that from the Gippsland basin
- installation of a gas processing plant at Longford and a compressor on the Eastern Gas Pipeline will enable greater exports to NSW and more rapid depletion of the Gippsland basin
- clean energy policies may result in substantially higher demand for gas as a substitute for coal in electricity generation and for electricity in final consumption.

GasNet concludes that:

(t)here are too many variables to make a confident prediction of these events, but there is no doubt that the risk of earlier depletion of the Gippsland basin has increased, and it would therefore be prudent to err on the side of a shorter life.¹⁴⁰

GasNet notes that the impact on users of ending the life of the pipeline in 2023 or 2029 is a relatively small change in tariffs, and that the depreciation profile of assets in general is a zero-sum game for users. By contrast, GasNet claims that a shorter economic life would increase its exposure to the risks of the pipeline being unviable before it is fully depreciated. It also noted that the ACCC's 2002 decision (i.e. an economic life ending in 2023) was made in consideration of GasNet's legitimate business interests under sections 2.24(a) and (f) of the code, and that the ACCC should continue to place a greater weight on these interests regarding this aspect of its access arrangement.

No other comments were received on this aspect of the draft decision.

3.5.4. Conclusion

In its 2002 decision, the ACCC approved the shortening of the life of the Longford pipeline in the context of GasNet's legitimate business interests in accordance with s. 2.24(a) of the code, noting that it may reassess this decision in view of future studies relating to reserves in the Gippsland Basin or other factors impacting on the pipeline's useful life.¹⁴¹ Consideration of this issue in the 2002 decision was influenced by the views of users who strongly supported setting an economic life of the pipeline to end in 2030. This contrasts to the current review where no stakeholders other than GasNet have commented on this issue.

¹⁴⁰ GasNet, *Response to the Commission's Draft Decision on Proposed Access Arrangement for the Principal Transmission System*, (Submission in Response), December 2007, p. 30.

¹⁴¹ ACCC, *Final Decision GasNet Australia access arrangement revisions*, November 2002, p. 190.

The ACCC's draft decision noted a variety of information sources which supported extending the life of the Longford pipeline based on production from the Gippsland basin lasting beyond 2030. In addition, the ACCC noted that the production rates assumed by Saturn Resources in 2002 were well above those observed and predicted by more recent analysis undertaken by ABARE. Annual production from the Gippsland basin would need to increase significantly above current levels to reach the 400PJ annual average production assumed by Saturn Resources and for depletion of the basin to occur in 2023. While this is possible, the ACCC considered it unlikely.

The ACCC notes, however, that production from the Gippsland basin in 2007 increased significantly (by 19.4 per cent) from production 2006.¹⁴² Production for the year to December 2006 had declined by 4 per cent from that in 2005.¹⁴³

While the information available at present indicates that production from the Gippsland basin may extend beyond 2023 there is still uncertainty about this aspect. As GasNet notes, ending the economic life of the Longford pipeline in 2023 or 2030 will not have any impact on the price paid by users in the long-term, but will increase the risk of the asset becoming redundant prior to its cost being recovered through regulated tariffs. The ACCC notes the nature of GasNet's capital redundancy policy and that setting appropriate economic lives for assets is GasNet's primary means of managing the risk of asset stranding.

Based on the information available, the nature of the capital redundancy policy and the arguments presented in response to the draft decision, the ACCC agrees that greater weight should be placed on GasNet's legitimate business interests under s. 2.24(a) of the code by maintaining the economic life of the Longford pipeline to end in 2023.

¹⁴² *Energy Quarterly Report* February 2008, p. 22.

¹⁴³ *Energy Quarterly Report* February 2007, p. 20.

4. Rate of return

4.1.1. Introduction

Chapter 4 of the draft decision assessed the rate of return, which is discussed below. GasNet proposed a nominal vanilla WACC of 9.01 per cent for the AA3 period. With the exception of the proposed forecast inflation rate and debt raising costs, the draft decision accepted all of GasNet's proposals. This resulted in a nominal vanilla WACC of 9.38 per cent and a corresponding real vanilla WACC of 6.19 per cent.¹⁴⁴

4.1.2. Proposed amendments

Proposed amendment 06 (reproduced below) expressed the ACCC's draft decision noted above.

Proposed amendment 06

Before the proposed revised access arrangement can be approved, GasNet must amend the rate of return in cl. 3.2 of the proposed access arrangement information to reflect the ACCC's estimates set out in table 4.1.7 of this draft decision.

Table 4.1.7 from the draft decision is reproduced below.

Table 4.1.7: Draft decision—CAPM parameters and WACC parameters

<i>WACC parameter</i>	<i>Proposal</i>	<i>Draft Decision</i>
Real risk-free rate*	2.68%	2.95%
Nominal risk-free rate*	5.85%	5.95%
Bond maturity period	10 years	10 years
Forecast inflation rate	3.09%	3.00%
Debt margin*	1.14%	1.62%
Debt raising costs	0.125%	0.104%
Credit rating	BBB	BBB
Cost of debt	7.12%	7.67%
Market risk premium	6.00%	6.00%
Gearing ratio	60:40	60:40
Value of imputation credits	0.50	0.50
Equity beta	1.00	1.00
Return on equity	11.85%	11.95%
Nominal Vanilla WACC	9.01%	9.38%
Real Vanilla WACC	5.74%	6.19%

* to be recalculated at a date closer to the final decision.

¹⁴⁴ The difference between GasNet's proposal and the ACCC's estimate was primarily due to the increase in the yields of ten-year CGS and ten-year BBB corporate bonds as of 27 September 2007 compared to 26 February 2007 in calculating the nominal risk free rate and the debt margin. These parameters and the WACC have been recalculated based on a sample ending at a date close to the final decision.

4.1.3. Response to the draft decision

GasNet states it accepts that the ACCC will undertake a major review of the appropriate WACC parameters in the near future and therefore has not pressed the issue of debt raising costs. Further, it notes that difference between the draft decision and its proposal is immaterial at this time.¹⁴⁵

GasNet submits that the term over which the forecast of inflation is estimated must be consistent with the nominal bond rate (ten-year).¹⁴⁶ GasNet also states that the inflation rate is unstable and establishing a ten-year forecast with any degree of robustness is very difficult. GasNet observes that The Treasury has observed that nominal bond yields are lower and the yield curve has become flatter as a result of a more stable long-term macroeconomic scenario.¹⁴⁷ GasNet argues that given this observed long-term macroeconomic stability and the success of the RBA's ability to institute a policy of targeting inflation between two to three per cent that that an inflation rate of 2.5 per cent (as a midpoint between two and three per cent of the RBA range) be used to calculate the real bond rate.¹⁴⁸

The APIA submits that it welcomes the approach to quantifying and recognising:

- an equity beta of 1.0
- the relative bias in CGS and
- allowing a BBB rating for the debt margin.¹⁴⁹

The APIA states that it supports the general industry positions, including:

- there is a persuasive case for supporting the retention of an equity beta of 1.0
- there is unambiguous evidence for the existence of absolute bias in CGS and
- an appropriate estimate of future inflation is 2.5 to 2.6 per cent.¹⁵⁰

The APIA also notes that the draft decision's approach does not align the ACCC's assumed inflation forecast with the period over which the risk-free bond rate is

¹⁴⁵ GasNet, *Response to the Commission's Draft Decision on Proposed Access Arrangement for the Principal Transmission System*, (Submission in Response), December 2007, p. 33.

¹⁴⁶ *ibid.*, p. 34.

¹⁴⁷ *ibid.*

¹⁴⁸ GasNet, *Submission in Response*, *op. cit.*, pp. 34-35.

¹⁴⁹ APIA, *Submission by the Australian Pipeline Industry Association on ACCC Draft Decision for Revised Access Arrangement Submitted by GasNet Australia Limited*, (Submission in Response), December 2007, p. 4.

¹⁵⁰ *ibid.*, p. 5.

relevant. APIA proposes that long term inflation should align with the middle of the RBA's range.¹⁵¹

The EUCV notes the assessment on implied inflation from the AER's draft decision for SP AusNet which shows that the expectation of inflation built into nominal bonds is not reflective of the duration. It also notes that the AER's analysis of the swap market finds the prevailing rate on an inflation swap to be 3.37 per cent.¹⁵² The EUCV also comments that the ACCC's final decision on GasNet in 2002 where it was found that the identified inflation derived from five-year indexed and nominal bonds was the same as that derived from ten-year bonds.¹⁵³

The EUCV proposes that the short-term inflation figure from the RBA's November 2007 forecasts (3.25 per cent in June 2008) should be used to convert nominal bond yields to 'real' bond yields based upon the above two findings.¹⁵⁴ The EUCV also propose that the ACCC should use the expected long-term inflation rate for the basis of developing the revenue stream, as the setting of the inflation rate for this purpose is not critical and is adjusted annually to actual inflation throughout the regulatory period.¹⁵⁵

The EUCV notes that the draft decision uses a credit rating of BBB while maintaining gearing at 60 per cent and considers that there is no substantive reason that a notional business should be downgraded from BBB+ used by the ACCC in 2002.¹⁵⁶ The EUCV submits that the ACCC must address why it persists in granting a higher WACC to businesses than they incur due to using a gearing that is too low for the market.¹⁵⁷

The EUCV notes that jurisdictional regulators have used lower equity betas for gas businesses in recent years (0.9 in South Australia and 0.8 in Victoria). It also notes that the analysis conducted by the Victorian regulator was extremely detailed.¹⁵⁸ The EUCV submits that the use of an equity beta of 1.0 is conferring an unnecessary

¹⁵¹ *ibid.*, p. 6.

¹⁵² EUCV, *Australian Competition and Consumer Commission - Victorian Gas Transmission Revenue Reset - AER Draft Decision on GasNet Application. A Response by the Energy Users Coalition of Victoria*, (Submission in Response) December 2007, p. 14.

¹⁵³ *ibid.*, p. 15.

¹⁵⁴ *ibid.*, pp. 15-16.

¹⁵⁵ *ibid.*, p. 16.

¹⁵⁶ *ibid.*, p. 17.

¹⁵⁷ *ibid.*

¹⁵⁸ *ibid.*

premium of cost onto consumers and that the AER decisions relate to electricity and not the gas industry.¹⁵⁹

The EUCV further submits that the ACCC does not have the power to allow a high equity beta to be included just because it intends to carry out a detailed assessment of the equity beta and other WACC parameters at a later time. If there is sustainable evidence it must use a contemporary assessment of the equity beta.¹⁶⁰

Multinet submits that it commissioned and an analysis by NERA, and economic consultants CECG and SFG prepared analyses for gas distributors that were complementary to the NERA work which supports an equity beta of 1.0.¹⁶¹

Multinet notes that the draft decision has not recognised the absolute bias in the CGS market and that CECG has updated research on the absolute bias which was provided by Multinet to the ESCV.¹⁶²

4.1.4. Conclusion

4.1.4.1. Approach to estimating WACC parameters

Section 8.30 of the code requires the regulator to approve a rate of return which is ‘commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service’. This in practice necessitates that the relevant regulator review and assess WACC parameters proposals having regard to the prevailing market evidence. WACC parameters cannot be directly observed and must be estimated, which requires the relevant regulator to form a view about the particular parameters that are appropriate.

At the time of the draft decision, the ACCC acknowledged that there may be increasing market evidence to suggest the values for certain WACC parameters previously approved by the ACCC may be conservative. However, the ACCC noted that departure from these WACC parameters is not appropriate in the absence of compelling and robust market evidence for a change in the relevant parameter. In response to the EUCV, at the time of the draft decision, the ACCC did not consider the market evidence available sufficiently supports a case for departure from the ACCC’s accepted approach in estimating WACC parameter values. Further, the ACCC considered that given the inter-relationship between WACC parameters, it is important that WACC parameters be subject to a comprehensive review. In this regard the ACCC indicated that it intends, in conjunction with the AER, to engage

¹⁵⁹ *ibid.*, p. 18.

¹⁶⁰ *ibid.*

¹⁶¹ Multinet, *Submission by Multinet Gas Partnership – ACCC Draft Decision for Revised Access Arrangement Submitted by GasNet Australia Limited*, (Submission in Response), December 2007, p. 5.

¹⁶² *ibid.*, p. 6.

with the sector as a whole and undertake a thorough review of all the WACC parameters during 2008.¹⁶³

The ACCC has assessed each of GasNet's proposed WACC parameters consistent with this approach, and where it considers appropriate has provided justifications for revised WACC parameters to be adopted by GasNet. Further, notwithstanding any of the conclusions drawn in this final decision, the ACCC is entitled to revise its assessment of a service provider's proposed WACC parameters in future decisions, consistent with applicable legislation or regulations and taking into account a settled view on the market data available at that time and having regard to the objective of maintaining certainty and preserving consistency.

4.1.4.2. Return on equity

(i) *Nominal risk-free rate*

In response to Multinet's submission the ACCC in the draft decision has already considered the issue of bias in CGS. As discussed in the draft decision the ACCC reviewed NERA's work and has received views from the Reserve Bank of Australia (RBA) and The Treasury.¹⁶⁴ Both the RBA and The Treasury do not consider there is an absolute bias in nominal CGS yields.

Further, it is unclear to the ACCC whether Credit Default Swaps (CDS) as proposed by NERA are a viable alternative to CGS yields given the recent market volatility and concerns regarding the credit downgrading of bond insurers who have insured CDSs.¹⁶⁵ Accordingly, the ACCC considers GasNet's proposal to use 10 year nominal CGS yields averaged over a 40 day sampling period to proxy the risk-free rate satisfies the requirements of ss. 8.30 and 8.2(e) of the code. However, given CGS yields are published daily by the RBA and the CAPM requires the adoption of up to date data, for the purposes of this final decision, the ACCC has sampled a 40 day moving average of the nominal CGS yields at a date close to this final decision.

This results in a nominal risk-free rate of 6.29 per cent.

(ii) *Forecast inflation rate*

The ACCC noted this issue has been raised before the AER in the context of the 2008 SP AusNet and 2008 ElectraNet electricity transmission determinations. At the time of the AER's draft decision for SP AusNet, the AER rejected the use of the Fisher equation on similar grounds outlined in GasNet's draft decision and considered an approach to estimating inflation more directly, having regard to

¹⁶³ This will coincide with the requirement for the AER to review WACC parameters every five years pursuant to cl. 6A.6.2(f) of the National Electricity Rules (NER) relating to electricity transmission and revised provisions under the new cl. 6 of the NER relating to electricity distribution.

¹⁶⁴ Australian Treasury, *Letter to the ACCC*, 7 August 2007; the Reserve Bank of Australia and *Letter to the ACCC*, 9 August 2007.

¹⁶⁵ The Australian, *'Banks at risk from default swaps'*, 19 February 2008

replicable, transparent, objective and widely-available market data was likely to result in the best estimate of the forecast inflation rate.¹⁶⁶

The ACCC in the draft decision recognised that the current market sentiment is that inflationary pressures in the short to medium term may result in a tendency for the RBA to tighten monetary policy (tightening bias). This is reflected in the RBA's recent *Statement on Monetary Policy* which forecasts the headline and underlying inflation rate for the year to June 2008 to be three per cent. For the year to June 2009, the RBA has stated:

... the central forecast is for both underlying and headline inflation to remain near the top of the target range.¹⁶⁷

Accordingly, the ACCC in its draft decision considered that an inflation forecast of three per cent per annum, which is at the upper end of the RBA's target range, provided the best estimate of the forecast inflation rate at the time.¹⁶⁸

The ACCC received submissions from the EUCV, GasNet and the APIA. The EUCV submits that there is no difference in inflationary expectations when comparing five and ten year bonds and proposed that the RBA's short-term forecast of 3.25 per cent be used.¹⁶⁹ While GasNet and the APIA note the inflation forecast in the draft decision is a short-term forecast and does not match with the term of the nominal bond rate.¹⁷⁰

The ACCC notes the arguments that the estimate of inflation should be consistent with the duration of the nominal CGS used as a proxy for the nominal risk free rate. The ACCC also notes that the AER has considered this issue as part of the SP AusNet electricity transmission review, which adopts a 10 year forecast of inflation.¹⁷¹ The AER derived a 10 year inflation based on an average of the RBA's short term inflation forecast and adopting the mid point of their RBA target range for inflation for the remaining years. The ACCC considers that this approach provides the best estimate of inflation at this time. Accordingly, an implied ten-year forecast has been derived from averaging the RBA's inflation forecasts of 3.5 per cent for 2008 and 3.25 per cent for 2009,¹⁷² and the use of 2.5 per cent, which is the mid point

¹⁶⁶ AER, *Draft Decision: SP AusNet transmission determination 2008–09 to 2013–14*, 31 August 2007, pp. 119–24.

¹⁶⁷ Reserve Bank of Australia, *Statement on Monetary Policy*, 13 August 2007, p. 63.

¹⁶⁸ This is consistent with many independent inflation indicators over 2008 to 2009. The ACCC notes most independent inflation indicators beyond 2009 assume a forecast inflation rate of 2.5 per cent, in line with the midpoint of the RBA's target band.

¹⁶⁹ Multinet, *Submission in Response*, op. cit., pp. 15-16.

¹⁷⁰ GasNet, *Submission in Response*, op. cit., p. 34, and APIA, *Submission in Response*, op. cit., p. 6.

¹⁷¹ AER, *Final Decision: SP AusNet transmission determination 2008–09 to 2013–14*, 31 January 2008, p. 107.

¹⁷² Reserve Bank of Australia, *Statement on Monetary Policy*, 11 February 2008, p.55.

of the RBA range for a further eight years. Accordingly, the ACCC considers that an inflation forecast of 2.68 provides the best estimate of the forecast inflation rate.

(iii) *Equity beta*

The ACCC received submissions from both the EUCV and Multinet on the equity beta.¹⁷³

The ACCC did not accept GasNet's submission that an equity beta of 1.0 is at the lower end of outcomes permitted under the code. GasNet did not provide any relevant information to support a view that the PTS faces increased systematic risks relative to the market portfolio that justify an equity beta above 1.0. Further, the ACCC considered that a degree of caution must be exercised in interpreting results which rely on international evidence and accordingly does not consider the results prepared by Synergies are the most appropriate in this regard.¹⁷⁴

Notwithstanding the difficulties in estimating an appropriate equity beta for GasNet, the ACCC acknowledged there is mounting evidence to suggest an equity beta of 1.0 is conservative. The ACCC agrees with the EUCV that this observation, to some extent, is supported in the recent ESC final decision for the Victorian gas distribution networks, which proposes an equity beta of 0.70 and ESCOSA's final decision (as upheld by the appeals division of the District Court of South Australia), which determined an equity beta of 0.90.¹⁷⁵

However, at this point in time, and in the context of establishing the national regulatory framework for electricity and gas transmission and distribution networks, including the establishment of the AER as the national regulator, the ACCC considers it is important to have due regard to consistency and continuity in regulatory decisions, unless a compelling case can otherwise be demonstrated. In this regard, the AER as noted in the draft decision will be undertaking a comprehensive review of all WACC parameters beginning in 2008 as part of its electricity regulatory responsibilities. This exercise will also inform its views on gas transmission and distribution as it considers these matters in forthcoming gas reviews over this period.

¹⁷³ EUCV, *Submission in Response*, op. cit., p. 18, and Multinet, *Submission in Response*, op. cit., p. 5.

¹⁷⁴ Consistent with these remarks, Synergies states: 'caution needs to be exercised when referencing firms from other jurisdictions, given the potential differences in industry structure and regulation': Synergies Economic Consulting, *Weighted Average Cost of Capital Review for GasNet Australia*, April 2007, p. 42 (GasNet, *Access Arrangement Submission 2008–12*, 14 May 2007, attachment F).

¹⁷⁵ Essential Services Commission, *Gas AA Review 2008–2012: Draft Decision*, op. cit., pp. 396 and 397; Essential Services Commission of South Australia, *Proposed revisions to the access arrangement for the South Australian gas distribution system: Final decision*, June 2006, pp. 68–71; *Envestra v Essential Services Commission of South Australia (No. 2)* [2007] SADC 90 (27 August 2007).

(iv) Market risk premium

No comments were received on this aspect of the draft decision. The ACCC considers a MRP of 6 per cent is consistent with s. 8.2(e) of the code and in turn will provide for a rate of return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the reference service.¹⁷⁶

4.1.4.3. Cost of debt

Consistent with s. 8.31 of the code, the ACCC considers a benchmarking approach to estimating the cost of debt facing a service provider is preferable to estimating the service provider's actual cost of debt which may not reflect efficient financing sources.

This approach requires determining the benchmark credit rating of GasNet and the corresponding market observed debt margin (above the risk-free rate). This approach has been applied by the ACCC in past gas transmission regulatory decisions.¹⁷⁷

(i) Benchmark credit rating

In determining the benchmark credit rating of the service provider, ss. 8.30 and 8.2(e) of the code are best met by reference to Australian gas transmission and distribution companies. It is important for consistency with other parameter assumptions that these companies are stand-alone privately owned entities.

The ACCC in the draft decision considered the BBB credit rating GasNet proposed was appropriate and complied with the code. The ACCC noted the BBB credit rating is supported with reference to the Tribunal decision in the *MSP* matter.¹⁷⁸

The ACCC notes that the APIA supports the selection of a BBB credit rating while the EUCV questions the usage of a BBB credit rating given that gearing has been assumed to be 60 per cent.¹⁷⁹ The ACCC agrees that the benchmark credit rating should be consistent with the assumed level of gearing (60 per cent debt) and therefore requires that the credit rating be amended in the AA to BBB+.

(ii) Debt margin

The ACCC considers it appropriate to measure the Bloomberg data by taking an average of the spread over the same period (40 working days) used to determine the risk-free rate. This reduces any potential distortions and results in a best estimate arrived at on a reasonable basis which is transparent and consistent with the determination of the other WACC parameters and satisfies the requirements of ss. 8.30 and 8.2(e) of the code. The ACCC notes the SP AusNet final decision where the AER found, based on analysis conducted by NERA, that the Bloomberg BBB-

¹⁷⁶ Code, s. 8.30.

¹⁷⁷ ACCC, Final Decision: East Australian Pipeline Limited Access arrangement for the Moomba to Sydney Pipeline, 2 October 2003, pp. 116–18; ACCC, Final Decision: GasNet Australia 2002–07, op. cit., pp. 92 and 93.

¹⁷⁸ Application by East Australian Pipeline Limited [2004] ACompT 8.

¹⁷⁹ APIA, *Submission in Response*, op. cit., p.4, and EUCV, *Submission in Response*, op. cit., p.17 .

rated bonds (normally comprising BBB-, BBB and BBB+ rated bonds) currently consists of a majority of BBB+ rated bonds.¹⁸⁰ Therefore, the ACCC considers that the difference between the methodology used to calculate debt margins in the draft and this final decision will be immaterial.

Further, firms with a credit rating of BBB generally have a higher ratio and therefore the ACCC would either require changing the gearing ratio or the credit rating. Given that the ACCC maintains that a gearing ratio of 60:40 is appropriate to determine the benchmark cost of debt, the ACCC assumes that a credit rating of BBB+ applies to GasNet in determining the benchmark cost of debt. The ACCC also notes that the Bloomberg data does not distinguish between BBB and BBB+ rated bonds. Consistent with the calculation of the nominal risk-free rate, the ACCC has recalculated the debt margin for a BBB+-rated bond based on Bloomberg data over a 40 day period for this final decision.

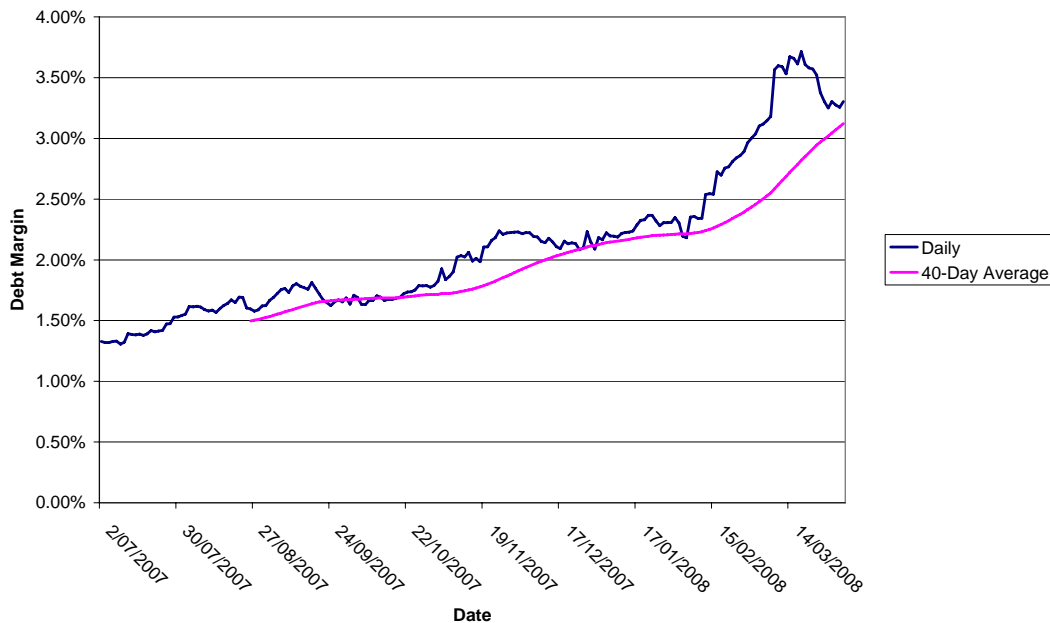
At the time of the draft decision, Bloomberg published 10-year corporate bonds for BBB+ rated businesses. The ACCC notes, however, at this time Bloomberg only publishes 8-year corporate bonds for BBB+ rated business. Given that the ACCC has used a 10-year period to calculate the risk-free rate and to maintain consistency with this period, it is necessary to replicate a 10-year benchmark for corporate bonds. The ACCC has followed the same approach taken in the SP AusNet decision by the AER. This approach involves using Bloomberg BBB fair yields and an averaging period consistent with the risk-free rate. As 10-year bond data is unavailable, the ACCC will use the 8-year Bloomberg BBB fair yield plus the yield spread between 8 and 10-year Bloomberg A fair yields to replicate a 10-year benchmark.¹⁸¹ This results in a debt margin of 299 basis points.

The ACCC has also examined the movement of the debt risk premium derived from Bloomberg fair yields to compare with that determined in the draft decision, as shown in figure 4.1.1. Since September 2007 the debt risk premium has steadily increased from around 170 basis points to above 200 basis points by the middle of November 2007. The steady increase continued into 2008 and the debt risk premium reached above 250 basis points in mid February 2008. From then the debt risk premium increased at a faster rate and had risen above 300 basis points by the beginning of March 2008. In the middle of March 2008 the debt risk premium was tracking above 350 basis points but by early April it dipped back to around 330 basis points. The ACCC notes that the average debt risk premium over the 40-day period immediately following the agreed averaging period was over 300 basis points.

¹⁸⁰ AER, *Final Decision: SP AusNet Transmission Determination 2008-09 to 2013-1*, 31 January 2008, p.95.

¹⁸¹ The AER found that using the Bloomberg A fair yield approach provided the best estimate of Bloomberg BBB fair yield when compared to other methods such as using the CGS 8 and 10-year spread, or using CBA Spectrum data: AER, *Final Decision: SP AusNet Transmission Determination 2008-09 to 2013-1*, 31 January 2008, pp.95-98.

Figure 4.1.1: Debt Margin



Overall, the ACCC is satisfied that the significant increase in the debt risk premium is driven by the ongoing global credit crisis impacting on the financial market. In particular, the ACCC notes the recent collapse of global investment bank, Bear Stearns, and financial problems affecting the childcare business, ABC Learning, as potential contributing factors placing upward pressure on the debt risk premium discussed above. Therefore, the ACCC requires that GasNet amend its debt margin to 299 basis points.

(iii) Debt raising costs

GasNet proposed a debt raising costs of 12.5 bppa to be added to the debt margin and submits this is at the lower end of outcomes permitted by the code. In support of GasNet refers to the 25 bppa approved by the Australian Competition Tribunal for AA2.¹⁸² The ACCC considers GasNet should be provided a benchmark allowance for debt-raising costs and that the best estimate of these forecast costs is one that is based on current costs.

An allowance of 10.4 bppa for debt-raising costs is considered the best estimate arrived at on a reasonable basis as required by s. 8.2(e) of the code. The ACCC notes GasNet disagrees with this outcome but considers the difference as immaterial.¹⁸³ Therefore, the ACCC requires that the debt-raising costs of 10.4 bppa be applied in this final decision to be added to a debt margin detailed in this decision.

(iv) Imputation credits

No comments were received on this aspect of the draft decision. As discussed in the draft decision, notwithstanding the evidence for a gamma value of 1.0, the ACCC

¹⁸² GasNet, *Submission*, op. cit., p. 37.

¹⁸³ GasNet, *Submission in Response*, op. cit., p. 36.

has decided to retain an assumed value of gamma equal to 0.5 for the purpose of this final decision. This is consistent with what was approved in the AA2 period and other recent regulatory decisions. The ACCC does not agree that value of 0.5 for gamma is at the lower end of the range of outcomes which would satisfy the code. The ACCC notes that in future decisions', the relevant regulator retains the option of revising the gamma parameter taking account of the most recent market evidence.

(v) Capital structure

To determine the appropriate weighted average cost of debt and equity in the WACC framework, the value of debt and equity as a proportion of an organisation's total value is required. The ACCC applies a benchmark gearing ratio in determining the WACC, rather than the service provider's actual gearing ratio consistent with s. 8.31 of the code.¹⁸⁴

GasNet proposed a 60:40 debt to equity ratio and submits this is consistent with recent regulatory decisions.¹⁸⁵ In addition, GasNet submitted that there is no justification to adopt a higher gearing ratio.

Having regard to both the available market data and the desire to preserve consistency as considered in the draft decision,¹⁸⁶ The ACCC notes the EUCV's submission however it did not receive any further information to substantiate a departure from the status quo of a 60:40 debt to equity ratio at this time. Further, the ACCC considers that a departure from a 60:40 debt to equity ratio could create potential distortions in the calculation of the WACC, given that a credit rating of BBB+ is considered to be consistent with a 60:40 debt to equity ratio.

4.1.5. Conclusion

GasNet proposes a nominal vanilla WACC of 9.01 per cent and a corresponding real vanilla WACC of 5.74 per cent.

The ACCC's assessment of GasNet's proposed WACC parameters for this final decision is set out in table 4.1.2. With the exception of the proposed forecast inflation rate and debt raising costs, the ACCC has accepted all of GasNet's proposals. This results in a nominal vanilla WACC of 10.55 per cent and a corresponding real vanilla WACC of 7.67 per cent.

Table 4.1.1 provides a comparison of the final decision with historical regulatory decisions

¹⁸⁴ This is consistent with the ACCC's *Statement of principles for the regulation of electricity transmission revenues*—December 2004 (SRP). In the SRP the ACCC stated it would not use actual gearing of the regulated entity, but an appropriate benchmark instead. The ACCC in its MSP final decision noted that a 60:40 debt equity ratio reflects a standard industry structure as evidenced by market data at that time: see ACCC, *Final Decision: MSP*, op. cit., p. 115.

¹⁸⁵ GasNet, *Submission*, op. cit., p. 38.

¹⁸⁶ ACCC, *Revised Access Arrangement by GasNet Australia Ltd for the Principal Transmission System*, 14 November 2007, pp. 89-91.

Table 4.1.1: Comparison of gas rate of returns

<i>Decision</i>	<i>Date</i>	<i>Nominal return on equity (%)</i>	<i>Nominal vanilla WACC (%)</i>
ACCC final decision for GasNet (AA3)	Apr 2007	12.29	10.55
ACCC final decision for MAPS	Sep 2001	12.6	9.1
ACCC final decision for GasNet (AA2)	Nov 2002	11.2	6.3 ^(a)
ACCC final decision for ABDP	Dec 2002	11.7	8.9
ACCC final decision for MSP	Sep 2003	11.3	8.2
ACCC final decision for RBP	Aug 2006	11.70	8.84
ACCC final decision for DVP	Aug 2007	11.97	9.08
ESC final decision for gas distribution	Oct 2002	11.8	6.8 ^(a)
ESC final decision for gas distribution	Mar 2008	n/a	6.2(a)
ICRC final decision	Nov 2004	10.8–12.0	n/a
ERA final decision GGT	May 2005	9.5–13.4	n/a
ERA final decision Alinta gas networks	July 2005	9.2–11.2	n/a
ERA final decision DBNGP	Nov 2005	9.5–12.7	n/a
QCA final decision for gas distribution	May 2006	11.9	n/a

Source: ACCC various decisions: ESC, *Final decision: gas access arrangements*, October 2002; ESC, *Final decision: gas access arrangements*, March 2008; ICRC, *Final decision: review of access arrangement for ActewAGL natural gas system in ACT, Queanbeyan and Yarralumla*, October 2004; ERA, final decisions: *Goldfields Gas pipeline access arrangement*, May 2005; *review of the access arrangement for the Mid-West and South-West gas distribution system*, July 2005; *review of the access arrangement for the Dampier to Bunbury Natural Gas Pipeline*, November 2005. QCA, *final decision: revised access arrangements for gas distribution networks*, May 2006 (Allgas and Envestra decisions).

(a) Real vanilla WACC, others are nominal.

Table 4.1.2: Final decision—CAPM parameters and WACC parameters

<i>WACC parameter</i>	<i>Proposed</i>	<i>Final Decision</i>
Real risk-free rate*	2.68%	3.52%
Nominal risk-free rate*	5.85%	6.29%
Bond maturity period	10 years	10 years
Forecast inflation rate	3.09%	2.68%
Debt margin*	1.14%	2.99%
Debt raising costs	0.125%	0.104%
Credit rating	BBB	BBB+
Cost of debt	7.12%	9.38%
Market risk premium	6.00%	6.00%
Gearing ratio	60:40	60:40
Value of imputation credits	0.50	0.50
Equity beta	1.00	1.00
Return on equity	11.85%	12.29%
Nominal Vanilla WACC	9.01%	10.55%
Real Vanilla WACC	5.74%	7.67%

Amendment 05

Before the proposed revised access arrangement can be approved, GasNet must amend the rate of return in cl. 3.2 of the proposed access arrangement information to reflect the ACCC's estimates set out in table 4.1.2 of this final decision.

5. Forecast revenue and revenue elements

5.1. Non-capital costs

5.1.1. Introduction

Sections 8.36 and 8.37 of the code allow for the recovery of all non-capital costs that a prudent service provider, acting efficiently and in accordance with accepted and good industry practice to achieve the lowest sustainable cost, would incur in providing the reference service.

GasNet proposed significant increases in its non-capital costs over the course of the AA3 period. GasNet forecast its operating and maintenance costs in 2008 to be 17 per cent higher than the actual costs in the base year (2006) rising to 35 per cent higher than the base year in 2012. GasNet submitted that the main drivers of the cost increases were escalating labour costs above inflation and operating costs associated with its proposed capital expenditure program.

The ACCC engaged Ross Calvert Consulting (RCC) to assess GasNet's proposed non-capital costs. In its draft decision the ACCC supported the majority of its proposed non-capital costs.

An area in which the ACCC differed from GasNet was in relation to GasNet's treatment of its corporate overheads. GasNet made no allowance for any expected reduction in its overheads following the acquisition of GasNet by the APA Group in 2006. The ACCC considered that GasNet could achieve cost savings in its corporate overheads as it is integrated into the APA Group and in the draft decision proposed to reduce GasNet's forecast costs by \$2m per annum. This was considered a conservative estimate of the potential size of overhead cost savings from the acquisition.

GasNet also proposed to roll into the capital base its transaction costs of \$8.84m associated with the acquisition. The ACCC did not support this proposal.

In its draft decision, the ACCC also indicated its intent to discuss further the issue of GasNet's uplift payment liability cap under the SEA (i.e. the potential liability for which GasNet claims a self-insurance allowance).

5.1.2. Proposed amendments

The following are the amendments that the ACCC proposed in its draft decision.

Proposed amendment 07

Before the proposed revised access arrangement can be approved, GasNet must implement the administrative arrangements 1 to 7 described above in this chapter 5.1 of this draft decision.

The seven administrative arrangements referred to in Proposed Amendment 07 are:

1. a board resolution to self-insure (i.e. a copy of the signed minutes recording resolution made by the board)
2. confirmation that the service provider is in a position to undertake credibly self-insurance for those events
3. self-insurance details setting out the specific risks which the service provider has resolved to self-insure
4. a report from an appropriately qualified actuary or risk specialist verifying the calculation of risks and corresponding insurance premiums
5. ensuring that the cost of self-insurance is recorded as an operating expense in the audited and published income statement, and thereby deducted from the calculation of attributable profits
6. ensuring that a self-insurance reserve (funded by self-insurance premiums charged in the income statement) is established in the audited and published balance sheet
7. ensuring that when a claim against self-insurance is made, that an appropriate deduction to the self-insurance reserve is recorded.

Proposed amendment 08

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.5.2 of the proposed revised access arrangement information to reflect table 5.1.13 of this draft decision.

Table 5.1.13 from the draft decision is reproduced below.

Table 5.1.13: Draft decision—AA3 non-capital costs

2006 Jul \$ m	2008	2009	2010	2011	2012
Base	19.55	19.55	19.55	19.55	19.55
Labour	0.62	0.94	1.26	1.60	1.95
Fuel	0.00	0.00	0.00	0.00	0.00
Scope changes	0.74	0.87	0.87	0.87	1.01
Workload changes	1.22 ^(a)	0.81	0.87	0.92	0.97
Sub-total	22.13	22.16	22.55	22.94	23.47
<i>Less</i>					
Overheads reduction	2.00	2.00	2.00	2.00	2.00
Total opex	20.13	20.16	20.55	20.94	21.47
Benefit sharing	0.90	-0.69	-1.59	-0.85	0.00
Reset costs	0.95				
K factor carry over ¹⁸⁷	0.91				
Asymmetric risk	0.19	0.19	0.19	0.19	0.19
Equity raising costs	0.00	0.00	0.00	0.00	0.00
Other allowances	0.18	0.18	0.18	0.18	0.18
Sub-total	3.13	-0.32	-1.22	-0.48	0.37
Total	23.26	19.84	19.33	20.46	21.84

(a) This figure was overstated in the draft decision, the correct figure is \$0.5m.

5.1.3. Response to the draft decision

The most prominent issue raised in submissions to the draft decision is the proposal to reduce GasNet's proposed overheads by \$2m per annum. The ACCC's approach is opposed by GasNet,¹⁸⁸ Australian Pipeline Industry Association (APIA),¹⁸⁹ Multinet¹⁹⁰ and Alinta.¹⁹¹ Those parties consider any synergies arising from the acquisition of GasNet by the APA Group should be treated like any other efficiency gains and GasNet should be allowed to retain the benefits for a period of time. On the other hand EUCV¹⁹² and Origin Energy¹⁹³ support the ACCC's approach.

¹⁸⁷ The draft decision only included the KT_b factor for 2006 and will be updated to include the KT_a factor for 2007 in this final decision.

¹⁸⁸ GasNet, *Response to the Commission's Draft Decision on Proposed Access Arrangement for the Principal Transmission System*, (Submission in Response), op. cit., pp. 37-41.

¹⁸⁹ APIA, *Submission by the Australian Pipeline Industry Association on ACCC Draft Decision for Revised Access Arrangement Submitted by GasNet Australia Limited*, (Submission in Response), December 2007, pp. 2-4.

¹⁹⁰ Multinet, *Submission by Multinet Gas Partnership – ACCC Draft Decision for Revised Access Arrangement Submitted by GasNet Australia Limited*, (Submission in Response), December 2007, pp. 2-5.

¹⁹¹ Alinta, *Submission by Alinta LGA Ltd – ACCC Draft Decision for Revised Access Arrangement – Submitted by GasNet Australia Limited*, (Submission in Response), pp. 2-4.

¹⁹² EUCV, *Australian Competition and Consumer Commission - Victorian Gas Transmission Revenue Reset - AER Draft Decision on GasNet Application. A Response by the Energy Users Coalition of Victoria*, (Submission in Response) December 2007, p. 6.

¹⁹³ Origin, *Draft Decision - GasNet Australia - Revised Access Arrangement 2008-12*, (Submission in Response), December 2007, p 1.

EUCV has concerns with the magnitude of the forecast cost increases, in particular the forecast increase in labour costs above the CPI.

GasNet also commented on the following issues:

- the proposal by the ACCC to exclude the costs of a regulatory accountant
- the reduction in operating costs associated with the ACCC's proposal to disallow certain capital expenditure projects
- the treatment of fuel gas
- the proposal required to implement the seven administrative arrangements for self-insurance.

GasNet submits that an allowance for equity raising costs must be included in its non-capital costs on the basis that:

- as the draft decision itself stated, those costs have not been included in GasNet's capital base, and therefore the justification for not subsequently including those costs (i.e. assuming that they have been incorporated) in the ACG report does not apply
- the ACG report suggests that it might be appropriate to provide a subsequent allowance in some circumstances
- GasNet should be able to recover all costs associated with the provision of the reference service and part of those cost include equity raising costs
- the code prevents the initial capital base being reopened and therefore the costs cannot now be incorporated into the RAB, but this should not prevent GasNet from recovering this as a non-capital cost and
- inclusion of these costs as non-capital costs is permitted under sections 8.36 and 8.37 of the code.¹⁹⁴

The EUCV submits that it agrees with the ACCC's position on equity raising costs. The EUCV states that as the equity needed for GasNet assets has already been raised, there should be no additional allowance for it to be raised.¹⁹⁵

In respect of its uplift liability cap, GasNet's submits that:

The Service Envelope Agreement was negotiated as a package and the liability regime reflects a trade-off in respect of various other aspects of the agreement. Accordingly, GasNet considers that it is inappropriate for the Draft Decision to simply focus on one aspect of that package and seek to enforce changes to that provision. The Commission's role is to consider GasNet's proposed Access Arrangement and not pro-actively procure changes to the liability cap regime through discussions with VENCORP.

¹⁹⁴ GasNet, *Submission in Response*, December 2007, pp. 46-47.

¹⁹⁵ EUCV, *Submission in Response*, op. cit., p. 6.

Moreover, if a rigorous review were to be conducted into the appropriate liability cap, the outcome of that review could just as likely lead to a conclusion that a lower cap should apply. Given that such a review has not been conducted, GasNet considers that the Commission has no basis on which to arbitrarily increase the cap.¹⁹⁶

5.1.4. Conclusion

5.1.4.1. Labour costs

EUCV is critical of GasNet's forecast labour costs above the level of inflation. EUCV is also critical of an aspect of a report from Econtech, the AER's consultant in the SP AusNet matter, which the ACCC relied on in its assessment of GasNet's proposed labour costs.¹⁹⁷

While the ACCC relied on the Econtech report, it was not the only material that the ACCC relied on. The ACCC notes that the available evidence supports GasNet's submission that labour costs will increase at a rate above inflation over the AA3 period. The ACCC's consultant, RCC, also agreed with GasNet's proposal.

5.1.4.2. Fuel gas

Given the volatility in fuel gas prices and the high degree of uncertainty in forecasting GasNet's future fuel gas costs, in the draft decision the ACCC proposed that variations in fuel gas costs above or below the costs in the base year of 2006 should be treated as a pass-through event. While GasNet has no objection to this proposal in principle, it proposes that the best estimate of fuel gas costs should be used as the basis for the pass-through event, rather than 2006's actual costs.¹⁹⁸ Any variations over or below the best estimate would be treated as a pass-through event. The ACCC agrees with GasNet's approach (see section 5.2.3.2 for more details).

Accordingly, the forecast non-capital costs for the PTS have been adjusted to include GasNet's forecast fuel gas costs. GasNet has revised the forecast costs contained in its submission of 30 April 2007 following a recent tender for its fuel gas requirements.¹⁹⁹ The up-dated fuel gas costs have been incorporated into GasNet's non-capital costs.

EUCV submits that the quantity of fuel gas should be fixed, so that users are exposed to price changes only.²⁰⁰ The ACCC does not agree with this submission. As VENCORP is the operator of the PTS, the quantity of fuel gas used is outside the control of GasNet. It would be inappropriate to fix the quantity of fuel gas in the manner proposed by the EUCV.

¹⁹⁶ GasNet, *Submission in Response*, op. cit., p.45.

¹⁹⁷ EUCV, *Submission in Response*, op. cit., pp. 6-13.

¹⁹⁸ GasNet, *Submission in Response*, op. cit., p. 36.

¹⁹⁹ GasNet, *Email to the AER*, 27 February 2008.

²⁰⁰ EUCV, *Submission in Response*, op. cit., p. 6.

5.1.4.3. Scope change - regulatory accountant

GasNet proposed a cost of \$100 000 per annum for a regulatory accountant to handle the expected additional workload arising from the imminent implementation of the National Gas Law (NGL). GasNet also proposed \$30 000 per annum for an external audit of its regulatory accounts. The ACCC omitted the costs (apart from the final year of the AA3 period) in case the new reporting requirements did not apply during the currency of an AA. However, the ACCC indicated in its draft decision that it would monitor the situation as the NGL developed and would review its position prior to releasing its final decision.

GasNet submits that no transitional provisions are contemplated in the second exposure draft of the NGL that would exempt service providers from general provisions such as reporting requirements. GasNet further submits that the second exposure draft is a sufficient basis on which the ACCC should reach its final decision.²⁰¹

The ACCC understands that the transitional arrangements under the NGL are still being developed. On the basis of the latest draft it seems likely that general provisions such as reporting requirements will apply to GasNet and other service providers from the date that the NGL takes effect. Accordingly, the ACCC agrees with GasNet's submission and has incorporated the costs of a regulatory accountant as originally proposed by GasNet into the forecast non-capital costs for the PTS.

5.1.4.4. Workload change - operating costs associated with capital expenditure

In its draft decision, the ACCC proposed to reduce the forecast operating costs as a consequence of the exclusion of certain compressors from GasNet's proposed capital expenditure program.

GasNet has made further submissions in relation to those facilities. GasNet submits that if the ACCC accepts its proposal to include the costs of those facilities a corresponding increase in operating costs is required. GasNet has calculated the associated operating costs for compressors at 2.2 per cent of the capital costs, based on the RCC report.²⁰² The ACCC agrees that where changes to GasNet's capital expenditure program are approved as part of its final decision, any required or consequential increases to operating costs are appropriate.

Following GasNet's submissions the ACCC approves the installation of a compressor at Euroa, with an associated increase in operating costs. The operating costs associated with that facility have been factored into the forecast non-capital costs for the PTS in this final decision.

In the draft decision, the ACCC considered that additional looping of the Wodonga to Wollert Pipeline was more cost effective than the Euroa compressor. Given that the ACCC has now approved the Euroa compressor, the additional looping is no

²⁰¹ GasNet, *Submission in Response*, op. cit., pp. 35-36.

²⁰² *ibid.*, p. 36.

longer needed. The operating costs have been reduced accordingly. In addition, as the ACCC has approved, the Pakenham loop and Warragul loop, the additional operating costs associated with these loops has been included in GasNet's operating costs.

5.1.4.5. Corporate overheads

(i) *Synergies arising from the acquisition*

GasNet considers that the synergies arising from the acquisition of GasNet by APA should eventually be passed on to users. However, GasNet does agree with the ACCC's approach of reducing the proposed overheads for the AA3 period in expectation of synergies being realised during that period. GasNet considers it should be able to retain the full benefits of the synergies for the AA3 period and also some of the synergies as part of the carry-over mechanism into the AA4 period.

In support of its proposal, GasNet submits:

- the quantity of the synergies cannot be estimated and it is better to allow the carry-over mechanism to deal with the synergies
- the manner in which the synergies were dealt with in the draft decision will discourage future efficient mergers and acquisitions
- in estimating the reduction in overheads, the ACCC has failed to take into account the transaction costs associated with the acquisition
- the information relied on by the ACCC in estimating the \$2m per annum savings in overheads is out-of-date
- the ACCC's approach is inconsistent with the fixed principle contained in the access arrangement.

APIA, Multinet and Alinta agree with GasNet, whereas EUCV and Origin agree with the ACCC's approach.

GasNet and the Australian Pipeline Industry Association (APIA) submitted supporting evidence, including a report from CRA International (CRA), which was engaged by GasNet to advise on the ACCC's approach.²⁰³ A common theme of that material is that synergies from mergers should be shared between users and the merged firm, but at the same time regulation should not discourage firms from seeking to merge.

²⁰³ Dr Kenneth Gordon and Wayne P. Olson, *Removing Disincentives: State Regulatory Treatment of Merger Savings*, The Electricity Journal, 15 October 2006. Attachment to APIA's submission in response to the draft decision.

CRA International, *A Treatment of GasNet Corporate Costs*, 19 December 2007 (the CRA report). Attachment 7 to GasNet's submission in response to the draft decision.

Ofgem, *Mergers in the electricity distribution sector: Policy Statement*, May 2002. viewed 13 March 2008, <<http://www.ofgem.gov.uk>>.

In its draft decision, the ACCC considered that the \$2m per annum estimated reduction in overheads arising from the integration of GasNet into the APA Group was conservative. The ACCC noted that any cost reductions in excess of that amount would form part of the carry-over mechanism. In a sense the difference between the ACCC's approach and that proposed by GasNet is one of timing. Under the ACCC's approach some of the synergies arising from the acquisition would be passed on to users during the AA3 period. Under GasNet's proposal the sharing of synergies with users would be deferred until the AA4 period.

Having considered the various arguments submitted by interested parties to the draft decision, the ACCC has come to the broad position that there is merit in the arguments contained in the submissions advocating that the synergies be treated like other efficiency gains and should form part of the carry-over mechanism.

In this case, there was also a concern about whether the treatment of synergies in the draft decision would discourage efficient merger behaviour. The ACCC agrees that regulation should not discourage efficient acquisition and mergers. The ACCC also agrees that the carry-over mechanism is an appropriate means of sharing the synergies over time between GasNet and users in the same way as any other claimed efficiencies. It is worth noting that the acquisition occurred towards the end of the AA2 period, whereas the synergies are not expected to be achieved until subsequent periods. Were the synergies achieved during the same AA period in which the acquisition took place, any cost savings would form part of the carry-over allowance in the same manner as other efficiency gains and would be passed on to users in later periods.

Another criticism of the ACCC's proposal to reduce GasNet's overheads by \$2m per annum is that GasNet would be disadvantaged if it could not achieve cost reductions of this magnitude. GasNet has made further confidential submissions, which suggests that the cost savings during the AA3 period will be much more modest than the \$2m per annum proposed by the ACCC.²⁰⁴ An advantage of the carry-over mechanism is that the precise impact of these synergies does not need to be predicted in advance and these savings are passed on in later periods when the actual amount of these savings becomes clear.

GasNet further submits that the approach proposed in the draft decision is prohibited by the fixed principle.²⁰⁵ The fixed principle (clause 7.2(h) of the access arrangement) states:

In calculating the allowable revenues for operations and maintenance expenditure for the Third Access Arrangement Period the Commission must:

- (i) comply with the requirements of the Code;

²⁰⁴ GasNet, *confidential Submission in Response*, 20 February 2008, p. 2.

²⁰⁵ GasNet, *Submission in Response*, op. cit., pp. 37-38.

- (ii) take into account the actual operating costs in 2006, adjusted for the change in forecast operating costs between 2006 and 2007, and, to avoid doubt, not taking into account the efficiency gain (loss) made in 2007;
- (iii) take into account forecast changes in workload, taxes, regulatory events, insurance premiums and other relevant costs between 2006 and each year of the Third Access Arrangement Period;
- (iv) take into account a percentage trend factor.

GasNet submits that parts (ii) and (iii) of clause 7.2(h) prohibit the ACCC from reducing the forecast overheads in the manner proposed in the draft decision. In GasNet's view only 'scope' and 'workload' changes are permitted by the fixed principle and the ACCC's proposed reductions in overheads did not fall within either category.

The ACCC does not interpret the fixed principle as narrowly as GasNet. The ACCC considers that it is entitled to take account of forecast changes in overheads as a result of a restructure under part (iii) of clause 7.2(h), which allows the ACCC to take account of forecast changes in 'other relevant costs'.

On the basis of all the submissions put to the ACCC in response to the draft decision, the ACCC has decided not to reduce GasNet's overheads by \$2m per annum as proposed in the draft decision. Any synergies achieved by GasNet during the AA3 period will be treated in the same manner as other efficiency gains and will be recognised in the carry-over mechanism.

(ii) *Transaction costs associated with the acquisition*

GasNet submits that the ACCC should take account of its transaction costs of \$8.84m as seller.²⁰⁶ The ACCC does not agree with GasNet and affirms its draft decision that these costs should not be recovered from users. The ACCC does not consider that these costs are associated with the synergies arising from the acquisition, as submitted by GasNet. The benefits associated with those costs accrued to the previous shareholders of GasNet in terms of the sale price they received for the assets. Alinta submitted:

For the most part, acquiring companies nearly always pay a substantial premium on the stock market value of the companies they buy.²⁰⁷

The seller's transaction costs are associated with the sale price and any premium above market value that the seller receives for the asset, not the synergies that accrue to the buyer. Allowing the new owner to recover the previous owner's transaction costs through higher tariffs to users cannot be justified and is not in the interest of users (s. 2.24(f)) of the code.

GasNet initially made no claim for APA's costs as buyer. In response to the draft decision to reduce GasNet's proposed corporate overheads by \$2m per annum,

²⁰⁶ GasNet, *Submission in Response*, op. cit., p. 42.

²⁰⁷ Alinta, *Submission in Response*, p. 3.

GasNet now submits that the APA Group's transaction costs of \$10m as buyer should also be taken into account. Moreover, GasNet proposes that these costs should be rolled into the capital base.²⁰⁸

There may be some argument for taking account of the full transaction costs and the sale price in instances where the asset is revalued following the acquisition. This would require some analysis that there is a net benefit to users arising from the acquisition. If the costs associated with the sale were to be passed immediately onto users, it would also require the expected synergies to be passed onto users immediately in the form of lower tariffs. However, this is not a consideration for the ACCC on this occasion as the code does not permit re-valuation of the capital base. Moreover, the ACCC is allowing GasNet (or more particularly APA as owner) to recover equity raising costs (associated with the DORC valuation methodology). To allow GasNet to recover APA's transaction costs of \$10m also would amount to double-counting.

In a further submission in response to the draft decision, GasNet stated:

GasNet's corporate governance structure for the next regulatory period and its possible reduction in corporate overhead costs is attributable to its acquisition by the APA Group. The transaction costs were necessarily incurred to facilitate the acquisition such that without them, the acquisition could not have proceeded.²⁰⁹

While it may be true that the synergies would not be realised in the absence of the acquisition, it does not follow that the transaction costs relate directly to the attainment of the synergies. It is important to distinguish between the costs associated with the initial negotiations and completion of the acquisition (transaction costs) and any further costs associated with the corporate restructure (restructure costs). It would be inappropriate to give weight to costs that relate to aspects of the acquisition other than the attainment of the synergies. For example, to the extent that GasNet's transaction costs of \$8.84m are associated with the premium it received from the sale, so APA's transaction costs, or at least a significant portion of them, can be attributed to the attainment of the most favourable price that APA could negotiate rather than to any subsequent action to restructure the business.

GasNet further stated:

If, however, the Commission [ACCC] were to decide to include unrealised synergies as part of the corporate overheads costs forecasts under s. 8.2(e) of the Code, it would also have to take into account the costs of delivering those synergies.²¹⁰

Under these circumstances, if the transaction costs can be disaggregated and a portion of those costs can be correctly attributed directly to the corporate restructure and associated synergies, the ACCC agrees that it may be appropriate to take account of that portion of the costs. However, as mentioned above, the ACCC has

²⁰⁸ GasNet, *Submission in Response*, op. cit., pp. 41-43.

²⁰⁹ GasNet, *Further Submission in Response*, 6 March 2008, p. 3.

²¹⁰ *ibid.*, p. 1.

decided not to proceed with the draft decision proposal to reduce GasNet's overheads by \$2m per annum to take account of expected cost savings arising from the integration of GasNet into the APA Group.

Another further issue raised by GasNet is the manner in which the transaction costs are treated. If GasNet's proposal to roll those costs into the asset base were implemented (or any similar approach that is based on the up-front recovery of costs) and the expected synergies were not realised, users would pay for the transaction costs without receiving any benefits from the synergies. In other words, users would be required to pay for an inefficient acquisition. This would not be in the interest of users (s. 2.24(f)) of the code and contrary to the code requirement for the recovery of efficient costs (s. 8.1(a) of the code).

As an alternative to GasNet's preferred approach of rolling the transaction costs into the asset base, GasNet has suggested the following mechanism:

- a separate notional account is established for the transaction costs
- in any year where there is an identified efficiency gain, that gain would be deducted from the balance in the notional account
- efficiencies would then be passed onto users after the costs have been fully offset.²¹¹

Under this approach the transaction costs would not be paid by users unless there are equivalent synergies which would eventually be passed on to users.

The main problem with this approach is that it essentially proposes a different mechanism to deal with claimed efficiencies than what is provided under the fixed principle which is to utilise the efficiency carry-over mechanism. GasNet is only predicting modest synergies during the AA3 period. Therefore, it is possible that a prolonged period of time will elapse before the synergies begin to be passed onto users, if at all. This approach appears inconsistent with the CRA report, which likened the carry-over mechanism to the outcomes that would be observed in a workably competitive market. CRA states:

Under a workably competitive market, the process of cost reduction is iterative and reflects the dynamic nature of competition: firms seek out efficiency gains, benefits are retained for a period of time, while over time other firms compete away super-normal profits.

The workings of the efficiency carry-over mechanism included as a fixed principle in GasNet's access arrangements reflects the above dynamics; a benchmark is set for operating expenditure based on historical expenditure; GasNet then has an incentive to seek out efficiency gains as any benefits are kept for 5 years; and subsequently the benchmark is altered reflecting the achieved efficiency gains.²¹²

²¹¹ GasNet, *Submission in Response*, p. 43.

²¹² CRA report, p. 7.

If the carry-over mechanism is to replicate the outcomes observed in a competitive market, then GasNet should not be allowed to retain the synergies for a prolonged period of time or for a longer period than what is implied by such a mechanism. This would be inconsistent with the carry-over mechanism and with the workably competitive market paradigm.

A further argument against the inclusion of the transaction costs is that GasNet submits that it is likely to incur integration costs during AA3.²¹³ In effect these integration costs will be offset against the synergies in the manner described by GasNet.

The ACCC has decided that the synergies from the acquisition will be recognised in the carry-over mechanism. However, neither GasNet's transaction costs as seller nor APA's transaction costs as buyer should be recovered from users. Under this approach, if the benefits of the synergies that are realised over time are greater than the transaction costs, GasNet retains the net benefits. On the other hand, if the benefits are less than the costs, GasNet, rather than users, bears the net loss.

With the exception of the rejection of GasNet's claim for its transaction costs of \$8.84 m, this decision is consistent with GasNet's original proposal. As mentioned above, GasNet did not claim APA's transaction costs in its proposed revised AA. The claim only arose in response to the draft decision's proposal to reduce GasNet's proposed overheads by \$2m per annum. However, the ACCC is no longer proceeding with this aspect of its draft decision.

5.1.4.6. Self-insurance administrative arrangements

GasNet objects to the seven administrative arrangements being imposed in order for the ACCC to approve its claims for self-insurance. GasNet submits:

The requirements which the Draft Decision intends to impose effectively seek to dictate board behaviour and accounting practices and in GasNet's view represent a level of interference in GasNet's business operations which is completely unwarranted.²¹⁴

GasNet notes that the 'Statement of principles for the regulation of electricity transmission revenues' states that the application of the administrative arrangements for self-insurance will depend on the individual circumstances and the AER will depart from those principles if required or justified by the National Electricity Rules.²¹⁵

GasNet considers that the imposition of the administrative arrangements in this case is neither required nor justified under the code. GasNet notes that the categories for self-insurance that it is claiming have previously been considered prudent by the Tribunal.²¹⁶ As noted in the draft decision, however, on that occasion the total self-

²¹³ GasNet, *Confidential Submission in Response*, 20 February 2008, p. 4

²¹⁴ GasNet *Submission in Response*, p. 45.

²¹⁵ *ibid*, pp. 44-48.

²¹⁶ *ibid*, p 45.

insurance amount approved by the ACCC was relatively small and the ACCC required only modest administrative arrangements. Following GasNet's appeal to the Tribunal, the total self-insurance allowance was substantially increased by order of the Tribunal. The Tribunal did not then address, however, the issue of whether more stringent administrative arrangements were warranted in light of the significant increase in the total amount allowed for self-insurance.

One of the reasons for the imposition of the administrative arrangements is to provide the regulator with the confidence that the regulated firm is in a position where it can credibly self-insure. So that the ACCC can be satisfied of this, the ACCC requires GasNet to compile with the first two of the administrative arrangements. That is, GasNet must provide a board resolution to self-insure and confirmation that GasNet can credibly undertake self-insurance. The ACCC notes that in relation to the AER's determination of SP AusNet's 2008-09 to 2013-14 revised revenue proposal for its electricity transmission network, SP AusNet was required to comply with these arrangements.²¹⁷

In relation to the third and fourth administrative arrangements, GasNet submitted a report from SAHA International (SAHA), which the ACCC has accepted in relation to the self-insurance matters.

Regarding the reporting requirements (the last three of the administrative arrangements) the ACCC has reviewed the position it took in the draft decision in light of GasNet's submissions and has decided not to impose these conditions on GasNet as part of its assessment of GasNet's AA. As noted by GasNet, the NGL will impose a greater regulatory reporting burden on service providers than the current regime requires, and the new requirements are likely to apply to service providers from the date the NGL comes into effect. The NGL is likely to provide the AER with some discretion to specify the form that the regulatory accounts will take.²¹⁸

Amendment 06

Before the proposed revised access arrangement can be approved, GasNet must include:

- a board resolution to self-insure (i.e. a copy of the signed minutes recording resolution made by the board); and
 - confirmation that the service provider is in a position to undertake credibly self-insurance for those events.
-

5.1.4.7. Asymmetric risk - uplift liability cap

In its draft decision, the ACCC did not intend to pro-actively procure an amendment to the liability cap regime as GasNet suggests in its response to the draft decision. Rather, the ACCC indicated its intent to seek views from VENCORP and GasNet as

²¹⁷ SPI PowerNet Pty Ltd, *Extracts of Minutes of a Meeting of the Board of Directors*, 12 October 2007, viewed 10 April 2008, <<http://www.aer.gov.au/content/index.phtml/itemId/715575>>.

²¹⁸ *National Gas (South Australia) Bill 2008*, 9 April 2008, Division 4, Subdivision 3 (Parts 53-55).

to TRUenergy's comments relating to the cap having never been escalated since its inclusion in the initial Service Envelope Agreement (SEA) in 1999.

GasNet submits that any change to the liability cap should only follow after a rigorous review of the SEA. It describes the SEA as a package document where the liability regime involved a trade-off in respect of various other aspects of the agreement.²¹⁹ VENC Corp staff have commented that they would be open to reviewing the liability cap in the Service Envelope Agreement with GasNet.²²⁰

The ACCC understands that the first substantial redrafts to the original SEA were agreed to in early 2007 but that these revisions did not encompass changes to the uplift liability cap. The absence of a change to the uplift cap is not intuitive given that the gas wholesale market and infrastructure now is substantially different to that which existed when the initial SEA was signed in 1999 — hence the basis on which any trade-off was made in 1999 no longer applies.²²¹

Whilst the ACCC approves necessary operational expenditure with a view to supporting the goal of making the PTS available at all times, potential uplift liability exposure within market rules/agreements also provides further incentives to reach this goal.²²²

A comprehensive review of the SEA, which included a review of the uplift cap, would be an important step to addressing all parties concerns. An escalation of the cap applied in 1999 to 2008 dollars is not supported by GasNet and the ACCC recognises GasNet's view that such an escalation would be an arbitrary exercise without consideration of what obligations have changed under the SEA since 1999. From a regulated revenue perspective, it would result in users paying higher tariffs without a consideration of whether the increase is justified²²³The ACCC notes, in respect of a review of the SEA by GasNet and VENC Corp, in accordance with the MSO rules, if there is a failure to agree, the contemplated mechanism in clause 5.3.1 is for the ACCC to appoint an independent expert to consider the issue.

²¹⁹ GasNet, *Submission in Response*, p. 45

²²⁰ VENC Corp, *Meeting with AER*, 11 December 2007

²²¹ For example since 1999 there has been an increase in the number of injection points and pipelines.

²²² The ACCC notes that a strong incentive is important since under the regulatory regime GasNet is allowed to share in the benefits of savings on operational expenditure and a strong incentive will assist to ensure that savings are not at the expense of reliability.

²²³ The ACCC notes that increasing the SEA would mean more operational expenditure costs to users given the present treatment of a reasonable chance of occurrence of such costs (despite best endeavours) as a pass through.

5.1.4.8. Equity raising costs

GasNet proposes an annual allowance in AA3 of 0.224 per cent per annum of regulated equity consistent with that approved for in AA2.²²⁴

In 2002, the ACCC acknowledged the two competing views relating to the validity of an allowance for equity raising costs being that GasNet's initial capital base reflected only the value of physical assets and did not compensate the service provider for capital raising costs, in contrast to the view that the initial capital base incorporated all capital costs.²²⁵ The ACCC considered the former to be the better view and an allowance for equity raising costs was approved. The ACCC noted, however, that this approval of equity raising costs was to be subject to further research in the future.²²⁶

In the context of this revision, GasNet's initial capital base was established in 1998 and will be rolled-forward for the second time. Accordingly, the ACCC considered in the draft decision that there was no justifiable reason to include an allowance for equity raising costs relating to be retrospectively provided given the ICB was established in 1998. The ACCC notes that the EUCV agrees with the position in the draft decision.²²⁷ However, the ACCC has reconsidered its position in respect of an allowance for equity raising costs.²²⁸

The final decision for SP AusNet states that:

ACG notes that whilst equity raising costs were not included in the 2002 RAB, a separate opex allowance for equity raising costs was granted in this decision. In effect, ACG argues that the inclusion of this opex allowance was analogous to including equity raising costs in the RAB, and on this basis that it would be appropriate to continue that allowance in this decision. The AER considers this a valid argument, and an appropriate application of the principles in ACG's original and updated advice to SP AusNet's specific circumstances.²²⁹

This leads to SP AusNet being compensated for both equity raising costs associated with its initial capital base (as at 2002), and equity raising costs associated with its capex over the current period [2002-2007].to disallow these costs now in response to a changing view on the appropriate regulatory treatment of equity raising costs would in effect be retrospective, and not in keeping with the principles of the ACG report.²³⁰

In the context of the decision made in AA2, the ACCC now considers that an allowance for equity raising costs on the closing capital base for this period is

²²⁴ GasNet, *Submission*, op. cit., p. 81.

²²⁵ ACCC, *Final Decision: GasNet Australia 2002–07*, op. cit., p. 150.

²²⁶ *ibid.*, p. 151.

²²⁷ EUCV, *Submission in Response*, op. cit., p. 6.

²²⁸ GasNet, *Submission in Response*, op. cit., pp. 46-47, and AER, *Final Decision: SP AusNet Transmission Determination 2008-09 to 2013-1*, 31 January 2008, p.146.

²²⁹ AER, *Final Decision: SP AusNet Transmission Determination 2008-09 to 2013-14*, 31 January 2008, p.146.

²³⁰ *ibid.*, p. 147.

consistent with regulatory practice. The ACCC notes that an allowance for equity raising costs was provided during the AA2 period. In keeping with the SP AusNet decision and the ACG report's view, the ACCC considers that the removal of equity raising cost would be a retrospective adjustment as this allowance was provided in the AA2 period to be recovered over future AA periods and therefore an allowance for equity raising cost should continue to be provided.

However, the ACCC does not consider that the forecast capex requires additional equity raising costs as assumed by GasNet in its Tariff Model and therefore considers that equity raising costs apply to the closing capital base in 2007, rather than the forecast capital base in each of the years over the AA3 period. This is consistent with the basis on which the allowance has been previously provided in relation to the AA2 period and the updated ACG advice commissioned by SP AusNet which was submitted to the AER.²³¹

The ACG advice is based on its original report which describes three different mechanisms for allowing for equity raising costs. The mechanism which applies to GasNet involves converting equity raising costs 'into a perpetuity-equivalent and provide an annual allowance.'²³² Based upon the closing capital base of \$560 m and the approved equity raising cost annuity factor in 2002 of 0.224 per cent, this equates to an annual real allowance of \$0.502 m.²³³

Table 5.1.1: Final decision—AA3 equity-raising costs

(\$ Dec 2007)	
Initial Capital Base 31 st December 2007	\$560,316,946
Gearing ratio (40% equity)	× 0.40
<i>Amount attributed to equity finance</i>	\$224,126,778
Equity raising cost annuity factor (0.224%)	× 0.00224
Annual allowance	\$502,044

Source: ACCC analysis.

5.1.4.9. K-factor carryover

It was noted in the draft decision that the carry-over allowance would have to be updated between the release of the draft decision and final decision.²³⁴ Accordingly, the carry-over allowance approved in this final decision is \$736 363, compared with the allowance of \$909 768 proposed in the draft decision.

²³¹ ACG, *SP AusNet draft decision: transaction cost of raising equity*, 12 October 2007, p.3, as found in 'Appendix O – ACG letter on equity raising costs', SP AusNet, *Electricity transmission revised proposal 2008-09 – 2013-14*, 12 October 2007.

²³² *ibid.*

²³³ ACCC, *Final Decision: GasNet Australia access arrangement revisions for the Principal Transmission System*, 13 November 2002, p. xii and GasNet, *GasNet Access Arrangement Information*, 23 December 2003, p. 11.

²³⁴ ACCC, *Draft decision : GasNet Australia access arrangement revisions for the Principal Transmission System*, 14 November 2007 p.188.

5.1.4.10. Other allowances - linepack

The ACCC's decision to exclude the additional looping of the Wollert to Wodonga pipeline has no material impact on the value of linepack. The allowance already includes the additional linepack related to the Pakenham and Warragul loops.

5.1.4.11. Other allowances – AMDQ/Credits

In the draft decision, the ACCC proposed an amendment to GasNet's proposed revisions to its AA to account for AMDQ/credit certificate revenue in GasNet's price control formula. In recognition of the costs associated with the issuance of AMDQ/credit certificates, the ACCC invited GasNet to propose additional operating costs.

In response to the draft decision, GasNet submits that the incremental operating costs required to administer AMDQ/credit contracts, conduct tenders, prepare contracts and conduct legal reviews are in the order of \$50 000 per annum²³⁵. However, given the ACCC's decision to no pursue AMDQ/credit contracts as a regulated service (see section 5.5.4.2) this amount has not been included in GasNet's non-capital costs.

5.1.5. Conclusion

The non-capital costs approved by the ACCC are shown in Table 5.1.2.

Table 5.1.2: Final decision—AA3 non-capital costs

2006 Jul \$ m	2008	2009	2010	2011	2012
Base	20.93	20.93	20.93	20.93	20.93
Labour	0.62	0.94	1.26	1.60	1.95
Fuel	1.53	1.43	1.50	1.56	1.70
Scope changes	0.87	1.00	1.00	1.00	1.01
Workload changes	0.50	1.07	1.13	1.18	1.23
Total opex	24.45	25.37	25.82	26.27	26.81
Benefit sharing	0.90	-0.69	-1.59	-0.85	
Reset costs	0.95				
K factor carry over ^a	0.74				
Asymmetric risk ^a	0.18	0.18	0.18	0.18	0.18
Equity raising costs ^a	0.50	0.50	0.50	0.50	0.50
Other ^b	0.19	0.19	0.19	0.19	0.19
Sub-total	3.46	0.18	-0.72	0.02	0.87
Total	27.91	25.55	25.10	26.29	27.68

^a December 2007 dollars

^b return on linepack and inventories.

²³⁵ GasNet, *Response to Queries on AMDQ Contracts*, 19 March 2008, p. 3.

Amendment 07

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.5.2 of the proposed revised access arrangement information to reflect table 5.1.2 of this final decision.

5.2. Pass-through events

5.2.1. Introduction

Section 8.3(d) of the code provides that the reference tariff policy may incorporate a ‘trigger event adjustment approach’. Under this approach reference tariffs may be varied if a specified event (pass-through event) occurred. Sections 8.3B–8.3H prescribe the approval process if a service provider wishes to vary reference tariffs as a consequence of a specified event occurring.

The mechanics of the pass-through events are considered in chapter 6.3 of the draft decision. This section discusses the merits of each of the pass-through events proposed by GasNet.

GasNet proposed the following changes to its pass-through events:

- a change in the definition of an insurance event. Specifically, GasNet no longer proposes to include as a pass-through event a change in one or more costs in insurance comprising GasNet’s minimum insurance level
- the introduction of an ‘asbestos event’.²³⁶ An asbestos event is defined as any cost, expense or liability incurred by GasNet arising out of or in connection with a claim by a third party in respect of an asbestos related disease.²³⁷

In its draft decision, the ACCC supported the change to the definition of an insurance event. However, the ACCC considered that the change in definition created the potential for GasNet to over recover costs. The ACCC did not consider that was GasNet’s intention and raised the apparent anomaly with GasNet. Consequently, GasNet agreed to amend the definition of an insurance event, which was dealt with by proposed amendment 09 in the draft decision.

The ACCC did not agree with GasNet’s proposal to include asbestos risk as a pass-through event. The ACCC did indicate, however, that it would consider any proposal to include a self-insurance allowance for asbestos risk.

In view of the current volatility and uncertainty over GasNet’s fuel gas costs the ACCC did not consider it appropriate to include an estimate of GasNet’s fuel gas costs for each year of the AA3 period. As an alternative the ACCC proposed that the base year’s (2006) costs are included in each year of the AA3 period and any differences between the base year’s costs and actual costs in any year would be

²³⁶ GasNet, *Proposed access arrangement*, op. cit., p. 16.

²³⁷ *ibid.*, p. 13.

treated as a pass-through event. The ACCC also proposed a condition that GasNet must tender for its fuel gas requirements.

5.2.2. Proposed amendments

The proposed amendments 09, 10, 11 (reproduced below) expressed the ACCC's draft decision noted above.

Proposed amendment 09

Before the proposed revised access arrangement can be approved, GasNet must:

- amend the definition of an Insurance Event in cl. 9.1 of its proposed revised access arrangement to only cover circumstances where GasNet is required to pay a deductible in connection with a claim under an insurance policy and
- remove the definition of Minimum Insurance Level from in cl. 9.1 of its proposed revised access arrangement

Proposed amendment 10

Before the proposed revised access arrangement can be approved, GasNet must amend the definition of a Pass Through Event in cl. 9.1 of its proposed revised access arrangement to remove the reference to an Asbestos Event.

Proposed amendment 11

Before the proposed revised access arrangement can be approved, GasNet must include:

- changes to its fuel gas costs from the base year (2006) as a pass-through event, excluding any fuel gas costs associated with the Euroa compressor and
 - as a condition that GasNet must tender for its fuel gas requirements.
-

5.2.3. Response to the draft decision

5.2.3.1. Definition of insurance event

As noted above, GasNet has no objection to Proposed amendment 09 in the draft decision.

Amendment 08

Before the proposed revised access arrangement can be approved, GasNet must:

- amend the definition of an Insurance Event in cl. 9.1 of its proposed revised access arrangement to only cover circumstances where GasNet is required to pay a deductible in connection with a claim under an insurance policy and
 - remove the definition of Minimum Insurance Level from in cl. 9.1 of its proposed revised access arrangement
-

5.2.3.2. Fuel gas

GasNet has no objection in principle to including variations to fuel gas costs each year as a pass-through event. However, GasNet proposes that variations from its best estimates, rather than the base year's (2006) form the basis of the pass-through.²³⁸

In its response to the draft decision, GasNet noted a number of changes to its operations that will lead to differences in fuel gas consumption between 2006 and each year of the AA3 period. GasNet submits that using best estimates, rather than 2006 actuals, as the basis for the pass through will avoid unnecessary tariff shocks if actual costs during the AA3 period differ significantly from actual costs in 2006. GasNet further submits that its approach will minimise the risk of GasNet being unable to recover a portion of a positive pass through amount because of the 2 per cent tariff re-balancing constraint on tariffs.²³⁹ The ACCC accepts GasNet's approach.

GasNet did not respond to the ACCC's proposal to impose a condition that GasNet must tender for its fuel gas requirements. GasNet subsequently confirmed that it has no objection to this proposal.²⁴⁰

Amendment 09

Before the proposed revised access arrangement can be approved, GasNet must include:

- variations to its fuel gas costs from the yearly forecast costs as a pass-through event, and
 - as a condition, that GasNet must tender for its fuel gas requirements.
-

5.2.3.3. Asbestos risk

GasNet maintains that asbestos risk should be treated as a pass-through event. GasNet engaged SAHA to critique the ACCC's draft decision.

The ACCC agrees with SAHA that asbestos risk is a genuine risk faced by GasNet. However, it does not agree that the logical conclusion from SAHA's arguments is

²³⁸ GasNet, *Submission in Response*, p. 36.

²³⁹ *ibid.*, p. 36.

²⁴⁰ GasNet, *Email to the AER*, 27 February 2008.

that asbestos risk should be treated as a pass-through event as opposed to an allowance for self-insurance.

SAHA states that if a risk is borne by only one firm in an industry that risk would be reflected in a lower asset value. In respect of an industry in which all firms face the same risk, SAHA states:

..if it is a risk that is faced by all participants within that industry (eg; security risks for airlines), then all participants will have to not only bear that risk, but they will pass the cost associated with bearing that risk onto customers through higher prices. The key factor in the latter scenario is that only the efficient cost associated with bearing that risk will be passed onto customers.²⁴¹

The ACCC considers that this passage supports asbestos risk being treated as self-insurance allowance rather than as a pass-through event. If the risk is current, it is current users who should bear the risk, not future users as would occur if asbestos risk is treated as a pass-through event and an asbestos related event occurs. By way of comparison all gas transmission businesses face fraud risk, yet GasNet is treating fraud risk as a self-insurance allowance rather than as a pass-through event.

SAHA states that failure to include asbestos risk as a self-insurance allowance may result in GasNet being encouraged to ‘undertake extremely expensive mitigation strategies within its business in order to reduce the probability of this risk occurring’.²⁴² However, this is what GasNet appears to be doing in order to comply with occupational health and safety regulations. SAHA itself seems to be acknowledging this elsewhere in its report.²⁴³

In SAHA’s view it very difficult to accurately quantify a self-insurance premium for asbestos.²⁴⁴ Even if this is the case, the ACCC does not consider that this justifies treating asbestos risk as a pass-through event. The extensive legal requirements placed on GasNet to minimise the risk of an asbestos related event occurring suggests that any self-insurance allowance for asbestos risk is likely to be minimal.

A service provider has the prerogative to submit revisions to an access arrangement to the regulator for approval any time prior to the scheduled review date. If an asbestos related event occurs it is open to GasNet to submit revisions to its AA at that time.

²⁴¹ SAHA International, letter to GasNet 19 December 2007, p. 5. (Attachment 4 to GasNet, *response to the Commission’s draft decision (Attachments)*).

²⁴² *ibid.*

²⁴³ *ibid.*, p. 4.

²⁴⁴ SAHA International, *op. cit.*, p. 5.

Amendment 10

Before the proposed revised access arrangement can be approved, GasNet must amend the definition of a Pass Through Event in cl. 9.1 of its proposed revised access arrangement to remove the reference to an Asbestos Event.

5.2.3.4. Immaterial pass-through amounts

In its draft decision, the ACCC proposed to accept GasNet's proposal for GasNet to be given the discretion not to seek a pass-through for immaterial amounts, defined as less than \$50 000 per annum. The ACCC understands that this will be less than \$50 000 which may be positive or negative. The ACCC approves this proposal.

5.3. Inflation

5.3.1. Introduction

For the purposes of its proposed AAI and AA submission, GasNet has calculated its revenue requirement in nominal terms, using a forecast inflation rate of 3.09 per cent. Reference tariffs have been calculated such that they will incorporate an actual inflation adjustment throughout the period.

The ACCC in its draft decision examined GasNet's revenue calculations and noted that a nominal framework has been applied in a consistent manner across the various elements such as the rate of return, the calculation of costs and depreciation. The use of a nominal framework rather than a real one does not impact on the total revenue for the AA period.

The ACCC in its draft decision estimated an inflation rate of 3 per cent on the basis that the RBA has stated its central forecast is for both the underlying and headline inflation to remain near the top of its target range.

5.3.2. Response to the draft decision

GasNet is response to the draft decision proposed an inflation rate of 2.5 per cent on the basis that this is in the middle of the RBA's target range of inflation.

A number of submissions were also received on this aspect of the draft decision (refer to section 4.1.4 of this final decision).

5.3.3. Conclusion

As noted in the draft decision, while the choice of nominal or real terms can be selected by the service provider, the code does require the regulator to be satisfied that estimates, of which forecast inflation is one, are the best estimates arrived at on a reasonable basis.

For this final decision, the ACCC considers that this results in a best estimate of the forecast inflation rate of 2.68 per cent (refer to chapter 4 of this final decision).

5.4. Volumes

5.4.1. Introduction

Section 8.2(e) of the code requires that any forecasts required in setting the reference tariff should represent best estimates arrived at on a reasonable basis.

GasNet initially submitted volume forecasts based on the then most recent VENCORP Annual Planning Review (2006 APR), for both annual withdrawals and peak day withdrawals.²⁴⁵ These forecasts are a key input, along with pipeline costs to derive tariffs to recover the cost of withdrawal pipelines, such as those located within the greater Melbourne area. These VENCORP forecasts include a stronger weather warming trend than in previous years. The adoption of this stronger warming trend contributed to a downwards impact on volumes for GasNet's proposed AA such that aggregate withdrawal volume forecasts for the AA3 period were lower than for the AA2 period. GasNet included its own withdrawal forecasts for system exports, gas storage refill into the WUGS, Dandenong storage facilities as well as for fuel gas.²⁴⁶ GasNet included VENCORP's annual Gas Power Generation (GPG) forecasts from the 2006 APR, but arrived at its own peak GPG volume forecast given the absence of a VENCORP forecast²⁴⁷

On the basis of forecast total system withdrawals for peak and annual days (that is VENCORP withdrawal volume forecasts plus its own volume forecasts) GasNet submitted injection forecasts to match these withdrawal volumes using its own forecasts. For the AA3 period, more injection volumes from the Otway Basin were predicted. GasNet considered that more volumes from the Otway basin were likely given the imminent commissioning of the Corio loop and the Woodside gas processing facility. GasNet's injection volume forecasts are a direct input into the calculation of injection tariffs to recover costs of injection pipelines, such as those connecting users to the Gippsland/Otway basins.²⁴⁸

GasNet submitted a proposal which normalised revenue outcomes to cold weather outcomes. That is, through its price control formula GasNet addresses in future years of the AA period revenue deviations in any year which were attributable to deviations from VENCORP's EDD, cold weather day forecasts. GasNet noted that its

²⁴⁵ Annual and peak volume forecasts are used to determine a withdrawal tariff. \$/GJ tariff equals (\$ peak volume forecast cost allocation (65 per cent), plus \$ annual volume forecast based cost allocation (35 per cent) divided by annual volume (GJ).

²⁴⁶ GasNet, *Submission*, op. cit., p. 88

²⁴⁷ *ibid.* pp.88, 89

²⁴⁸ Annual, peak and four month winter volumes are used to determine an injection tariffs in accordance with GasNet's proposal where \$/GJ tariff equals (\$ peak day volume forecast based cost allocation (65 per cent), plus \$ annual volume forecast based cost allocation (35 per cent) divided by four month winter volumes. The ACCC, however, is requiring as part of its final decision that Injection volumes be calculate as \$ direct cost allocation of individual asset group costs (at injection zones) divided by top ten forecast peak day volumes, refer to chapter 6.1 of this final decision.

revenue volatility over the AA2 period, where some years were hotter (less EDDs) than others had affected its revenue and considered that as a largely fixed cost business it was inappropriate for its revenue stream to continue be exposed to fluctuations from weather effects.²⁴⁹

Submissions to the issues paper focussed on GPG volume forecasts. Submissions considered that the VENCORP annual GPG forecasts were too low.²⁵⁰

In relation to withdrawal volume forecasts for the draft decision:

- It was considered that VENCORP forecasts were best estimates based on independent forecasts.
- VENCORP's annual GPG forecasts were not accepted as they were based on information which events subsequent to the forecasts (principally drought outcomes) had overtaken. Instead forecasts based on updated data and modelling of the electricity market from a consultant engaged by the ACCC were required to be included.²⁵¹
- It was noted that GasNet's storage refill forecasts appeared low when viewed against 2007 data. The potential for an under-forecast was noted and it was considered the tariff should remain as a marginal cost tariff outside the price control formula. An amendment was required to the price control formula.²⁵²
- It was noted that GasNet's forecasts of export volume matched what was understood then of GasNet's likely take or pay Authorised MDQ arrangements at the Interconnect.²⁵³

As well, it was noted that GasNet's revenue adjustment in its price control formula to remove revenue volatility caused by cold weather outcomes was such that any variations from VENCORP forecasts of the warming trend over the AA3 period should not be reflected in a revenue reduction/increase by GasNet.

In relation to injection volume forecasts the draft decision:

- considered that it was appropriate to defer until the final decision on GasNet's forecasts of significant increases in Port Campbell/Otway Basin pending latest timing information on the Corio loop and new Woodside gas production facility²⁵⁴ and

²⁴⁹ GasNet, *Submission*, op.cit., pp. 106-107.

²⁵⁰ TRUenergy, *Submission to the Issues Paper*, 29 June 2007 p.9; Origin, *Submission to the Issues Paper*, 10 July 2007, p.3

²⁵¹ ACCC, *Draft Decision*, op.cit., pp. 140-141.

²⁵² *ibid.* p.144; GasNet *Submission*, op.cit., p.88. GasNet noted there was a dramatic decline in usage of underground storage in 2006, which it forecast to continue over the AA3 period.

²⁵³ *ibid.* p. 145.

²⁵⁴ *ibid.* p.139.

- consequent on considerations elsewhere in the draft decision considered that a top ten peak day injection tariff must be included in deriving injection tariffs, it proposed that GasNet include top ten peak days volumes by injection source in its access arrangement information in accordance with ss. 2.6 and 2.30 of the code.²⁵⁵

5.4.2. Proposed amendments

Proposed amendment 12 and 13 (reproduced below) expressed the ACCC's draft decision noted above.

Proposed amendment 12

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 4.2 of the proposed revised access arrangement information to incorporate the annual GPG forecasts in table 5.4.7 of this draft decision.

Table 5.4.7 of the draft decision is reproduced below.

Table 5.4.7: Draft decision—Forecast of annual gas usage across gas power generators

<i>Year</i>	<i>Jeeralang</i>	<i>Laverton North</i>	<i>Newport</i>	<i>Somerton</i>	<i>Valley Power</i>	<i>Total GPG</i>	<i>GasNet forecast</i>	<i>Difference</i>
2006	0.7	0.2	6.7	0.5	0.2	8.4		
2007	0.7	6.2	15.9	1.8	7.7	32.3		
2008	0.2	1.1	11.3	0.4	3.4	16.4	6.8	9.6
2009	1.5	0.1	4.5	0.1	0.2	6.4	6.7	-0.3
2010	0.8	0.1	3.4	0.0	0.1	4.4	6.7	-2.3
2011	1.2	0.2	4.5	0.1	0.2	6.2	6.7	-0.5
2012	1.8	0.4	5.5	0.1	0.3	8.1	6.7	1.4

Proposed amendment 13

Before the proposed revised access arrangement can be approved, GasNet must include top-ten peak day volume forecasts for each injection zone in cl. 4 of the proposed revised access arrangement information.

5.4.3. Response to draft decision

GasNet's response to the draft decision noted that subsequent to the draft decision, the VENCORP APR (2007 APR) had been released which included updated residential, industrial and commercial volume forecasts as well as GPG volume forecasts. The ACCC understands that GasNet proposes adopting the 2007 APR

²⁵⁵ *ibid.* p. 149.

forecasts for industrial, commercial and residential customers (non GPG forecasts) and the ACIL Tasman forecasts for GPG volumes.²⁵⁶

GasNet notes that it prefers the ACIL Tasman forecast of GPG volumes used in the ACCC draft decision to the 2007 APR GPG forecasts:

GasNet understands that ACIL has a sophisticated electricity demand and production models, whereas VENCORP states in their 2007 Forecast Report (see section 4.5) that the GPG forecasts have not been prepared with an integrated gas and electricity model. Hence GasNet prefers the ACIL forecast to the VENCORP forecast prepared by NIEIR.²⁵⁷

No submissions were received from parties other than GasNet on VENCORP's industrial, commercial and residential demand forecasts.

Submissions received in response to the draft decision in relation to GPG volume forecasts are listed below:

- International Power questions the VENCORP 2007 APR GPG forecasts and considers that GPG demand is likely to increase over the period²⁵⁸
- Origin supports the revision of GPG forecasts made in the draft decision but considers if anything the forecasts may be on the low side, noting in particular that even if drought conditions may ease substantial inflows will be required to allow sustained contributions from depleted water storages, particularly in the Snowy Mountain scheme²⁵⁹
- TRUenergy Gas Storage agrees with the conclusion of the ACCC in its draft decision that gas powered generation is likely to remain significant, even if it does reduce from the unprecedented levels of 2007 but queries likely long term GPG trends²⁶⁰
- VENCORP notes that GPG volume forecasts in its 2007 APR are on the basis of a scenario based approach, whereas the ACIL Tasman forecasts adopt a market based approach and comments that it considers the VENCORP medium based scenario forecasts to be equivalent to the ACIL Tasman high scenario forecasts.²⁶¹

²⁵⁶ *ibid.*

²⁵⁷ GasNet, *Submission in Response*, op. cit., p.49

²⁵⁸ International Power (Australia) Pty Ltd, *GasNet Access Arrangement Revisions 2008 – Draft Decision*, (Submission in Response) 21 December 2007 p.3

²⁵⁹ Origin Energy, *Submission in Response*, op. cit., p. 2

²⁶⁰ TRUenergy Gas Storage, *TRUenergy Gas Storage Submission - GasNet Revised Access Arrangement for the Principal Transmission System - 14 November 2008 Draft Decision*, (Submission in Response), December 2007, p. 5

²⁶¹ VENCORP, *Re: ACCC's Draft Determination of GasNet's Revised Access Arrangement*, (Submission in Response), December 2007, p.3

5.4.4. Conclusion

5.4.4.1. VENCORP withdrawal volume forecasts

The ACCC agrees with GasNet that it is appropriate to use the revised and updated 2007 APR forecasts. This is consistent with the requirement in section 8.2(e) of the code and the use of best estimates. The 2007 APR estimates for 2008-2012 are based on more up to date information than the forecasts for the previous APR derived a year earlier.

Adoption of these forecasts will require GasNet models supporting reference tariff calculations to be adjusted including:

- using updated peak day volume forecasts distributed across system withdrawal zones
- including annual volume forecasts
- updating injection volume forecasts to match the revised annual/peak day forecasts and
- re-calculating reference tariffs.

Amendment 11

Before the proposed revised access arrangement can be approved, GasNet must amend its revised access arrangement so that cl. 1.2 and 1.3 of schedule 1 reflect final injection and withdrawal tariffs which incorporate VENCORP 2007 APR volume forecasts for the AA3 period. GasNet must also amend its proposed revised Access Arrangement Information to reflect VENCORP 2007 APR forecasts under clause 4 and Schedule 2.

5.4.4.2. ACIL Tasman annual GPG volume forecasts

The ACCC notes GasNet supports adopting ACIL Tasman's annual GPG forecasts, but that there is some other view that these forecasts may be too low. The ACCC notes also a difference between the ACIL Tasman's forecasts because, whilst having the same profile trend over the period the 2007 APR forecasts are lower than the VENCORP medium scenario forecasts (and closer to the low GPG demand growth scenario).²⁶² However, VENCORP comments that its scenario based approach is not an equivalent forecasting basis one for one with the low, medium, high ACIL market based forecast approach indicating that its high forecasts are equivalent to ACIL medium forecasts (implying its low forecasts are equivalent to ACIL medium forecast).

The ACCC considers that ACIL Tasman's medium forecasts meet the requirements of section 8.2(e) of the code as the ACCC considers that:

- the usage of ACIL Tasman forecasts is consistent with the requirements of s 8.2(e) of the code. Forecasts have been derived on a best estimate on a

²⁶² VENCORP, *Submission in Response*, op. cit., p.3

reasonable basis accounting for factors such as typical weather conditions, known future commissioning of plants, electricity market demand forecasts

- GPG gas usage forecasts have been derived based on forecast output in the electricity market and an implied gas usage²⁶³
- the ACCC has reviewed early 2008 GPG volumes and note these volumes are lower than volumes at a similar time in 2007. This is consistent with the ACIL Tasman analysis of a trend down over 2008 in volumes from unprecedented 2007 levels²⁶⁴ and
- ACIL Tasman’s forecasts produce usage across generators enabling costs to be attributed in proportion to the likely individual generator usage. This distribution of volumes (which is not included in the VENCORP forecasts) means the allocation of volumes across generators is achieved in a more rigorous method than it was for the AA2 period. That is, costs are allocated to TUoS zones in accordance with likely individual generator output.

Following the draft decision, ACIL Tasman advised the ACCC in early 2008 that it did not consider any factors had changed to warrant a revision of these forecasts.²⁶⁵

Amendment 12

Before the proposed revised access arrangement can be approved, GasNet must amend its revised access arrangement:

so that the final injection / withdrawal tariffs set out in cl. 1, 2 and 1.3 of schedule 1 of the proposed revised access arrangement reflect the annual GPG forecasts in table 5.4.1.

GasNet must also amend its proposed revised access arrangement information at clause 4 and schedule 2 to incorporate the annual GPG forecasts in table 5.4.1.

Table 5.4.1: Final decision—forecast of annual gas usage across gas power generators

<i>Year</i>	<i>Jeeralang</i>	<i>Laverton North</i>	<i>Newport</i>	<i>Somerton</i>	<i>Valley Power</i>	<i>Total GPG</i>	<i>GasNet forecast</i>	<i>Difference</i>
2006	0.7	0.2	6.7	0.5	0.2	8.4		
2007	0.7	6.2	15.9	1.8	7.7	32.3		
2008	0.2	1.1	11.3	0.4	3.4	16.4	6.8	9.6
2009	1.5	0.1	4.5	0.1	0.2	6.4	6.7	-0.3
2010	0.8	0.1	3.4	0.0	0.1	4.4	6.7	-2.3
2011	1.2	0.2	4.5	0.1	0.2	6.2	6.7	-0.5
2012	1.8	0.4	5.5	0.1	0.3	8.1	6.7	1.4

²⁶³ ACCC, *Draft decision: revised access arrangement by GasNet Ltd for the Principal Transmission System*, (Draft decision), 14 November 2007, p. 142

²⁶⁴ Volumes until February 24 2008 were 3.2PJ in comparison to 4.9PJ at the same time last year.

²⁶⁵ Advice from ACIL Tasman, 19 January 2008.

5.4.4.3. Culcairn export volumes

GasNet has entered into Authorised MDQ contracts for export volumes at Culcairn subsequent to lodging its access arrangement. These contracts provided for take or pay contracts starting in 2008 and extending over AA3 of 16 TJ/d. The ACCC notes that, whereas GasNet appears to have used volume forecasts based on these contracts in its calculation of marginal cost tariff / fully allocated tariff (5.85 / 5PJ per year) over 2008 -2012 it has not indicated it will revise its volume forecasts.

The ACCC considers given the nature of these Authorised MDQ contracts, in accordance with section 8.2(e) of the code GasNet's current volume forecasts may not represent best estimates arrived at on a reasonable basis. In particular in 2008 and 2009 volumes forecasts of 2.5/3.75 PJ appear to be very low estimates given the incentive to flow gas that take or pay terms provide.²⁶⁶

Amendment 13

Before the proposed revised access arrangement can be approved, GasNet must amend its revised access arrangement so that the final injection / withdrawal tariffs set out in cl 1.2 and 1.3 of schedule 1 incorporate volume forecasts for Exports at Culcairn based on most recent information including the terms of take or pay arrangements entered into. GasNet must also amend clause 4 and schedule 2 of its proposed revised access arrangement information.

5.4.4.4. Storage refill volumes

GasNet has forecast 0.8 PJ per annum for storage refill for the AA3 period. However, 2007 metered data indicates that last year over 6PJ was withdrawn from the PTS into WUGS and a similar amount of 6PJ at the LNG storage facility. It is noted that in December 2007 alone, the combined total of storage refill slightly exceeded 0.8 PJ.²⁶⁷ As discussed in the draft decision, if these volume forecasts were included within GasNet's average revenue yield price control, there would be revenue upside for GasNet if a repeat of the higher than forecast figures in 2007 occurred over the AA3 period. However, as set out in the draft decision, the ACCC proposes that GasNet recover this tariff (set at marginal cost) outside the average revenue yield control. This amendment is contained in chapter 6.3 of this final decision.

5.4.4.5. Distribution of injection volume forecasts across zones

In its draft decision, the ACCC indicated that it would consider the latest information on progress of projects to the west of Melbourne at the Woodside gas processing facility and the Corio loop for the final decision. Since the draft decision, Woodside has indicated in its 2007 annual report that gas was first exported in September 2007 with a shut down over the fourth quarter, but production had been restored in

²⁶⁶ See also chapter 6.1.4.5 of this final decision.

²⁶⁷ VENCORP, *Email to the AER : 2007 metered data*, 14 February 2007

February 2008.²⁶⁸ GasNet has indicated to the ACCC that the Corio loop project would be completed in winter 2008 and is well advanced.²⁶⁹ Accordingly, on the basis of latest information on the progression of the Corio loop and the Woodside processing facility, the ACCC considers GasNet's proposed distribution methodology approach for injection volumes to be reasonable.

The final decision maintains that as proposed in the draft decision, GasNet must charge users on the basis of top ten peak day injection volume forecasts (see chapter 6.1 of this decision). As discussed in the draft decision, GasNet must amend its proposed revised access arrangement information to include top ten peak day volume forecasts.

Amendment 14

Before the proposed revised access arrangement can be approved, GasNet must include top-ten peak day volume forecasts for each injection zone in cl. 4 of the proposed revised access arrangement information.

²⁶⁸ Woodside Annual Report, lodged with ASX, viewed on 20 February 2008, <www.asx.com.au>; Origin, *Australia and New Zealand 5th Annual Investment Conference London March 2008*, lodged with ASX, viewed on 6 March 2008 at <www.asx.com.au>

²⁶⁹ Gas Market Consultative Committee Meeting on March 18 2008

5.5. Revenue

5.5.1. Introduction

5.5.1.1. Cash-flow timing assumptions

GasNet argued in its initial proposal that the modelling of its revenue requirement should be amended to recognise capex in the middle of each year, meaning that it should include a half year return on annual capex amounts. It argued that this would better align the costs and revenues to be incurred over the AA3 period in NPV terms than the existing approach, where capex is recognised at the end of the year (and so does not earn any returns for that year). To illustrate the improvement in accuracy resulting from its proposal, GasNet modelled its costs and revenues on a monthly basis under the current and proposed approach, using cash-flows implied from the annual values used in its AA3 proposal documents. It argued that the introduction of a half year return on capital and depreciation would result in an over-recovery of revenues, in NPV terms over the period, by an estimated 0.4 per cent and an under-recovery of 1.9 per cent where these additional returns are not provided.²⁷⁰

Table 5.5.1 sets out the revenue requirement proposed by GasNet under the building block methodology, and its components, for each year of the AA3 period. It also shows the smoothed forecast revenue for each year. Section 8.4 of the code states that the total revenue is to be calculated by one of three methodologies—cost of service, internal rate of return (IRR) or net present value (NPV). Whichever of these is used, it is to be applied in accordance with generally accepted industry practice.

Table 5.5.1: Proposal—revenue requirement components, forecast revenue

\$2006 Dec m	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>
Return on capital	32.42	37.63	41.86	42.42	42.43
Depreciation	22.53	25.79	28.09	28.58	29.40
Non-capital costs	27.37	26.25	26.03	27.59	29.40
Total revenue requirement	82.30	89.68	95.98	98.59	101.23
Forecast revenue	86.18	89.77	93.79	96.87	100.55

Source: GasNet, *Proposed AAI*, pp. 11 and 12 (converted to 2006 Dec \$ m).

In its draft decision, the ACCC noted that the results of the monthly model depended heavily on present value (PV) adjustments which were designed to equate, in NPV terms, the annual and monthly values of opex and revenues. It stated that GasNet's monthly model and its results were inconsistent with its proposed annual building block modelling as the PV adjustments to opex and revenues were not applied in its proposed building block modelling. Hence to achieve the same degree of accuracy implied in the monthly modelling outcomes, the ACCC accepted GasNet's proposal to recognise capex mid year but also applied PV adjustments to opex and revenues when determining its revenue requirements.

²⁷⁰ GasNet, *Submission*, p. 85.

5.5.1.2. Authorised MDQ and AMDQ credit certificate revenues

Over the AA3 period GasNet will receive revenue from administering contracts for AMDQ/credit certificates under the MSO rules. The administration of these contracts and the revenue derived has not been included in GasNet’s access proposal.

In its draft decision the ACCC considered that the sale of AMDQ/credit certificates was a service falling within the ambit of the AA and that the associated revenues should be recognised in GasNet’s proposal. Specifically, the ACCC noted that the reference service involved making the PTS available in accordance with the MSO rules, which encompasses AMDQ/credit certificates. While the ACCC did not explicitly define the provision of AMDQ/credit certificates as a particular service under the code, it stated that it was “ancillary to the reference service”.²⁷¹ The ACCC was concerned that, due to their take or pay nature, recovering revenue for AMDQ on the basis of capacity (under a market carriage arrangement) would result in GasNet over-recovering its efficient costs.

In order to maintain an incentive on GasNet to allocate AMDQ/credit certificates, the ACCC proposed that GasNet should be allowed to recover the cost of issuing and administering these instruments through its regulated revenues. The ACCC did not propose to retrospectively ‘claw back’ any revenue that GasNet had received from issuing AMDQ/credit certificates in the past.

5.5.2. Proposed amendments

Proposed amendment 14 (reproduced below) expressed the ACCC’s draft decision noted above.

Proposed amendment 14

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.7 of the proposed revised access arrangement information to reflect table 5.5.3 of this draft decision.

Table 5.5.3 of the draft decision is reproduced below.

²⁷¹ ACCC, *Draft decision*, p. 154.

Table 5.5.3: Draft decision—revenue requirement components, forecast revenue

2006 Dec \$ m	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>
Return on capital	35.58	36.70	36.61	35.54	34.46
Depreciation	22.73	23.97	24.28	24.11	24.20
Non-capital costs	24.36	20.95	20.86	21.61	23.03
PV revenue adjustment	-2.08	-2.06	-2.06	-2.05	-2.06
Total revenue requirement	80.58	79.56	79.70	79.21	79.63

Source: ACCC analysis.

5.5.3. Response to the draft decision

5.5.3.1. Cash-flow timing assumptions

In its response GasNet reiterated its concern that, given the large nature of its capex proposal, that it should be compensated for a return on this expenditure from when it is commissioned, at approximately the middle of each year.

GasNet states that the draft decision is based on a misinterpretation of the monthly model and that this monthly model and its proposed annual building block revenue calculations are already consistent in NPV terms. It noted that it would re-submit its modelling to the ACCC to reflect changes to forecast capex in the draft decision and discuss these issues with the ACCC to ensure correct interpretation and application of its modelling. These discussions would also include the ACCC's adjustments to carry-over amounts identified in the draft decision.

No other comments were received on this aspect of the draft decision.

5.5.3.2. Authorised MDQ and AMDQ credit certificate revenues

GasNet notes that s. 10.8 of the code contains the following definition with respect to services:

'Service' means:

- (a) a service provided by means of a Covered Pipeline (or when used in section 1 a service provided by means of a Pipeline) including (without limitation):
 - (i) haulage services (such as firm haulage, interruptible haulage, spot haulage and backhaul); and
 - (ii) the right to interconnect with the Covered Pipeline
- (b) services ancillary to the provision of such services

GasNet notes the draft decision's implication that the allocation of AMDQ/credit certificates is ancillary to the reference service. GasNet asserts that its actions with respect to AMDQ do not fall within the definition of services "ancillary" outlined in (b) above:

The concept of "ancillary" clearly contemplates that an ancillary service is one which supports or aids the provision of the main service. This is not the case in respect of GasNet's Reference Service, which is clearly capable of being provided without the support of the AMDQ rights/certificates. Indeed, the fact that the MSO Rules give GasNet a

discretion as to the allocation of AMDQ rights/certificates indicates that it is not ancillary to the provision of the Reference Service.²⁷²

GasNet considers that, should the ACCC still regard the provision of ADMQ/credit certificates as ancillary to the reference service, the revenues derived should not be regulated since they are difficult to predict and doing so may act as a disincentive to provide that service. GasNet notes that the ACCC's suggestion to allow it to recover the costs of administering AMDQ/credit certificates would provide no incentive to administer them as GasNet would be cost neutral.

AGL supported the ACCC's recognition of revenue from the sale of AMDQ/credit certificates as contributing to reference tariff services.

Victoria Electricity agrees that the provision of AMDQ/credit certificates is ancillary to the reference service. It considers that the current arrangements allow for a 'doubling up' on revenues without any corresponding benefit, and also provide an incentive for GasNet to inflate prices or limit access to AMDQ/credit certificates. It is also concerned over the lack of transparency in how GasNet allocates AMDQ/credit certificates and suggests that a tender process be established, the costs of which could then be defined and incorporated into GasNet's forecast operating expenditures.

TRUenergy states that AMDQ/credit certificates represent a service falling within the ambit of the AA, and that the associated revenues should be regulated as they are derived from assets that relate to GasNet's ownership of the PTS.

International Power raises concerns over certain design aspects of the Victorian wholesale gas market, which include AMDQ/credit certificates. It notes that AMDQ/credit certificates are linked to particular supply sources and so are limited as a risk mitigation tool. It notes that such linking was intended to replicate a contract carriage model and provide incentives for system augmentation but suggests this should be removed.

TRUenergy Gas Storage notes that the purchase of AMDQ/credit certificates has not provided a means for market participants to fund expansions of the PTS. It suggests that the mechanism for expansions of the PTS and role of AMDQ/credit certificates be reviewed to ensure it is not hindering investment.

Subsequent to receiving GasNet's response, the ACCC sought²⁷³ to clarify its proposed treatment of AMDQ/credit certificates in the draft decision and also requested further information regarding the nature of AMDQ/credit certificates and GasNet's future involvement in allocating them. In particular, it provided GasNet an opportunity to comment on whether the allocation of AMDQ/credit certificates could also be characterised as a service under paragraph (a) of the code's definition of service and included in GasNet's services policy.

²⁷² GasNet, *Submission in Response*, op. cit., p. 51.

²⁷³ AER, *Email to GasNet*, 19 February 2008.

In its response²⁷⁴, GasNet noted the following:

- it reiterated its position that it did not consider the allocation of AMDQ/credit certificates would be properly characterised as a regulated service
- if the ACCC intended on including AMDQ/credit certificates in GasNet's Services Policy, its preference would be to characterise it as a Negotiated Service
- it intended to allocate future AMDQ/credit certificates through a tender process and that it was willing to formalise such a process.

5.5.4. Conclusion

5.5.4.1. Cash-flow timing assumptions

In considering GasNet's proposed cash-flow timing assumptions the ACCC has been guided by GasNet's desire to avoid a significant under-recovery of costs over the AA3 period.

In discussions with ACCC staff, GasNet has stated that the present value adjustments proposed in the draft decision are unnecessary and by implication would worsen GasNet's potential under-recovery of costs. GasNet noted that the impact of particular timing assumptions would be affected by the size of the capex program approved by the ACCC. It re-submitted its monthly model with the capex projects proposed to be approved in the ACCC's draft decision, which indicates that recognising capex mid year would now result in revenues being 0.7 per cent above costs over the period (in NPV terms), while the current assumptions (i.e. capex end of year), would result in costs being one per cent greater than revenues. When the monthly model is populated with data from this final decision, the results are not materially changed.

Following discussions with GasNet, the ACCC acknowledges that the results of GasNet's monthly and proposed annual building block revenue modelling are consistent, and therefore the results on which the ACCC based its draft decision are incorrect. The ACCC notes that GasNet's proposed timing assumptions in combination with its particular circumstances (notably its capex profile) appear to result in its forecast revenues being marginally above its expenditures for the AA3 period. For this reason the ACCC accepts GasNet's proposed cash-flow timing assumptions. The ACCC notes, however, that the alternative timing assumptions would have resulted in an under-recovery that was much less than initially suggested by GasNet, and that any changes in GasNet's revenues and expenditures will require a re-examination of these assumptions at the next access review.

5.5.4.2. Authorised MDQ and AMDQ credit certificate revenues

The ACCC considers that while the allocation of AMDQ/credit certificates could be regarded as a service under the code it has not sought to regulate this service as part of GasNet's AA.

²⁷⁴ GasNet, *Email to AER*, 22 February 2008.

While GasNet submits that a service could be defined as an ancillary service if it supports or aids the reference service, this does not mean that such support is necessary to provide the reference service. Similarly, the degree of GasNet's discretion in allocating AMDQ/credit certificates is unrelated to whether they are ancillary to the reference service.

AMDQ/credit certificates provide benefits to market participants in the form of preferential access to the PTS (i.e. priority in the event of load shedding and in tied bidding) and also in the form of risk mitigation (i.e. avoidance of uplift payments). These are ancillary to (and, using GasNet's interpretation, supportive of) the reference service. Arguably they are also provided by means of the covered pipeline since users purchasing a certain amount of AMDQ are able to exercise the associated rights with respect to flows on the PTS.

However, treating the allocation of AMDQ/credit certificates as a service under the code would require the development of an associated reference tariff. In the case of AMDQ/credit certificates, this tariff would be set to recover annual costs in the order of \$50,000 (the costs of issuance). In light of the scarcity of AMDQ/credit certificates such a price would not reflect the value placed on these instruments by market participants and result in an inefficient and arbitrary allocation process, such as GasNet's 'first come, first serve' approach. Furthermore, the MSO rules envisage VENCORP undertaking an auction in the case that demand for authorised MDQ exceeds its supply. The ACCC views the development of such a tender or auction process as desirable and something that would be undermined if a fixed tariff were set.

The ACCC also considered whether the allocation of AMDQ/credit certificates could be classified as a rebatable service under the code given the uncertain nature of its demand and revenues. This would have allowed GasNet and users to reach a negotiated price (e.g. through a tender process) rather than have this set under GasNet's AA. Under the code, a rebatable service must be supplied in a market that is substantially different to that of the Reference Service. This definition qualifies what could be otherwise considered rebatable services and gives rise to doubt about whether AMDQ/credit certificates would satisfy the code definition of rebatable service.

The ACCC notes that there are broader issues with GasNet's processes and the intent of AMDQ/credit certificates. These issues are better addressed through a review and potential amendments to the MSO rules rather than a somewhat narrower and necessarily incomplete solution through regulation under the code. The MSO rules provide for VENCORP to allocate and facilitate the exchange of AMDQ/credit certificates, but also provide a role for GasNet to direct VENCORP and to possess relinquished AMDQ/credit certificates. Whereas the MSO rules explicitly oblige VENCORP to refund revenues arising from AMDQ allocation, the same policy intent is not clear in relation to GasNet's allocation. Stakeholders have also raised concerns regarding the inadequacies of AMDQ/credit certificates as a means to provide congestion signals for users to fund new expansions. VENCORP raised the same concerns regarding the role of AMDQ/credits in its 2004 Pricing and Balancing

Review.²⁷⁵ As a result of this review, VENCorp recommended various changes to the operation of the Victorian gas market, including to the role and nature of AMDQ/credits, through a staged implementation process.²⁷⁶ The ACCC intends to monitor the progress of this implementation and liaise with VENCorp and the Victorian Government where appropriate. The ACCC considers that it would be preferable to reconsider both the need and form of regulation of AMDQ/credit certificates following further consideration of VENCorp's recommendations or following a separate review of the MSO rules.

GasNet has advised it will conduct a tender process for AMDQ credits on the southwest pipeline which should provide a reasonable opportunity for all interested parties to purchase these credits.

5.5.5. Total revenue

The ACCC's assessment of GasNet's proposal is that various elements of its proposed costs do not comply with the requirements of the code. Accordingly, the ACCC proposes a number of changes to be made to these costs, which requires an amendment to GasNet's proposed total revenue. The ACCC's estimate of the resulting total revenue requirement is outlined in table 5.5.2.

The forecast revenues for the AA3 period have increased sufficiently for GasNet to fully offset the tax losses it accumulated over the AA1 period. Accordingly the ACCC has calculated that GasNet will begin to incur tax liabilities towards the end of the AA3 period and included this as a separate element in its revenue requirement.

Table 5.5.2: Final decision—revenue requirement components, forecast revenue

2006 Dec \$ m	2008	2009	2010	2011	2012
Non-capital costs	27.85	25.53	25.08	26.27	27.67
Depreciation	25.06	27.86	29.55	29.47	29.71
Return on capital	43.54	48.32	51.14	49.47	47.88
Net tax liability	0.00	0.00	0.00	0.00	0.34
Total revenue requirement	96.45	101.71	105.77	105.22	105.60

Source: ACCC analysis.

Amendment 15

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.7 of the proposed revised access arrangement information to reflect table 5.5.2 of this final decision.

²⁷⁵ VENCorp, *Victorian Gas Market Pricing and Balancing Review, Final Recommendations to Government*, 30 June 2004.

²⁷⁶ <http://www.vencorp.com.au/index.php?sectionID=8051&pageID=8062>

6. Reference tariffs

6.1. Cost allocation and tariff structures

6.1.1. Introduction

Section 8.38 of the code requires that, to the maximum extent that is commercially and technically reasonable, reference tariffs should recover costs directly attributable to the reference service and a fair and reasonable share of costs incurred jointly with other services. Section 8.42 of the code also requires that the recovery of a particular user's share of costs also follows these principles. These requirements must be met, regardless of the methodology used to calculate total revenue. In addition, the code requires the relevant regulator to take into account the objectives set out in s. 8.1 of the code. However, if the s. 8.1 objectives conflict, the relevant regulator must also consider other elements in s. 2.24 of the code, (which include amongst other things, the service provider's legitimate business interests, the interests of users, and the public interest) to assist in resolving that conflict.

An exception to the objectives in s. 8 of the code is the case of prudent discounts. If a user or prospective user would not be a user at the reference tariffs, s. 8.43 of the code allows for a lower tariff to be charged (that is, a prudent discount to be given) to that user with the shortfall in revenue met by higher tariffs for other users. This is conditional on the prudent discount not causing tariffs to other users to be higher than they would have been if the potential user in question was not a user.

GasNet proposed a number of changes to its cost allocation methodology and tariff structures for the AA3 period. These proposed changes and GasNet's current cost allocation methodology and tariff structures are discussed in detail in chapter 6.1 of the draft decision.

6.1.1.1. Direct cost allocation

The ACCC considered that GasNet's current cost allocation methodology is more cost reflective than the proposed methodology. In assessing GasNet's proposal, the ACCC concluded that whilst a number of methodologies may be considered appropriate, the ACCC notes that ss. 8.38 and 8.42 of the code require that tariffs reflect the cost of each service and each user 'to the maximum extent that is commercially and technically reasonable'. The ACCC noted that this requirement reflects certain aspects of the s. 8.1 objectives, in particular s. 8.1(d) of the code which specifies the reference tariff should not distort investment decisions in pipelines.

Other considerations proposed by GasNet such as simplicity, predictability, robustness and price stability were considered to be applicable only in the way they contribute to s. 8.1 objectives and are therefore less significant to the issue of cost allocation. Accordingly, in its draft decision, the ACCC assessed GasNet's proposed cost allocation methodology was to be assessed against the requirements of ss. 8.38 and 8.42 of the code in light of the s. 8.1 objectives. The ACCC concluded that GasNet's current cost allocation methodology satisfies the requirements of ss. 8.38

and 8.42 of the code and proposed that GasNet must amend its allocation of direct costs to use pipeline specific direct cost unit rates.

6.1.1.2. Indirect cost allocation

(i) *Western and northern zones*

GasNet advised that the Western zone is not allocated rolled-out costs because it does not benefit from the system-wide benefits as accepted by the ACCC for the AA2 period.²⁷⁷ The ACCC in the draft decision considered that GasNet's proposal to exclude the rolled out costs from the Warrnambool and Koroit zones to be consistent with the previous treatment of the Western zone.

The draft decision noted that in its 2002 decision, in considering Northern zone tariffs, the ACCC stated that it must consider whether it is fair and reasonable for the majority of users in the zones with low tariffs, to pay some of the costs attributable to users in the zones with high tariffs, in order for those users in the higher tariff zones to face tariffs which will encourage greater use of the system. The draft decision noted that for the AA3 period, GasNet however, has not claimed there is a continuing need to encourage usage in the northern zones (i.e. Murray Valley, Wodonga, North Hume and Interconnect withdrawal zones). Nevertheless, the ACCC concluded that as it proposes that GasNet re-calculate these northern zone tariffs based on the current cost allocation methodology,²⁷⁸ it is likely that these tariffs will increase and therefore accepts that the Northern zones supplied from the south should not be allocated indirect costs for the AA3 period.

(ii) *Brooklyn Lara (Corio) loop*

GasNet proposed that 100 per cent of the Brooklyn Lara (Corio) loop costs be rolled-out on a postage stamp basis (i.e. there be a general uplift across all withdrawal tariffs). The ACCC concluded in the draft decision that the recovery of 100 per cent of the Corio loop costs through a general uplift in the withdrawal tariffs is consistent with the recovery of costs under the system-wide benefits test in s. 8.16(a)(ii)(B) of the code and justifies a tariff increase for all users.

(iii) *Carry-over K-factor allocation to tariffs*

GasNet's current AA includes a provision for a K-factor carry-over adjustment as part of the transmission tariff control formulae for annual tariff approvals. The K-factor carry-over adjustment allows for an increase (decrease) in the maximum average tariff above (below) the price path in the tariff control formulae in the regulatory year following an under-recovery (over-recovery). However, the limitation on increases on individual tariffs of two per cent per year has restricted the amount of any shortfall that GasNet has recovered during the AA2 period. As result, this under-recovery is carried over (i.e. K-factor carry-over) from the AA2 period to be recovered in AA3 tariffs.

²⁷⁷ Rolled-out costs refer to costs recovered across the PTS as there are deemed to be system-wide benefits justifying a tariff increase across all users in accordance with s. 8.16(a)(ii)(B) of the code.

²⁷⁸ The existing cost allocation methodology is referred to as the zone-gate methodology.

For the AA3 period, GasNet proposed to allocate the carryover K-factor carry-over amount on a uniform percentage basis to all withdrawal and injection tariffs with the exception of the following:

- Murray Valley, North Hume, Wodonga and Interconnect zonal withdrawal tariffs sourced from the south
- Echuca and Southwest zonal withdrawal tariffs and
- Port Campbell and Pakenham injection tariffs.

Subsequently, GasNet advised that the proposed exclusion of the K-factor carry-over amount from the Echuca and Southwest withdrawal zones and the Pakenham injection tariff is an error, which GasNet intends to correct.²⁷⁹

6.1.1.3. Murray Valley Pipeline – cost allocation and inclusion in the average revenue yield control

The draft decision noted that for the AA2 period, the ACCC approved the inclusion of the Murray Valley Pipeline (MVP) in GasNet's capital base on the basis that it satisfied the economic feasibility test. Users of the MVP are currently charged a withdrawal tariff that consists of two components. The first component recovers the cost of the withdrawal pipeline usage based on the physical flow path of gas to the Chiltern Valley (i.e. before the start of the MVP). The second component, the incremental tariff, is designed to recover the costs (stand alone costs) associated with the \$15.6 million MVP lateral as approved in the AA2 revisions under the economic feasibility test.²⁸⁰

For the AA3 period, GasNet proposed to recover the costs of the MVP in the same way as all other withdrawal pipelines, which is to include the MVP costs in the calculation of the average \$/TJ-KM direct cost unit rate for all withdrawal pipelines. GasNet also proposed to bring the revenues generated by the MVP within the annual price control mechanism.

In the draft decision, the ACCC found GasNet's proposal to recover the costs of the MVP lateral to be inconsistent with its earlier approval that the MVP costs be recovered under the economic feasibility test. The economic feasibility test implies that the capital expenditure enters the capital base if it will not result in an increase in the prevailing reference tariff, so that existing users do not incur additional costs and these costs are not recovered by users on other tariff zones. In particular, in its draft decision, the ACCC found that GasNet's proposal to recover the costs of the MVP in the same way as all other withdrawal pipelines resulted in the Murray Valley zone tariff being allocated insufficient direct costs to recover the incremental cost of the MVP lateral. Instead, most of the MVP lateral costs would be averaged across users in other zones. Accordingly, the draft decision required the incremental

²⁷⁹ GasNet, *Email to the AER*, 26 June 2007

²⁸⁰ ACCC, *Final Decision: GasNet Australia access arrangement revisions for the Principal Transmission System*, 13 November 2002, (Final Decision: GasNet Australia 2002-2007), p. 233.

costs of the MVP lateral to be recovered directly from users of the MVP lateral. The draft decision also required that the revenues generated on an annual basis from the Murray Valley tariff be quarantined from the price control formulae to ensure that other users do not contribute to the recovery of the costs of the MVP lateral.

6.1.1.4. Reference tariffs and structure

(i) *Postage stamp withdrawal tariff-V*

GasNet proposed to apply a single rate for tariff-V users across the PTS, so that all gas withdrawals from the PTS, which are allocated to tariff-V users will pay the same \$/GJ postage-stamp tariff. GasNet submitted that this will simplify the tariff, reduce administrative costs and facilitate retail competition.

The draft decision considered that the introduction of the postage stamp proposal for tariff-V users is not consistent with ss. 8.38 and 8.42 of the code. Further, in its draft decision, the ACCC noted that one benefit of cost reflective pricing is that it facilitates efficient usage and investment decisions' by users. In particular, the draft decision considered that if users of the PTS are not sent the correct price signals at the transmission level, investment decisions in pipeline transportation systems or in upstream and downstream industries may be distorted. The draft decision considered that this would be inconsistent with s. 8.1(d) of the code. Furthermore, these signals operate on these users whether or not these users also pass the signals on to end users. Consequently, the ACCC concluded that it is appropriate for signals to be given to users (retailers) even if they do not pass them on to end users. While a single tariff-V would be simpler, the ACCC concluded there is no evidence that tariff complexity is an undue burden and that changing tariff structures also creates additional costs. Accordingly, in its draft decision, the ACCC required GasNet to retain the zonal withdrawal tariffs for tariff-V users.

(ii) *Injection tariff structure*

GasNet proposed to charge the injection tariff as a single flat rate over the peak winter period (being the months of June to September). GasNet submitted that this will improve predictability and transparency, since injection tariffs will be known in advance.²⁸¹ GasNet also submitted that the very high level of the current injection tariffs fall disproportionately on those injectors who provide the injections required to balance the PTS during the current 10 day peak period.²⁸² GasNet's proposal to move to an injection tariff based on winter volumes was supported by AGL and TRUenergy on the basis that this proposal would provide greater billing certainty for retailers and customers.²⁸³

The draft decision noted that under GasNet's proposal, injectors with relatively constant injections over the winter period (i.e. users with high load factors) are likely

²⁸¹ GasNet, *Access arrangement submission 2008-2012*, 14 May 2007, p. 96.

²⁸² *ibid.*

²⁸³ AGL, *Submission to the issues paper*, 16 June 2007, pp. 2-3; TRUenergy, *Submission to the issues paper*, 27 June 2007, pp. 4-5.

to experience large increases in charges. In contrast, users with a more peaky injection profile will experience either a decrease in charges or a small increase.²⁸⁴ As a result, GasNet's proposal will advantage those users with lower load factors (i.e. peakier usage profiles). The draft decision noted that it is peak usage which puts constraints on the system and contributes to the need for more investment and that in a competitive market these constraints would be reflected in the cost of providing the service. As such, the ACCC considered that GasNet's proposed change to its injection tariff is less consistent with ss. 8.1(b) and 8.1(e) of the code.²⁸⁵

The ACCC also concluded that whilst there is no evidence of constraints on the injection pipelines that peak signals are appropriate before congestion occurs, as they are not only a tool for the allocation of capacity costs to those users who constrain the system, they are also a tool to discourage users from adding to the capacity constraint.²⁸⁶ Accordingly, the draft decision proposed not to approve GasNet's proposal to change its peak injection charge to apply over the whole winter period.

6.1.1.5. Prudent discounts

(i) *Pakenham*

In the draft decision, the ACCC considered a prudent discount at Pakenham appropriate, but noted the requirement to re-calculate the injection tariff based on the top 10 peak days. Given this requirement, the ACCC noted that the prudent discount for Pakenham may change. Accordingly, in the draft decision, the ACCC considered that the proposed prudent discount for Pakenham is not appropriate and should be amended. The ACCC stated that it is open to assessing a proposed prudent discount based on the top 10 peak days.

(ii) *Warrnambool and Koroit*

GasNet submitted that a bypass risk in the Western zone arises from the SEA Gas pipeline which parallels the PTS between the towns of Warrnambool and Koroit. To discourage bypass GasNet proposed to continue to apply two discounted withdrawal tariffs for tariff-D users at Warrnambool and Koroit, but discontinue those for tariff-V users since a uniform withdrawal tariff for these users is proposed for the PTS.

In its draft decision, the ACCC proposed to approve GasNet's discounted withdrawal tariffs for tariff-D users at Warrnambool and Koroit. However, the ACCC did not accept GasNet's proposed postage stamp tariff-V. Accordingly, in the draft decision, the ACCC noted that GasNet may need to reconsider its approach to the tariffs and bypass risk associated with tariff-V users in the Warrnambool and Koroit zones.

²⁸⁴ ACCC, *Draft decision: revised access arrangement by GasNet Ltd for the Principal Transmission System*, (Draft decision), 14 November 2007, p. 188.

²⁸⁵ *ibid.*

²⁸⁶ *ibid.*, p. 189.

(iii) *Latrobe/Wodonga*

The ACCC received submissions from both Australian Paper and the EUAA expressing concern regarding the removal of the prudent discount at the Latrobe zone for withdrawal tariff-D users. The ACCC received no submissions regarding the removal of prudent discounts to the Wodonga zone tariff-D and tariff-V. In the draft decision, the ACCC noted that in the case of GasNet, if it does not re-apply for a prudent discount for the Latrobe zone at the end of the AA2 period, the regulator under s. 8.43 of the code cannot by itself determine that the current prudent discount be reinstated.²⁸⁷ The ACCC concluded that GasNet is not required to justify why it has not re-applied for a particular prudent discount, as any prudent discount in place will simply expire at the end of the AA2 period.

(iv) *Culcairn export tariff*

GasNet proposed that in view of the highly competitive nature of the market, the Culcairn export tariff should be discounted to a level which still exceeds the incremental cost of supply.²⁸⁸ GasNet proposed an export tariff of \$0.50/GJ, which it considered exceeded the incremental cost of supply, such that no user on the PTS could be worse off and therefore justified a prudent discount.²⁸⁹ GasNet considered that if a higher tariff (based on the New Tariff Model) was applied there is a risk that the flows might not eventuate, which would therefore provide no immediate or future benefits to Victorian users. GasNet also provided evidence to the ACCC of what the tariff would be in the absence of a discount that is around \$0.80/GJ.²⁹⁰

In its draft decision, the ACCC concluded it was unable to fully assess whether a discount is justified for the export tariff. The ACCC noted that GasNet had not provided evidence of other network competition to support justification of a proposed discounted export tariff on the basis of bypass risk in accordance with s. 8.43(a) of the code.²⁹¹

In its draft decision, the ACCC considered that both pipeline looping and compressor capex will accommodate the requirements for meeting anticipated pressure breaches at Shepparton and concurrently allow 17 TJ/d of firm capacity through the Interconnect. Accordingly, the ACCC considered GasNet's calculation of the export tariff should reflect a proportion of these costs.²⁹² In addition, the ACCC considered GasNet's proposed calculation of its discounted export tariff did not benefit existing users as it recovers only the incremental cost required to facilitate the forecast

²⁸⁷ *ibid.*, p. 192.

²⁸⁸ GasNet, *Submission*, *op.cit.*, pp. 102-103.

²⁸⁹ *ibid.*, p. 103.

²⁹⁰ Models received from GasNet. Based on GasNet models provided, the non-discounted tariff would be similar whether under the Current Tariff Model or the New Tariff Model.

²⁹¹ ACCC, *Draft decision*, *op.cit.*, pp. 193-194.

²⁹² *ibid.*, pp. 194.

exports and not a share of common costs. Accordingly, the ACCC did not consider GasNet's proposal satisfied s. 8.43(b) of the code.²⁹³

The ACCC required GasNet to provide further evidence to justify a prudent discount.²⁹⁴

6.1.1.6. Cross-system withdrawal tariff

For AA2, the ACCC approved GasNet's proposal to introduce a cross-system withdrawal tariff. As discussed in the draft decision, the cross-system tariff is an additional levy for carriage of gas through the Metro zone, for withdrawals off the injection pipeline, which are linked to injections at an unrelated injection point. This levy is calculated as the Metro zone tariff discounted for the indirect cost allocations (which are already recovered from the withdrawal zones). The cross-system tariff does not apply to the northern zones as the costs of transmission through the Metro zone are included in the northern zone withdrawal tariffs.

TRUenergy suggested that the cross-system tariff should be abolished to simplify tariffs in the AA3 period. The ACCC noted in the draft decision that the cross-system tariff recognises the additional cost of carriage across the PTS for serving a zone which is not supplied from its nearest injection point. The draft decision considered the cross-system charge to be consistent with ss. 8.38 and 8.42 of the code as this tariff recognises the additional costs of transportation.

6.1.1.7. Matched rebates

GasNet proposed to continue its matched rebates for tariff-D users for the AA3 period. However, GasNet proposed removing matched rebates for tariff-V users related to withdrawals from the North Hume, Murray Valley, Interconnect and Wodonga zones for gas injected at Culcairn on the basis of its proposed postage stamp tariff for V users.

In its draft decision, the ACCC proposed not to approve the postage stamp tariff-V and therefore GasNet's basis for removing the matched rebates no longer applied. The ACCC considered that matched rebates continue to be consistent with the code requirements that tariffs be cost reflective to the maximum extent that is commercially and technically reasonable. Accordingly, the ACCC considered that matched rebates should be maintained for tariff-V users for the AA3 period as this is consistent with ss. 8.38 and 8.42 of the code.

6.1.1.8. Storage refill tariffs

GasNet proposed to continue to charge a gas storage refill tariff. For the underground storage at Port Campbell, GasNet proposed a tariff of \$0.20/GJ and for refill of the LNG Storage Facility, a tariff of \$0.15/GJ. GasNet submitted that these tariffs are intended to reflect the marginal cost of delivering these services, which is

²⁹³ *ibid.*, pp. 193-194.

²⁹⁴ *ibid.*

the amount of fuel used by the compressor units to transport each GJ of gas to these facilities.

The ACCC in the draft decision considered that the information provided by GasNet justifies an increase in the tariff for the AA3 period. The ACCC noted that while there appears to be some judgement involved in deriving the estimated costs, this is balanced against the under-recovery of fuel gas costs incurred by GasNet over the last several years.

6.1.1.9. Introduction of the Geelong withdrawal zone

GasNet proposed to separate Geelong from the Metro zone. GasNet submitted that with the increased gas volumes flowing on the SWP, Geelong users will have a bypass opportunity to obtain supply direct from the SWP, thereby avoiding the Metro zone tariff.²⁹⁵ It was noted that the allocation of direct costs to each of the off-takes in the Geelong zone assumes that all gas supplied to these off-takes is injected at Port Campbell. GasNet stated that this is a more defined zone than the current Metro zone, which includes off-takes supplied from Port Campbell, Pakenham and Longford and accordingly for which the average cost of transportation is higher.

In its draft decision, the ACCC considered GasNet's proposal to introduce a new Geelong withdrawal zone is consistent with s. 8.42 of the code. However, given the ACCC's requirement that GasNet calculate specific direct cost unit rates to allocate direct costs, the ACCC considered it more appropriate to allocate costs to the Geelong withdrawal zone based on specific direct cost unit rates. Further, given the ACCC's requirement that GasNet retain zonal tariffs for tariff-V users, the ACCC considered it appropriate that GasNet also calculate a Geelong zonal withdrawal tariff for tariff-V users.

6.1.2. Proposed amendments

Proposed amendment 15, 16, 17, 18, 19, 20, 21 and 22 (reproduced below) expressed the ACCC's draft decision noted above.

Proposed amendment 15

Before the proposed revised access arrangement can be approved, GasNet must amend the revised access arrangement:

- So that the final withdrawal tariffs as set out in cl. 1.3 of schedule 1 of the proposed revised access arrangement reflect the allocation of costs to withdrawal zones based on the asset group annual and peak direct cost unit rates as these are derived in the modelling for the AA2 period and
 - So that final injection tariffs as set out in cl. 1.2 of schedule 1 of the proposed revised access arrangement reflect the allocation of costs associated with each injection pipeline segment directly to the relevant injection pipeline consistent with the modelling for the AA2 period.
-

²⁹⁵ GasNet, *Submission*, op.cit., p. 94.

Proposed amendment 16

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3 of schedule 1 of the revised access arrangement to recover

- 100 per cent of the MVP incremental costs directly from the pipeline and
 - retain the two part tariff for users located on the Murray Valley pipeline: one part to recover the costs associated with the Murray Valley pipeline extension (Murray Valley incremental tariff) and the other part to recover the costs (calculated as per GasNet's current cost allocation methodology using specific direct cost unit rates) associated with transportation of gas on the withdrawal pipes to the beginning of the Murray Valley pipeline at Chiltern Valley (Chiltern Valley tariff).
-

Proposed amendment 17

Before the proposed revised access arrangement can be approved, GasNet must retain the zonal withdrawal tariffs for tariff-V users and remove the withdrawal tariff-V set out in cl. 1.3(b) of schedule 1 of the proposed revised access arrangement.

Proposed amendment 18

Before the proposed revised access arrangement can be approved, GasNet must amend the proposed revised access arrangement to maintain the current injection tariff structure, where the peak period applies to the top 10 peak days during the winter period, instead of applying the charge over the whole winter period as proposed in cl. 1.2 of schedule 1 of the proposed revised access arrangement.

Proposed amendment 19

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3(g) of schedule 1 of the proposed revised access arrangement to remove the prudent discount for tariff-D users at Pakenham.

Proposed amendment 20

Before the proposed revised access arrangement can be approved, GasNet must amend the proposed revised access arrangement to calculate its export tariff (as proposed in section 11.6.2 of the revised access arrangement submission) based on the tariff model used in the second access arrangement.

Proposed amendment 21

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3(b) of schedule 1 of the proposed revised access arrangement to include

matched rebates for tariff-V users in the North Hume, Murray Valley, Interconnect and Wodonga withdrawal zones for gas injected at Culcairn.

Proposed amendment 22

Before the proposed revised access arrangement can be approved, GasNet must:

- allocate direct costs to the Geelong withdrawal zone based on specific direct cost unit rates and
 - calculate a Geelong zonal withdrawal tariff for tariff-V users.
-

6.1.3. Response to the draft decision

6.1.3.1. Cost allocation methodology

(i) *Withdrawal pipelines*

GasNet submits in its response to the draft decision that its simplified cost allocation method is sufficiently cost reflective to satisfy the objectives of the code, and also draws an appropriate balance between cost reflectivity and other considerations. Further it believes that the method used in the AA2 period goes beyond the requirements of economic efficiency²⁹⁶.

GasNet states that ss. 8.38 and 8.42 of the code require that costs which are directly attributable to a user should be allocated to that user. However, GasNet considered that it is not clear what makes a cost attributable to a user. In particular, GasNet submits that:

Under the zone-gate model, it is taken for granted that if a user uses 20% of the capacity of a pipeline segment, then they should be attributed 20% of the costs of the pipeline segment. This principle is applied to every pipeline segment on the PTS.

However, economic theory would suggest that one should attribute to a user only the long run marginal costs associated with that user. This may or may not be the same as the percentage share of capacity as assumed by the zone gate model. Since pipelines generally show economies of scale, the marginal costs attributable to an incremental user would tend to be less than the percentage share of capacity utilisation of the asset.²⁹⁷

GasNet further considers that the requirements of ss. 8.38 and 8.42 of the code do not distinguish between a ‘marginal cost allocation model’ and ‘capacity usage allocation model’²⁹⁸ and do not indicate a preference for one model over the other.

²⁹⁶ GasNet, *Response to the Commission’s draft decision on proposed access arrangement for the Principal Transmission System*, (Submission in Response), 20 December 2007, p. 53.

²⁹⁷ *ibid*, p.54.

²⁹⁸ GasNet refers to the existing zone-gate cost allocation methodology as a ‘capacity usage allocation model’.

GasNet concludes it is therefore necessary to consider ss. 8.1 and 2.24 of the code to determine which approach should be preferred.²⁹⁹

GasNet submits that economic theory requires that allocated costs should be between the marginal cost and the stand-alone cost and exactly where allocated cost should sit between these limits depends on other considerations. GasNet states that particularly where economies of scale are present, there is nothing in economic theory to suggest that the correct allocation is based on a capacity sharing rule. GasNet concludes that in its view the best and most efficient method to allocate costs on a pipeline system cannot be reduced to a simple cost sharing model and there are many interrelated factors which could cause a cost sharing model to deviate from the best price signal. GasNet therefore concludes that rigid application of the existing zone-gate model is not necessarily consistent with economic theory or the objectives of the code.³⁰⁰ GasNet notes some factors that lead to inconsistent price signals are:

- economies of scale in pipeline augmentation, which mean that the marginal cost price signal is significantly less than the average allocated tariff
- under-utilisation of capacity (the zone gate model amplifies the unit rates in pipeline segments which are under utilised)
- system development which deviates from the re-optimised configuration and
- changes in the direction of flows (as on the northern pipeline and within the metro zone).³⁰¹

GasNet suggests that in light of these other factors, it is appropriate to consider the range of other factors such as stability of the price signal over time, robustness to changing volumes and the timing of augmentation, and encouraging development in regional areas.³⁰²

(ii) *Injection pipelines*

GasNet submits that the current (zone-gate) cost allocation model calculates the tariffs on each injection pipeline on a stand-alone basis. That is, the injection tariff on a particular pipeline is calculated from the specific pipeline assets, and the forecast flows on that pipeline. This means that the injection tariff faced by a user is strongly dependent on the forecast of injection volumes on that pipeline.

GasNet submits that it has presented its best estimate of injection volumes but the injection volumes on each pipeline can only be conjectured. It is quite possible that market participants might enter new commercial arrangements which significantly change the mix of injections between injection points. Therefore the injection tariff on each injection pipeline is largely an arbitrary number based on conjecture and assumption about the volumes to be injected into each pipeline. This is not an appropriate price signal to send to the market.

²⁹⁹ GasNet, *Submission in Response*, op.cit. p. 54.

³⁰⁰ *ibid.*

³⁰¹ *ibid.*

³⁰² *ibid.*

On the contrary, the proposed volume-distance model calculates the relativity between injection tariffs solely on the basis of pipeline distances. The relativities are not affected by the assumed injection volumes on each pipeline. In GasNet's opinion this creates a more stable, valid and cost-based price signal over time, which is therefore more efficient.³⁰³

6.1.3.2. Murray Valley Pipeline – cost allocation and inclusion in the average revenue yield control

GasNet does not agree with the draft decision that 100 per cent of the MVP incremental costs should be recovered directly from users of the pipeline based on the ACCC's previous decision to include the MVP in the capital base under the economic feasibility test s. 8.16(a)(ii)(A) of the code. GasNet asserts that s. 8.16 of the code simply sets out the basis on which new facility investment can be rolled into the capital base. Specifically, GasNet states in the 2002 decision, it was accepted that this proposal met the economic feasibility test. As a result, the capital expenditure was rolled into the capital base and there is no basis now under the code for the ACCC to require that the tariffs for the MVP be determined in accordance with s. 8.16(a)(ii)(A) of the code.³⁰⁴

GasNet further states that once an asset is rolled in to the capital base there is no reason to deviate from the standard cost allocation method that is applicable to all other assets in the capital base. If the cost allocation and tariff methodology that is applied to all other laterals is satisfactory, then it should be equally valid for the MVP lateral. GasNet further states that the MVP should not be singled out for special treatment because it was constructed shortly after the AA1 period than shortly before it.³⁰⁵

GasNet also sets out that even if the MVP lateral remains subject to the economic feasibility test, the draft decision's application of the test is incorrect. The test requires that the tariff charged to users of the pipeline must cover the incremental costs. The incremental costs include the cost of the lateral, plus the incremental cost of transportation to the lateral, which in this case are the incremental costs from Longford and/or from Culcairn.³⁰⁶

GasNet considers that, the incremental costs required to obtain transportation from Longford or from Culcairn should be deemed to be zero. GasNet considers this to be the case because the system supplying the MVP had adequate capacity at the time of construction to supply the forecast load growth on the pipeline, and hence no augmentation costs are required to meet the future load growth. In particular, GasNet submits that:

Before the MVP was constructed, the Victorian government put aside an amount of AMDQ to cover the future growth on the pipeline. That is, at the time of construction of the lateral, the system was capable of delivering to all existing users (including 17TJ/day of exports at Culcairn), with spare capacity for the expected growth on the MVP. Therefore the economic feasibility test

³⁰³ *ibid.*, p. 56.

³⁰⁴ *ibid.*, p. 57.

³⁰⁵ *ibid.*

³⁰⁶ *ibid.*, p. 58.

requires that only the cost of the lateral must be recovered from the sum of the lateral tariff plus the tariff to Chiltern Valley. This would give a significantly lower tariff to users on the MVP than would apply under the methodology adopted in the Draft Decision.³⁰⁷

Origin Energy supports the ACCC's decision to require the recovery of incremental costs associated with the MVP from the pipeline and the retention of a two part tariff for the MVP³⁰⁸.

6.1.3.3. Reference tariffs and structures

(i) *Postage stamp withdrawal tariff-V*

GasNet maintains that its proposed postage-stamp tariff for tariff-V users is supported by retailers; will reduce administrative costs for new entrants and will facilitate retail competition.³⁰⁹ GasNet submits that the draft decision has not given any weight to the facilitation of retail competition, which it notes has also been raised in AGL's submission. GasNet considers that a large investment has been made in billing and reconciliation systems to facilitate retail competition and is a major policy objective of Australian governments and is a factor which the ACCC must consider under s. 2.24(e) of the code.

GasNet notes Origin Energy's concern that some users, especially in the Gippsland zone, may see a doubling of tariffs. GasNet submits however, this applies only to a very small number of customers, and in any case the absolute increase is only between \$0.15/GJ to \$0.20/GJ³¹⁰.

GasNet submits that it believes that the draft decision has interpreted ss. 8.38 and 8.42 too narrowly. In particular, GasNet states that efficiency in the level and structure of tariffs (s. 8.1(e)) must be balanced by other requirements such as interests of users and prospective users (s. 2.24(f)) and public interest in having competition in markets (s. 2.24(e)). GasNet also submits that the benefits of a simple tariff structure to retail competition (and the resulting efficiency gains) outweigh the relatively small economic efficiency benefits of a complex zonal tariff structure for tariff-V customers and this proposition has not been refuted in the draft decision.

GasNet also considers that its simplified cost allocation method is sufficiently cost reflective to satisfy the objectives of the code and draws an appropriate balance between cost reflectivity and other considerations. GasNet also considers that the method used in the AA2 period goes beyond the requirements of economic efficiency (s. 8.1(e)) of the code.

Further, GasNet submits that it is worth noting that distribution regulators have generally approved postage stamp tariffs for tariff-V or residential customers.

³⁰⁷ *ibid.*, p. 58.

³⁰⁸ Origin Energy, *Response to ACCC draft decision*, (Submission in Response), 13 December 2007, p. 2.

³⁰⁹ GasNet, *Submission in Response*, *op.cit.*, pp. 58-59.

³¹⁰ *ibid.*, p. 59.

GasNet asserts that this is because in their opinion the requirements of cost reflectivity are outweighed by issues of practicality and simplicity. GasNet states that it should be noted that distribution tariffs are significantly higher than GasNet's transmission tariffs, so if cost reflectivity were an over-riding issue, it would have greater weight in its application to the distribution networks.³¹¹

AGL comments that the dominance of the metropolitan load in Victoria is such that the benefits in moving towards a simpler tariff regime would outweigh any loss in reduced cost reflectivity embedded in price signals. AGL states it is confident that the new tariffing methodology would result in a simpler administration and management of competitive retail price offers by retailers³¹².

TRUenergy argues that the extreme tariff increases under zonal gate tariffs for customers located in the west under zonal gas tariffs in the AA3 period would impact the market for gas reference services in breach of s. 8.1(f) of the code. TRUenergy expresses the view that the relatively elastic nature of gas in rural areas would lead to a substantial reduction in throughput volumes from assets located in western Victoria, as customers switch to substitute products³¹³.

Origin Energy submits that reference tariffs should recover at least a share of the direct costs associated with augmentations and costs specific to tariff zones, rather than allow for the allocation of these costs to all users, which would occur under postage stamp pricing.³¹⁴ Origin Energy supports the ACCC's decision to retain zonal pricing for tariff-V customers over the AA3 period as an appropriate application of code principles. Origin also states that:

....while the arguments put by GasNet and some other stakeholders that the application of postage stamp pricing would promote administrative simplicity this and other reasons asserted are not of themselves sufficient enough to justify another change to the tariff structure underpinning withdrawal transmission tariffs. We believe that retailers, to the extent they wish to amalgamate zonal tariffs can do so. Retaining the current approach provides retailers with this flexibility in the development of tariffs for end-use customers.³¹⁵

(ii) Injection tariff structure

GasNet submits that in assessing its proposal to levy the peak tariff on the whole of the winter period, the issues are whether the peak signal is relevant to investment in the pipeline, and if so, whether the peak signal should be made stronger or weaker.³¹⁶

³¹¹ *ibid.*, p. 59.

³¹² AGL, *Response to ACCC draft decision*, (Submission in Response), 17 December 2007, p. 4.

³¹³ TRUenergy, *Response to ACCC draft decision*, (Submission in Response), 14 December 2007, p. 5.

³¹⁴ Origin Energy, *Submission in Response*, *op.cit.*, p. 3.

³¹⁵ *ibid.*

³¹⁶ GasNet, *Submission in Response*, p. 60.

With respect to the relevance of the pipeline signal, GasNet submits that:

The gas market already sends a strong signal to users to avoid peak consumption. This is partly related to the higher costs of gas supply during the winter which is signalled through the gas price, but also through the uplift charges which signals congestion on the transmission pipelines. The very high uplift charges in 2007 clearly signalled the costs of peak consumption to users.³¹⁷

With respect to the strength of the peak signal GasNet agrees that there is a need for a peak signal on the injection tariff. However, GasNet suggests it is not clear that it should be a strong peak signal levied on the peak day.³¹⁸ GasNet submits that economic theory suggests that prices should reflect the marginal costs however, where there are economies of scale, the marginal cost is less than the average cost. GasNet on this basis concludes that it is not appropriate to charge the whole cost to the peak and some of the cost must be smeared over a longer period.

GasNet also submits that:

...it is not correct to argue that the peak day demand alone “causes” the need for augmentation, and should therefore pay the full cost of capacity. This conclusion is only correct under limited conditions – where the pipeline is at full capacity, and where the injection volumes are not growing over time. First, if injection volumes are not at full capacity and are not expected to grow over time, then there is no economic justification for charging only on the peak. Second, if the pipeline is at full capacity, and the injection volumes are expected to grow over time, then the peak day alone is not the sole cause of future augmentations. The injection volumes over the whole winter period will eventually grow to the point where they benefit from an augmentation. Therefore, these volumes also deserve an appropriate price signal of the cost of augmentation³¹⁹.

On this basis, GasNet believes that the winter injection charge does send an appropriate level of peak signal, in conjunction with the uplift and gas price signals sent by the gas market. The winter charge has the additional benefit of providing tariff certainty to retailers and users. It also allows the injection charge to be incorporated in the gas market price, thereby removing a distortion in the market.

TRUenergy submits it is of the view that the basis for the existing 10 peak day injection tariff has not worked³²⁰. TRUenergy maintains that it is unlikely (if not impossible) for users to respond to 10 peak day charges in a manner that enables discretionary withdrawals to respond on high injection days for the following reasons:

- For end use customers, it is difficult (without a close operational relationship with the supplying retailer) to align load to the relevant injection source, since peak injection days are assessed separately for each injection point. Further to take advantage of a reduction in injection tariff, end use customers would need to have a relatively sophisticated forecasting capability that relates the commercial characteristics of site load to anticipated injection behaviour for the PTS (on a probabilistic basis). It is unlikely for end users to see a cost

³¹⁷ *ibid.*, pp. 60-61.

³¹⁸ *ibid.*, p. 61.

³¹⁹ *ibid.*

³²⁰ TRUenergy, *Submission in Response*, op.cit., p. 3.

benefit from these facilities and TRUenergy has seen no evidence of end consumers responding to a 10 peak day injection charge over the five years of the current access regime.

- For retailers with discretionary loads such as Gas Fired Generation (GFG), the alternative for demand side response on peak injection days (as a result of the 10 peak day charge) is equally unlikely to succeed. Apart from the fact that GFG needs to predict a system peak injection day, the substantive decision to generate (or not) invariably will be driven by perceived value of gas against spot prices in the NEM, rather than the likelihood that the day will be one of the ten peak injection days.
- For the wholesale Victorian gas market, GasNet's existing 10 peak day charge delivers a strong and perverse pricing signal. On these days, the cost of injections to supply high system demand rises by the value of the peak injection charge. This dynamic delivers a perverse market signal; prospective injectors are deterred from providing additional gas on days of elevated demand.³²¹

TRUenergy also submits that there are numerous precedents on other gas transmission pipelines for peak winter charges, such as the MSP and EGP. Further TRUenergy states that due to higher gas usage for GFG in winter, there is a winter seasonal generation peak for gas transportation and wholesale gas.

Marsden Jacobs Associates (MJA) in a submission on behalf of Australian Paper endorses the principle arguments advanced by the ACCC to reject the changes proposed by GasNet. MJA consider that GasNet's proposals, particularly the proposal to use total winter peak period consumption to allocate peak pricing signals, would have further diluted 'peak pricing incentives' and resulted in transfer of costs from users contributing more to peak demand costs and long run marginal costs (such as peak gas generators) to those contributing less to peak demand costs (such as the Maryvale Mill). MJA submit that such an outcome would clearly contribute to breach of the requirements of ss. 8.1(b), 8.1(e) and s. 8.42 of the code. MJA further state that even if billing information sends 'confused signals' to users, a tariff methodology that is more cost reflective (than less) is more likely to signal efficient outcomes over the long term and provide revenue that more closely tracks GasNet's actual costs.³²²

6.1.3.4. Prudent discounts

(i) *Pakenham*

GasNet submits that any revision to the tariff structure is unlikely to change the need for a prudent discount on Pakenham injections. GasNet submits that prior to the final decision GasNet will re-calculate the prudent discount on the relevant tariff structure if required.³²³

³²¹ *ibid.*, p. 4

³²² Marsden Jacobs and Associates, *Response to ACCC draft decision*, 19 December 2007, (Submission in Response), 19 December 2007, p. 10.

³²³ GasNet, *Submission in Response*, *op.cit.*, p. 62.

(ii) *Warrnambool and Koroit*

GasNet did not comment with respect to the Warrnambool and Koroit prudent discounts. In particular, regarding the need to calculate prudent discounts for tariff-V users, should the ACCC not approve the proposed postage stamp tariff-V.

(iii) *Latrobe*

GasNet submits that based on confidential information provided by Australian Paper there may be a risk of economic bypass at the Maryvale plant. GasNet proposes to create a new zone at Maryvale, which will include the lateral to the Maryvale plant. GasNet proposes that this zone should receive a prudent discount equal to the tariff which would have applied under the normal operation of the Latrobe zone price path from 2004, escalated by CPI.

(iv) *Culcairn export tariff*

GasNet submits that it provided a calculation of the marginal costs of supply on the basis of the Euroa compressor option for the northern zone augmentation and the proposed export tariff of \$0.50/GJ is greater than the marginal cost.³²⁴ GasNet notes however, that the calculation will be affected by changes in volumes along the pipeline, and by the option adopted for the northern zone augmentation. GasNet states it will review the marginal cost calculation when these issues are resolved.³²⁵

GasNet submits that the discounted tariff should be determined by reference to the cost of supply from GasNet's competitors. GasNet considers that it faces strong competition for supply to Sydney from Longford gas transported through the EGP for supply to Sydney. GasNet also considers it faces some competition for supply to country NSW through gas swaps with Moomba gas. That is, Moomba supply to a Sydney customer could be redirected to the country region with a net saving in the MSP tariff, and the Sydney customer would be supplied from the EGP.³²⁶

GasNet also submits that the MSP is capable of delivering gas from Queensland through the MSP and the proposed new QSN Link and Moomba, although this is subject to availability and price. The QSN Link is expected to be completed at the end of 2008. GasNet understands that coal seam methane from Queensland is significantly cheaper than other gas supplies in the south eastern states which, is likely to mean that transportation to NSW is commercially attractive.

Finally, GasNet submits that given the strongest competition is from the EGP at this time, the discounted export tariff should be the EGP tariff less the (regulated) Culcairn to Sydney tariff and the published VENCORP charges. Based on GasNet's estimates it believes the competitive tariff is in the range of \$0.42 - \$0.45/GJ. If

³²⁴ *ibid.*, p. 63.

³²⁵ *ibid.*

³²⁶ *ibid.*

Moomba was considered a potential competitor, the competitive tariff would be approximately \$0.50/GJ.³²⁷

6.1.4. Conclusion

6.1.4.1. Cost allocation methodology

(i) *Withdrawal pipelines*

In assessing GasNet's proposed methodology, the ACCC must consider the requirements of ss. 8.38 and 8.42 of the code. Ss. 8.38 and 8.42 of the code require that tariffs should reflect the costs of each service and each user to the maximum extent that is commercially and technically reasonable: where the ACCC is left with discretion there may be room for consideration of the s. 8.1 objectives.

In its 2002 decision, the ACCC concluded that the tariff structure and cost allocation methodology proposed by GasNet, as modified by the ACCC's amendments, offered an appropriate balance to the sometimes competing objectives of the code.³²⁸ As noted by GasNet, this implicitly recognises a trade-off between cost reflectivity and other considerations (i.e. administrative simplicity, tariff stability). For example, it is technically and commercially feasible to approve a separate tariff for every one of the 120 off-takes on the PTS, but the 2002 draft decision weighed this objective against the benefits of simplicity by approving an amalgamation of off-takes into geographic zones³²⁹. For the AA2 decision, the ACCC considered the issue of the maximum extent commercially and technically reasonable by referring to an appropriate balance between cost reflectivity and simplicity. Given that the zone-gate methodology to cost allocation has been in place since the beginning of the AA1 period, the ACCC considers that the existing zone-gate methodology allocates costs to services and users to the maximum extent that is technically and commercially reasonable.

The ACCC notes that both GasNet's existing zone-gate methodology and proposed volume-distance methodology to cost allocation, involve a degree of averaging costs across users to derive the final zonal tariffs. GasNet argues that the marginal costs attributable to an incremental user would tend to be less than the percentage share of capacity utilisation of the asset³³⁰. The ACCC agrees that this may be the case and in many instances the marginal cost of servicing a user may be zero. The ACCC considers, however, that given GasNet's zonal tariffs' under both the existing and proposed methodologies are an average for a group of users, the more relevant question is to consider what makes costs directly attributable to a particular group of users. Specifically, the ACCC considers it appropriate to consider the question of

³²⁷ *ibid.*

³²⁸ ACCC, *Final decision: GasNet Australia 2002-2007*, op.cit., p. 235.

³²⁹ ACCC, *Draft decision: GasNet Australia access arrangement revisions for the Principal Transmission System*, (Draft decision: GasNet 2002), 14 August 2002, p. 53.

³³⁰ GasNet, *Submission in Response*, op.cit., p. 54.

what makes costs directly attributable to a user, as raised by GasNet, by considering the costs directly attributable to a group of users.

In establishing a set of efficient tariffs, GasNet notes that economic theory recognises that at a minimum, the tariff charged should recover the incremental costs of supplying that customer and at a maximum, tariffs should not exceed the costs to the customer of alternatives (the stand-alone cost). If tariffs lie within this range, then the tariff is covering the directly attributable costs of supplying a user, as well as contributing to the common costs of the business. This would mean tariffs outside this range are inefficient. The ACCC considers this economic principle is appropriate in addressing GasNet's question of what makes costs directly attributable to a user (or group of users). GasNet's final tariff zones group users together and all users within the zone are charged the same zonal tariff. Under GasNet's current zone-gate methodology, final zonal tariffs reflect a share³³¹ of the specific costs of each pipeline segment required to provide gas to all withdrawal points within the zone. Under this methodology the zonal tariffs reflect differences in the costs of pipeline segments required to transport gas to different zones. Zones that require the use of pipeline segments which are larger in diameter and contain more transmission assets such as regulators and compressors will have higher tariffs than zones that require the use of smaller diameter pipeline segments with less transmission assets. Put another way, higher cost zones will be associated with higher tariffs than lower cost zones.

In contrast, GasNet's proposed volume-distance model which uses the same average direct cost unit rate across all pipeline segments assumes that in the long-run all pipeline segments will require the same upgrade or augmentation. As noted in the draft decision, the ACCC does not consider that all segments of the transmission system will require the same upgrade or augmentation at some point in time. The argument that long-run tariffs will be cost reflective under GasNet's proposal assumes that the increments to capacity will be made in the same proportion across all tariff zones over time (e.g. this assumes that capacity for a 500 mm pipe serving a zone and 150 mm pipe serving another zone will both increase in the same proportion over time). As discussed in the draft decision, the ACCC considers this unlikely as not all zones in Victoria can be expected to grow in demand at the same rate even in the long term. In some regions, for example, growth may stagnate, while others face rapid increases in demand.³³² Consequently, in the long-run, the ACCC considers the revised tariff model will not produce zonal tariffs which are reflective of the long-run costs of individual segments of the pipeline used to deliver gas to

³³¹ The proportion of pipeline segment direct costs allocated to a tariff zone reflects the volume of gas withdrawn by the withdrawal points in the zone. For example, if a flow to a withdrawal point passes through 3 pipeline segments, and comprises 1 per cent of the total flow through the first pipeline segment and 3 per cent of the total flow through the second pipeline segment, and 100 per cent of the total flow through the third pipeline segment then that withdrawal point would receive 1 per cent of the first pipeline segments cost recovery and 3 per cent of the second pipeline segments cost recovery, and 100 per cent of the third pipeline segments cost recovery. The final tariff zone groups the direct costs allocated to all withdrawal points in the zone to determine the final tariff for the zone.

³³² ACCC, *Draft decision*, op.cit., p. 175.

each tariff zone. This would mean that the tariffs would not be indicative of the costs of expansion of the system in particular zones and will not provide appropriate investment signals.

Under GasNet's proposed volume-distance methodology, which uses the same average direct cost unit rate to allocate costs, the costs of specific pipeline assets to serve tariff zones are diluted across other tariff zones to a greater extent than the existing cost allocation methodology. In some cases, this may result in final tariffs which are less than the incremental cost of supplying the customer. For example, as noted in the draft decision, GasNet proposes that users in the Calder zone would be allocated around 30 per cent less direct costs under its proposed methodology despite GasNet's proposal to recover a proportion of the proposed capacity related capex in this zone.

Accordingly, the ACCC maintains that GasNet's current allocation methodology meets the requirements of ss. 8.38 and 8.42 of the code, which require that tariffs reflect the cost of each service and each user 'to the maximum extent that is commercially and technically reasonable', whereas GasNet's proposed cost allocation methodology does not meet ss. 8.38 and 8.42 of the code.

The ACCC notes that whilst GasNet appears to agree that existing cost allocation methodology (zone-gate model) provides the 'best' price signal, GasNet also considers that there are a number of factors which could cause a cost sharing model to deviate from the best price signal such that rigid application of the zone-gate model is not necessarily consistent with economic theory or the code. In particular, GasNet considers that some of the factors leading to inconsistent price signals include:

- economies of scale in pipeline augmentation, which mean that the marginal cost price signal is significantly less than the average allocated tariff
- under-utilisation of capacity (the zone gate model amplifies the unit rates in pipeline segments which are under-utilised)
- system development which deviates from the re-optimised configuration and
- changes in the direction of flows.

The ACCC understands that GasNet considers that where there are economies of scale in pipeline augmentation the (long) run marginal costs of providing the service may be less than the average allocated tariff. However, as discussed, the ACCC considers that GasNet's existing (zone-gate) cost allocation methodology reflects the cost to a service and users, which is to the maximum extent commercially and technically reasonable (ss. 8.28 and 8.42)). To the extent that GasNet's existing cost allocation methodology deviates from the 'best' pricing signal in terms of signalling the long run costs of expanding capacity, the ACCC accepts that there may be circumstances where deviations from GasNet's standard cost allocation methodology is appropriate. Further, the ACCC considers that the central issue is that GasNet's proposed methodology will dilute any pricing signals associated with supplying services and cost attributable to users.

The ACCC notes that whilst the zone-gate methodology may in some cases amplify unit rates in pipeline segments that are under-utilised, where necessary adjustments can be made to GasNet's current model so to reduce tariffs for a period of time until demand increases such that a pipeline is not under-utilised. In particular, the ACCC has previously provided prudent discounts to reduce tariffs in some zones where there is a risk that the system will not be utilised by users. Further, GasNet has not allocated any indirect costs to the northern zones supplied from the south. At the commencement of the AA2 period, GasNet proposed to allocate some costs which would normally be allocated to the northern zones, to other zones. The purpose was to produce tariffs in the northern zones which would not discourage gas transportation, and to recover the shortfall from zones in which a marginal increase would not discourage gas transportation. At the time, the ACCC considered it fair and reasonable for the majority of users, who are in zones with low tariffs, to pay some of the costs attributable to users in the zones with high tariffs, in order for those users in the higher tariff zones to face tariffs which will encourage greater use of the system³³³.

Accordingly, the ACCC acknowledges whilst the existing zone-gate methodology may lead to an under-utilisation of capacity in some tariff zones, the existing zone-gate cost allocation methodology has been modified to encourage greater usage of the system where appropriate.

GasNet also submits that system development which deviates from the re-optimised configuration will lead to inconsistent price signals. GasNet provides two examples to demonstrate potential inconsistencies that arise from a strict application of the zone gate model. These include:

- optimized asset valuation³³⁴ and
- Northern augmentation³³⁵

³³³ ACCC, Final decision: GasNet Australia 2002-2007, op.cit., p. 222.

³³⁴ GasNet suggests that as new assets are added, the enlarged system should in theory be re-optimized, and costs allocated according to the optimized system. In practice this is not done, and therefore the costs allocated under the zone gate model are only approximate representations of the correct price signal.

³³⁵ GasNet notes that two options have been discussed to augment the northern zone. The first option is to construct a long loop northwards from the Wollert compressor station. The second is to construct a short loop from Wollert, and to construct a new compressor station at Euroa. Both scenarios have similar costs. Under the zone gate model, the South Hume zone (from Wollert to Euroa) would be allocated very different costs under the two options. In the Euroa compressor option, South Hume would not pay the cost of the compressor since it is downstream of the zone. However they would benefit from the lower tariffs in their zone created by the higher flows on the pipeline. Nevertheless, if the longer loop option is selected, they will pay a significantly higher share of the costs of the augmentation since the loop is located within the South Hume zone. Under the volume distance model, the costs for users in the South Hume zone would increase marginally. However, the tariff increase would be the same whichever option is selected.

The ACCC agrees with GasNet's view that as the asset values of the PTS are not periodically re-optimised, the allocation of costs across the GasNet system may give only approximate price signals of the actual costs of supplying each service and the costs to users (or groups of users). While the zone-gate model can only give approximate price signals, the ACCC however considers that these price signals better approximate the long-run costs of providing services to users (or groups of users) than GasNet's proposal. As discussed above, GasNet's proposed volume-distance methodology results in a greater averaging of direct costs across the PTS, which results in final tariffs which are less reflective of the actual pipeline segment costs of delivering gas to users (or groups of users). The ACCC considers GasNet's proposed methodology amplifies any misallocation of costs attributable to a service and users, as the averaging of direct costs across all pipeline segments is less costs reflective across users and tariff zones.

GasNet also submits that the northern zone is an example of inconsistent pricing signals, which may result from a rigid application of the zone-gate model. GasNet states that under the zone-gate model, the South Hume zone would be allocated very different costs under the two options to augment the northern zone. The ACCC agrees that a rigid application of the zone-gate methodology may not be appropriate to all tariff zones nor is it required under the existing methodology. The ACCC considers that the aim of the model is to allocate the cost of segments of the pipeline to users of those segments. Generally, the users within a zone will be the users of the assets in that zone. However, if the users of the expansion of the South Hume zone are located in another zone, the logic of the model would require the costs of that expansion to be allocated to the users in that other zone.

GasNet has also indicated that changes in gas flows may lead to inconsistent price signals. The ACCC notes that under the zone-gate methodology, that tariffs' already to some extent accommodate changes in gas flows. Wodonga users, for example, receive a different tariff depending on whether gas is sourced from Culcairn or Longford, which reflects the different costs of transporting gas to Wodonga from these different injection sources. Again the ACCC considers that to the extent that changes in gas flows may lead to inconsistent price signals, the cost allocation methodology should be modified and therefore accepts that in some circumstances a rigid application of a zone-gate approach is not appropriate. Further, it is not clear to the ACCC as to whether GasNet's proposed volume-distance methodology would also provide inconsistent pricing signals associated with changes to gas flows.

(ii) *Injection pipelines*

GasNet argues that the current allocation of costs to injection pipelines involves conjecture as to likely commercial outcomes (between producers and retailers affecting top ten peak day injection outcomes) and sends an inappropriate, arbitrary price signal. However, the ACCC notes that GasNet's proposal also relies on volume forecasts and the tariff derived will depend on conjecture as to the relative flows on pipeline assets over three sets of volume forecasts — peak day, four month and anytime volumes. Under either approach the level of the tariff is based on forecasts, which as GasNet notes may be superseded by new commercial arrangements. GasNet considers that these new commercial arrangements may significantly change the mix of injections between injection points. The ACCC does not disagree that this may occur but notes that changes to injections (peak, top 10 day and anytime

volumes) at certain injection points may occur generally (not just on top 10 peak day injections) through new commercial arrangements. The impact of this arrangement is likely to influence tariffs under both approaches. The forecast volumes under both GasNet's current and proposed approaches to setting injection tariffs are on the basis of historic profiles (winter, peak, and annual volumes) and if these profiles change over time, then these forecasts will be inaccurate. The ACCC concludes that both GasNet's current and proposed approach rely on forecasts which could subsequently be found inaccurate and which will influence the level of tariffs.

While the relativity in tariffs between injection pipelines may be more stable under GasNet's proposed Methodology (volume-distance), the ACCC considers the key requirement of the code given the requirements of ss. 8.38 and 8.42 considered in light of the s 8.1 objectives is that tariffs reflect the cost of each service and each user to the maximum extent commercially and technically reasonable. In particular, GasNet's proposed methodology averages the injection direct costs across all injection pipelines. Accordingly, while the average cost may vary in level depending on the volumes forecast, the relativities in tariffs between each injection pipeline may be more stable because under this methodology the direct cost allocated to each pipeline is based on the length of the pipeline.

The ACCC, however is concerned that the averaging of injection direct costs to a \$/TJ-KM rate and the subsequent allocation of these costs based on the length of the pipeline means that the allocation of costs to each pipeline will not reflect the actual direct costs of the specific pipeline assets. As a result, the final tariffs derived for each pipeline will not reflect the individual pipeline costs. For example, under GasNet's proposed methodology, the ACCC estimates 33 per cent less direct costs are allocated to the Interconnect than the actual direct costs associated with that pipeline's assets. This results in a final tariff level, which is less than that required if the tariff were based on the specific costs of the Interconnect assets. Whilst the total direct costs associated with injection pipelines will be recovered under the proposed methodology the ACCC is concerned that this methodology will result in final tariff levels which are less likely to reflect the direct costs associated with each injection pipeline. The ACCC considers this approach to be less consistent with the requirements of ss. 8.38 and 8.42 of the code.

Amendment 16

Before the proposed revised access arrangement can be approved, GasNet must amend the revised access arrangement:

- So that the final withdrawal tariffs as set out in cl. 1.3 of schedule 1 of the proposed revised access arrangement reflect the allocation of costs to withdrawal zones based on the asset group annual and peak direct cost unit rates as these are derived in the modelling for the AA2 period and
 - So that final injection tariffs as set out in cl. 1.2 of schedule 1 of the proposed revised access arrangement reflect the allocation of costs associated with each injection pipeline segment directly to the relevant injection pipeline consistent with the modelling for the AA2 period.
-

6.1.4.2. Indirect cost allocation**(i) *Western and northern zones***

The ACCC received no submissions regarding the exclusion of any rolled-out costs to the Western, Warrnambool and Koroit zones. The ACCC notes that the Western zone has not previously been allocated rolled-out costs because it does not receive the system-wide benefits as accepted by the ACCC for the AA2 period. As there is no evidence that this circumstance has changed, the ACCC maintains its draft decision that these rolled-out cost should not be allocated to the Western, Warrnambool and Koroit zones for the AA3 period.

The ACCC also received no submissions regarding the retention of the AA2 period approach, where the northern zones are not allocated any indirect costs. At the time of the AA2 revisions GasNet submitted that these tariff are considered to be too heavily burdened, such that the existing level of tariff would discourage gas consumption. The draft decision noted that given that the ACCC has accepted GasNet's forecast capex in the northern zones and requires that GasNet apply the zone-gate methodology, tariffs are likely to increase in the AA3 period. Accordingly, the ACCC maintains its draft decision that indirect costs not be allocated to the northern zone tariffs.

(ii) *Carry-over K-factor allocation to tariffs*

The ACCC notes that GasNet considers that the proposed exclusion of the K-factor carry-over from the Echuca and Southwest withdrawal zones and the Pakenham injection tariff is an error, which GasNet intends to correct. Accordingly, the ACCC requires that GasNet allocate K-factor carry-over to the Echuca and Southwest withdrawal zones and the Pakenham injection tariff.

Amendment 17

Before the proposed revised access arrangement can be approved, GasNet must amend the revised access arrangement so that carryover K-factor carry-over is included in the Echuca and Southwest withdrawal zones and the Pakenham injection tariff.

(iii) Brooklyn Lara (Corio) loop

The ACCC notes that while it has previously considered that benefits need not accrue equally and simultaneously to all users to be considered ‘system wide’³³⁶, it notes GasNet’s view that users in zones on injection pipelines are likely to be substantially lower as their requirements for additional capacity and linepack should be lower given their proximity to injection points. Accordingly, the ACCC accepts GasNet’s revised proposal to not allocate the Brooklyn Lara pipeline costs to the South West, Latrobe, Tyers or Lurgi zones.

6.1.4.3. Murray Valley Pipeline – cost allocation and inclusion in the average revenue yield control

GasNet comments that there is no basis now for the Murray Valley tariffs to be determined in accordance with the s 8.16(a)(ii)(A) economic feasibility test.³³⁷

Removal from average revenue yield control

At the time of approving the MVP investment in AA2, the ACCC clearly stated, as a condition of inclusion, that the MVP assets (the MVP lateral) must recover its costs from its own tariffs over AA2 and at scheduled reviews. As stated in the ACCC’s final decision for AA2:

GasNet has proposed two parts to the tariffs applicable to users located on the Murray Valley Pipeline: one part recovers the costs associated with the Murray Valley Pipeline extension and the other part recovers a fair share of costs (calculated using GasNet’s standard cost allocation model) associated with transportation of gas on the withdrawal pipes to the beginning of the Murray Valley Pipeline (at Chiltern Valley). Removal of the Murray Valley Pipeline from the K factor mechanism is effectively accomplished by removing only the first part of the tariffs as this is the component associated with recovery of Murray Valley Pipeline costs. If volumes vary from those forecast on the Murray Valley Pipeline, the K factor calculation will then ensure that the average costs of the system (other than Murray Valley Pipeline and Southwest Pipeline) are recovered. However, revenues associated with the cost of the Murray Valley Pipeline itself will be totally determined by the volumes of user demand.³³⁸

and:

At the scheduled reviews, their tariffs should be calculated in such a way that they fully recover the costs associated with the assets (that is, their tariffs should not be derived from the general cost allocation methodology as described in chapter 8 of this Final Decision). To do otherwise would be contrary to the interests of users and prospective users (section 2.24(f)). This decision means that these assets will need to recover their costs from their own tariffs.³³⁹

³³⁶ ACCC, Final Decision, *Access Arrangement for the Principle Transmission System – Application for Revision by GPU GasNet Pty Ltd*, 28 April 2000, p. vi (the Interconnect Decision).

³³⁷ GasNet, *Submission in Response*, op.cit., p. 57

³³⁸ ACCC, *Final decision: GasNet Australia 2002-2007*, pp. 161-162.

³³⁹ *ibid.*, p. 161.

That is, in its 2002 decision, the ACCC concluded that the MVP lateral costs should be recovered for the AA2 period and future periods outside the average revenue yield control.³⁴⁰ The ACCC maintains for this final decision that MVP tariffs should be excluded from the average revenue yield control to prevent GasNet charging any under-recovery on these new assets to users of existing facilities as this would undermine the stand-alone basis on which they were included in the regulatory asset base (RAB) under the economic feasibility test.³⁴¹ Accordingly, the ACCC requires that the MVP lateral costs be treated outside the standard reference tariff variation methodology in schedule 4 of GasNet's proposed AA in order to uphold the intent of section s. 8.16(a)(ii)(A) of the code. The required amendment to achieve this exclusion is in chapter 6.5 of this final decision.

Cost allocation

For AA2, GasNet proposed a cost allocation methodology for the MVP lateral which differed from the standard cost allocation methodology and in its final decision the ACCC accepted a methodology which differed to the standard cost allocation methodology.³⁴² GasNet opposes the ACCC's draft decision to retain the AA2 approach noting:

Once an asset is rolled into the Capital Base, there is no reason to deviate from the standard cost allocation method that is applicable to all other assets in the Capital Base. If the cost allocation and tariff methodology that is applied to all other laterals is satisfactory, then it should be equally valid for the Murray Valley pipeline lateral.³⁴³

The ACCC is unclear as to why GasNet is absolute in its views that once an asset is rolled into the capital base there is no reason to deviate from standard cost allocation methods applicable to other assets in the capital base given its AA2 proposal.³⁴⁴

For AA3, GasNet now proposes that Murray Valley users not be required to pay any of the costs of pipeline usage up to Chiltern Valley based on an incremental cost argument. However, this proposed approach can be seen as a deviation from the standard cost allocation methodology. Currently users in other 'end zones' bear the

³⁴⁰ *ibid.*, p. xv

³⁴¹ ACCC, *Draft decision: GasNet Australia 2002-2007*, op.cit., p. 180. It is noted that for AA2 the inclusion of the MVP assets within the average revenue yield control would have seen under-recovery on these assets over the period paid for by other users.

³⁴² ACCC, *Final Decision: GasNet Australia 2002-2007*, pp. 227,234. GasNet proposed the incremental costs of the Murray Valley Pipeline (from Chiltern Valley) departing from the general cost allocation model, with all (100 per cent) capital costs allocated to peak flows in order to minimise tariff shock. The ACCC accepted a 75 per cent cost allocation approach having considered that this asset having considered the previous method of cost recovery prior to it being accepted into the capital base, but also the desirability of moving towards the general cost allocation methodology.

³⁴³ GasNet, *Submission in Response*, op.cit., p.57.

³⁴⁴ *ibid.*

costs of withdrawal zone specific assets (i.e. users on the Echuca lateral). GasNet considers however such a deviation to be justified noting:

...the incremental costs required to obtain transportation from Longford or from Culcairn should be deemed to be zero. This is because the system supplying the Murray Valley Pipeline had adequate capacity at the time of construction to supply the forecast load growth on the injection pipeline, and hence no augmentation costs are required to meet future growth. Before the Murray Valley Pipeline was constructed, the Victorian Government put aside an amount of AMDQ to cover the future growth on the pipeline...³⁴⁵

That is, GasNet proposes a discount from the amount that would otherwise be charged to Murray Valley users under a continuance of the AA2 approach of allocating flow path costs (75 per cent on peak volume flows) or the proposed cost allocation methodology for AA3 (65 per cent on peak volumes flows).³⁴⁶

As noted in the draft decision, actual volumes over the AA2 period on the MVP reveal GasNet has under-recovered the direct costs on the MVP lateral at the prevailing tariffs. Table 6.1.1 provides actual, forecast volumes and tariffs for MVP users for the AA2 period and as proposed for the AA3 period.

Table 6.1.1: Murray Valley user volumes and tariffs

	2004	2005	2006	2007	2008
Murray valley zone final tariff (including incremental tariff)					
Tariff-D (\$/GJ)	1.1298	1.164	1.166	1.146	0.89 (vd)
Tariff-V (\$/GJ)	1.9624	2.0218	2.0365	2.0018	0.35 (ps)
Murray Valley incremental tariff portion of final tariff					
Tariff-D (\$/GJ)	0.7936	0.8177	0.8424	0.8756	n/a
Tariff-V (\$/GJ)	1.4923	1.5375	1.584	1.6464	
Total volumes (TJ)	825(a) 1364(f)	889(a) 1608(f)	1098(a) 1849(f)	1055(a) 2127(f)	1117(f)

(vd) for 2008, GasNet's proposed volume-distance tariff D methodology outcome for the Murray Valley zone

(ps) for 2008, GasNet's proposed single postage stamp tariff-V across all zones.

(a) actual volumes

(f) forecast volumes

The ACCC has reviewed actual and forecast volumes as well as tariffs for the period 2004 to 2012. The ACCC notes that:

- GasNet did not recover forecast volumes over the AA2 period resulting in an under-recovery of direct costs at the prevailing tariffs, however
- some volume increases at Murray Valley have occurred over the AA2 period, while at the same time tariffs have stayed relatively constant in nominal terms and therefore decreased in real terms.

³⁴⁵ *ibid.*

³⁴⁶ *ibid.*

The ACCC notes that whilst GasNet would not have recovered the costs of the MVP lateral as envisaged in its forecast volumes over the AA2 period, it has to some extent built its market.

Prudent discount

The ACCC considers GasNet's suggested approach represents in substance a prudent discount application where a full discount is requested to just cover the incremental costs as permissible under section 8.43 of the code. The ACCC considers that maintenance of the existing level of tariffs faced by MVP users could facilitate a further build up of usage of these assets. In this context, noting that tariffs will increase generally for this period, the ACCC considers that allowing GasNet to charge users the costs of the MVP lateral (the incremental costs as proposed by GasNet), would better facilitate the maintenance of current tariffs. The ACCC considers the MVP lateral market, in accordance with s 8.43(a), to be one where a prudent discount is required in order to promote sustained and increased volumes noting that GasNet has been struggling to develop and keep a market (see table 6.1.1. above). Such an approach may not allocate costs across users in accordance with the standard cost allocation methodology of flow path based asset usage (i.e. for usage of downstream assets in the South Hume and others withdrawal zones) for this period, but it may support future volume increases. If volumes increases occur on the MVP this will both reduce tariffs on the MVP lateral and any increased volumes could be applied in future periods, in accordance with the standard cost allocation methodology, across all asset zones to better share costs of asset usage amongst users. In order to satisfy section 8.43(b) of the code in addition to paying incremental costs of the MVP lateral, MVP users must make some contribution to common costs.³⁴⁷

In future AA periods, the ACCC will re-consider the cost allocation methodology for Murray Valley users.

Amendment 18

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3 of schedule 1 of the revised access arrangement to include a Murray Valley Tariff which recovers 100 per cent of the MVP incremental costs directly from the MVP lateral pipeline plus some contribution to common costs.

6.1.4.4. Reference tariffs and structure

(i) *Postage stamp withdrawal tariff-V*

In considering GasNet's proposed postage-stamp tariff-V, the draft decision has considered GasNet's claim that it will reduce administrative costs and facilitate retail competition. This view is also supported by AGL.

As discussed in the draft decision, the ACCC notes GasNet has not provided any evidence to support its view that the proposed postage stamp structure for tariff-V

³⁴⁷ Note, for prudent discounts, section 8.43(b) of the code requires that in the absence of revenue from the discounted tariff other Reference Tariffs would be greater.

users will reduce administrative costs and encourage retail competition. Accordingly, the ACCC is not convinced given the lack of evidence provided by GasNet that the structure of zonal tariffs for V users is hindering retail competition or will increase the costs for new entrants. The ACCC notes that the AEMC has recently considered potential barriers to retail competition in the Victorian gas market and states that:

A barrier to entry does not properly include a cost or other impediment that applies more or less equally to any party wanting to participate in the retail market, irrespective of whether it is an established retailer or a new retailer.³⁴⁸

The ACCC concurs with the AEMC conclusion and considers that any administrative costs described by GasNet will be incurred by all existing and new entrants and as such is not a barrier to entry.

The ACCC has considered TRUenergy's argument that users in the western zones' would see increases in tariffs under the zonal tariff structure. The ACCC notes that it has approved prudent discounts for both Warrnambool and Koroit zones located in the west in this decision, which reduces tariffs below the level of prevailing zonal tariffs in the absence of these discounts. The ACCC has also approved a new Geelong zone, which reflects the lower cost of transportation for gas injected on the SWP.

As discussed, the ACCC understands that ss. 8.38 and 8.42 require the reference tariff to be cost reflective to the maximum extent commercially and technically reasonable, not just sufficiently as GasNet suggests. GasNet considers that ss 8.38 and 8.42 do not produce a sufficiently clear outcome and recourse should be had to the s. 8.1 objectives and s. 2.24 considerations. The ACCC considers that GasNet has failed to demonstrate that the existing zonal tariff-V structure is not cost reflective to the maximum extent commercially and technically reasonable. The ACCC notes that while the s. 8.1 objectives may provide guidance as to what is technically and commercially reasonable, it has formed the view that in this case the requirement that tariffs be cost reflective to the maximum extent technically and commercially reasonable means that the proposed tariff-V structure does not satisfy ss. 8.38 and 8.42 of the code. Further, to the extent that the s. 8.1 objectives are indirectly relevant, GasNet has not demonstrated that there is a conflict between the s. 8.1 objectives and as such the need to consider the s. 2.24 objectives. In addition, as noted above, the ACCC does not consider administrative costs to be a relevant consideration in facilitating retail competition. Accordingly, the ACCC considers that any reduction in efficiencies associated with adopting a postage stamp tariff for tariff-V users would not be expected to be outweighed by other efficiencies as this proposal is unlikely to promote retail competition.

In response to GasNet's comment that distribution tariffs are levied on a postage stamp basis, the ACCC notes that a single postage stamp tariff does not apply to tariff-V users across the Victorian distribution networks. The distribution network is divided into three separate geographic areas each operated by an independent

³⁴⁸ Australian Energy Market Commission, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria*, First Final Report, 19 December 2007, p.112.

distribution business which each apply separate tariff-V rates. Further, each of the distribution businesses has separated its tariff-V customers into two or more separate zones within its geographic area and two businesses further differentiate between residential and non-residential tariff-V users. This results in at least six separate distribution pricing zones for tariff-V customers. The ACCC considers that notwithstanding the tariff-V structure at the distribution level, cost reflective pricing at the transmission level will provide the appropriate basis for users to make their own investment decisions and is more consistent with ss. 8.38, 8.42 and s. 8.1(d) of the code.

Accordingly, the ACCC does not approve GasNet's proposal for a single postage-stamp tariff-V.

Amendment 19

Before the proposed revised access arrangement can be approved, GasNet must retain the zonal withdrawal tariffs for tariff-V users and remove the withdrawal tariff-V set out in cl. 1.3(b) of schedule 1 of the proposed revised access arrangement.

(ii) *Injection tariff structure*

GasNet submits that the issues are whether the peak signal is relevant to investment in the pipeline, and if so, whether the peak signals should be made stronger or weaker. GasNet argues that the pipeline is not constrained and therefore strong peak signals are not required.

The ACCC as discussed in the draft decision considers that if constraints are to occur on the pipelines, it is most likely to occur on winter peak days. Accordingly, it is appropriate that those users injecting on peak days incur the cost of using the pipeline at peak times. Also as discussed in the draft decision, this will send peak pricing signals to users to try and minimise their injections during the peak period. The ACCC also considers peak signals are appropriate before congestion occurs, as they are not only a tool for the allocation of capacity costs to those who constrain the system, they are also a tool to discourage users from adding to the capacity constraint.

In considering GasNet's argument that it is not clear that a strong peak signal needs to be levied on the peak day, the ACCC notes that if peak costs are spread over a longer period, those users who have high load factors (a constant injection profile throughout the year) will pay more of the injection costs even though most of their use will occur at times when the pipeline is not constrained and there is spare capacity. The ACCC does not consider it appropriate that these more efficient pipeline users pay more of the cost particularly when the pipeline is not constrained. The ACCC considers that it is the peak days when price signals are required and the users injecting on those days should pay for the cost of using the pipeline at a peak time.

GasNet considers that the wholesale market already sends a strong signal to users to avoid peak consumption as illustrated by 2007 'uplift charges'. The ACCC recognises that the wholesale market will provide a congestion signal, when gas delivery is constrained, as occurred in 2007 when the Corio loop was not in place.

However, for future periods the ACCC considers that following the Corio loop expansion, the continuance of such strong wholesale market price congestion signals is not guaranteed and it might be expected that prices will flatten across the year³⁴⁹. If this occurs the top 10 peak days injection costs will more visibly contribute to yearly costs (if wholesale market prices are flatter) and users may therefore choose to alter their flow of gas on top 10 peak days.

The ACCC considers that it is desirable to retain strong peak injection signals for transmission costs, to signal the cost of future congestion on the transmission system particularly when pipelines are relatively *unconstrained*. In this respect, injection pipeline charges appear better suited to signalling costs when sufficient spare capacity exists across the system than wholesale market prices. This is because the wholesale market would be expected, when pipelines are relatively unconstrained, to operate to price the most competitively offered gas without regard to future pipeline costs. That is, injection bids would not be expected to include the future costs of expansions needed as a result of gas usage responding to low wholesale prices.

The ACCC notes that GasNet has not substantiated that economic theory supports its view that as the marginal cost will be less than the average costs, it is not appropriate to charge the whole cost to the peak period. GasNet also argues if the pipeline is at full capacity, and the injection volumes are expected to grow over time, then the peak day alone is not the sole cause of future augmentations. GasNet submits that the injection volumes over the whole winter period will eventually grow to the point where they benefit from an augmentation. Therefore, these volumes also deserve an appropriate price signal of the cost of augmentation³⁵⁰. The ACCC considers the requirement for augmentation is most likely to be driven by demand on the top 10 peak days. The ACCC agrees that eventually demand growth will mean that full capacity will be required over the whole winter period. However, it is demand on the top 10 winter peak days which will require the pipeline capacity to be expanded earlier than an expansion of capacity which will eventually be required for the whole winter period. Given that a delay in expanding capacity will be less costly in NPV terms, and the top 10 peak day demand requires an earlier expansion of capacity to be built, it is the top 10 peak day demand which imposes the costs on the network. Hence, the ACCC considers price signals on the top 10 peak days reflects the cost of the system as any augmentation of the pipeline to accommodate the top 10 peak day demand will also accommodate an increase in demand over the whole winter period.

TRUenergy comments that it is difficult to align load to the injection source since peak injection days are assessed separately for each injection point. It also considers

³⁴⁹ (1) Some recent analysis suggests that average gas prices for 2008 are likely to be closer to \$4/GJ than the \$7/GJ experienced in winter 2007. Frontier Economic, *Assessment of the Gas Continuity Scheme: A report prepared for the NSW Department of Water and Energy*, March 2008. pp. 17-18; (2) Price information on VENCORP's website suggests that in previous years (such as 2005) wholesale prices have exhibited little variance across the year; VENCORP website, *Prices and Withdrawals 2005*, http://www.vencorp.com.au/index.php?action=filemanager&doc_form_name=download&folder_id=426&doc_id=3437&pageID=8548§ionID=8246

³⁵⁰ GasNet, *Submission in Response*, op.cit., p. 61.

users typically lack the sophistication of forecasting capability to probabilistically project likely peak days and account for such days within costs citing a lack of evidence of such activity occurring over the AA2 period. The ACCC notes that:

- many users could understand by location (especially if informed by their retailer) that their location to the west /east /in the Melbourne metro region means that usage is more than likely to be matched to one of the Port Campbell/Longford injection zones
- furthermore, for Port Campbell and Longford injections the top 10 days are likely to be located within a limited range of cold weekdays which users could consider any one of which may form one of the top 10 peak days³⁵¹
- as noted above user's attention to the costs of injection tariffs may become more pronounced to the extent that expansions on the system, such as the Corio loop reduce the variance in wholesale market prices over the year from 2008.

As discussed in the draft decision, the top 10 peak day charge acts as a restraint on injections throughout the whole winter period. This is because users are uncertain within a range of days as to which days the actual peak injection days will be and accordingly are encouraged to manage their demand throughout the winter period. For example in 2007, in accordance with VENCORP data, there were 26 days where injections exceeded 1.1 PJ, almost exclusively on weekdays.³⁵² The top 10 peak days not being known in advance gives users the incentive to modify their behaviour over the whole winter period on any day they consider it is likely to be a top 10 peak day on which the peak charges may arise. The ACCC as discussed in the draft decision considers this pricing structure is the feature which provides incentives for optimal utilisation of pipeline infrastructure. To the extent that users avoid peak times, the pressure on system capacity (and enhancements) is diminished and efficient use of assets is encouraged.

TRUenergy also argues that for retailers with discretionary loads such as Gas Fired Generation (GFG), the alternative for demand side response on peak injection days (as a result of the 10 peak day charge) is equally unlikely to succeed. Whilst, the ACCC notes that a decision to generate by a GFG will be driven by the perceived value of gas against spot prices in the NEM, the ACCC considers this is a commercial decision and if users decide to inject on a peak day when a constraint is most likely to occur, then they should incur the cost of using the pipeline in proportion to their contribution to the cost of congestion. Accordingly, the ACCC notes that if GFG users choose to inject on peak days in response to high electricity prices in the NEM that these users should incur the costs of congestion, otherwise, GPG users may be encouraged to use greater amounts of gas during peak period rather than rely on alternative fuels to generate such as diesel fuel.

³⁵¹ For 2007, Port Campbell and Longford injection peak days for tariffing purposes typically occurred on one of the top 20 yearly system peak demand days; VENCORP, *Email to the AER : 2007 TUoS data*, 14 February 2008.

³⁵² *ibid.* For 2007 injection volumes these days were in the case of all but one weekday.

TRUenergy submits for the wholesale Victorian gas market, GasNet's existing top 10 peak day charge delivers a strong and perverse pricing signal; as prospective injectors are deterred from providing additional gas on days of elevated demand³⁵³. However, TRUenergy does not elaborate on the nature of the precise deterrence caused by this so-called perverse incentive. The ACCC understands that retailers (as injectors) are not prevented from passing the costs of injection tariff charges on to users through tariffs to their customers as they see fit.³⁵⁴ To the extent a participant tends to sell gas on the wholesale market to other parties (net injectors) any perceived increased transmission charge could be reflected in bid step price / quantity combinations. As noted in the draft decision, the ACCC considers users have the discretion whether or not to include the injection tariff in their market bids and of itself this should not be justification to move from a 10 peak day charge. The ACCC can not see how a top ten peak day tariff will lead to the withdrawal of sufficient gas from the market if this is TRUenergy's concern.

The ACCC maintains its view in the draft decision that that all users that use the injection pipelines on the peak days should be required to contribute to the costs of congestion in proportion to their contribution to the maximum capacity demanded from the system.

The ACCC concludes that maintaining a peak injection tariff will provide tariffs that are efficient in level and structure and not distort investment decisions respectively in accordance with ss. 8.1(e) and 8.1(d) of the code. Accordingly, the ACCC proposes not to approve GasNet's proposal to change the charging basis in its peak injection charge from the top 10 peak days to a winter period charge.

Amendment 20

Before the proposed revised access arrangement can be approved, GasNet must amend the proposed revised access arrangement to maintain the current injection tariff structure, where the peak period applies to the top 10 peak days during the winter period, instead of applying the charge over the whole winter period as proposed in cl. 1.2 of schedule 1 of the proposed revised access arrangement.

6.1.4.5. Prudent discounts

(i) *Pakenham*

In accordance with the draft decision, the ACCC requires GasNet to re-calculate the injection tariff based on the top 10 peak days. The ACCC requires GasNet to remove its proposed prudent discount for tariff-D users at Pakenham. However, GasNet may propose a prudent discount based on the top 10 peak days in its further final approval.

³⁵³ TRUenergy, *Submission in Response*, op.cit., p. 4.

³⁵⁴ In the Victorian market retailers typically contract with producers (or have their own gas) which they bid (inject) in to match part or all of their expected customer load.

Amendment 21

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3(g) of schedule 1 of the proposed revised access arrangement to remove the prudent discount for tariff-D users at Pakenham.

(ii) *Warrnambool and Koroit*

GasNet has noted that the application of a postage stamp tariff for tariff-V users at Koroit does not create a bypass concern, although it may for tariff-V users at Warrnambool. Given that the ACCC does not accept GasNet's proposed postage stamp tariff for tariff-V users, GasNet may propose a prudent discount for tariff-V users at Warrnambool and Koroit for the ACCC's consideration in its further final approval.

The ACCC accepts GasNet's proposed prudent discount for tariff-D users in the Warrnambool and Koroit zones for the AA3 period.

(iii) *Latrobe*

GasNet proposes to create a new zone at Maryvale, which will include the lateral to the Maryvale plant. GasNet proposes that this zone should receive a prudent discount equal to the tariff which would have applied under the normal operation of the Latrobe zone price path from 2004, escalated by CPI.

The ACCC has reviewed GasNet's proposal to re-introduce a discounted tariff for the Australian Paper Maryvale Mill in the Latrobe zone. Based on confidential information received from Australian Paper regarding its production processes and energy usage, the ACCC finds that while bypass through the construction of another gas pipeline is uneconomic that there is significant threat of bypass through a change in production processes. Further, based on the confidential information, it is likely that bypass of the PTS could occur if tariffs increase above existing levels. If this were to occur, the Maryvale Paper Mill could operate without an external supply of gas.

GasNet's proposed tariff for the Maryvale plant will recover the full direct capital and operating costs of supplying gas to the Mill plus a proportion of the indirect costs. Since the proposed discounted tariff for the Maryvale Mill will recover a proportion of indirect costs, the Maryvale Mill will contribute to the reduction of indirect costs allocated to all other users of the PTS. Accordingly, the ACCC considers the discount prudent in accordance with s. 8.43 of the code as the retention of the Maryvale Mill as a user results in lower withdrawal tariffs for all other users than if Maryvale Mill were no longer a user.

Accordingly, the ACCC approves GasNet's proposal to introduce the Maryvale zone and apply a discounted tariff to this zone, which is based on the 2004 Latrobe zone price path from 2004 escalated by CPI for the AA3 period.

(iv) *Culcairn export tariff*

GasNet submits that its marginal cost calculation (\$0.498/GJ) establishes the floor for a prudent discount, and the tariff model sets the maximum tariff (\$0.83/GJ) and

submits that the actual tariff should be determined by reference to the cost of supply from GasNet's competitors.³⁵⁵

In response to the draft decision's view on the effect of different options to address the pressure breach at Shepparton, GasNet notes that the (marginal cost) calculation will be affected by changes in volumes along the pipeline, and by the option adopted for the northern zone augmentation and that it will review the marginal cost calculation when these issues are resolved.³⁵⁶

In response to the draft decision query on whether GasNet's proposed discounted tariff satisfied s. 8.43(b) of the code, GasNet submits that its proposed discounted export tariff exceeds the marginal cost of supply and therefore it follows that any export flows must make a contribution to fixed costs, and therefore must benefit existing users and satisfy that section³⁵⁷.

In response to the draft decision request for more information as to evidence of the threat of bypass ((s 8.43(a)) of the code, GasNet submits that:

- it faces strong competition for supply to Sydney from Longford gas transported through the EGP for supply to Sydney
- also faces some competition for supply to country NSW through gas swaps with Moomba gas. That is, Moomba supply to a Sydney customer could be redirected to the country region with a net saving in the MSP tariff, and the Sydney customer would be supplied from the EGP
- the MSP is capable of delivering coal seam methane gas from Queensland through the MSP and the proposed new QSN Link is expected to be completed at the end of 2008.³⁵⁸

GasNet's response concludes that:

Given that the strongest competition is from the EGP at this time, the discounted export tariff should be the EGP tariff less the (regulated) Culcairn to Sydney tariff and the published VENCORP charges. Based on GasNet's estimates it believes the competitive tariff is in the range of \$0.42-\$0.45/GJ. If Moomba was considered as a potential competitor the competitive tariff would be approximately \$0.50/GJ.³⁵⁹

In addition, GasNet provides a confidential attachment to its response which set out Culcairn export tariff comparisons with the EGP, MSP in support of its proposed

³⁵⁵ GasNet, *Submission in Response*, op.cit., pp. 62-63.

³⁵⁶ *ibid.*

³⁵⁷ *Ibid*; GasNet, *Email to the AER*, 26 June 2007. GasNet provided a model demonstrating the incremental cost to be just under \$0.50/GJ accounting for incremental capex and opex costs.

³⁵⁸ *ibid.*

³⁵⁹ *ibid.*

discount.³⁶⁰ That is, the Culcairn withdrawal tariff which GasNet argues is necessary to compete with potential gas delivery via the EGP or MSP.

Subsequent to its response to the draft decision, GasNet has provided further information to the ACCC in relation to the likely location of export markets and AMDQ arrangements entered into:

- in addition to its estimates of a competitive tariff required to deliver to Sydney, it provided additional estimates of a competitive tariff required to deliver to markets at Wagga Wagga and Canberra³⁶¹
- evidence of commercially confidential contracts it has entered into with parties for the access period allocating 16 TJ/d of the existing 17 TJ/d of authorised MDQ it holds at the Interconnect.³⁶²
- a review of the marginal cost calculations, the need for the Euroa CS in a no export scenario and the marginal cost tariff³⁶³
- an estimate of a “fully allocated export” tariff using the general cost allocation methodology.³⁶⁴

Considerations on proposed Marginal Cost Tariff— For the calculation of the marginal cost tariff, the ACCC considers the \$0.498/GJ is likely to under-represent the costs, having reviewed the model GasNet provided prior to the draft decision:

- VENCORP has advised that in the absence of exports on peak days, upon the completion of the Wollert CS upgrade no further expansions would be required on the PTS to maintain pressures in the Northern Zone during the AA3 period.³⁶⁵ VENCORP planning reports are indicative that no further augmentation beyond the Wollert CS would be needed beyond the AA3 period.³⁶⁶ This suggests that the estimated costs GasNet has included in its model calculating the marginal cost tariff under-represent the extra costs attributable to delivering exports of 17 TJ/d as it assumes the Euroa CS will be only be delayed by one year if there were no exports.

³⁶⁰ Ibid. GasNet, *Email to the AER*, 29 February 2008 Some key assumption underpinning GasNet’s forecast required Culcairn withdrawal tariff are (1) advice it has received of an approximate 75 cent tariff previously available on the EGP and (2) that for MSP scenario delivery comparisons, equivalent ex basin charges from Moomba (to Victorian gas supply) should be assumed.

³⁶¹ GasNet, *Email to the AER*, 1 February 2008

³⁶² *ibid.*; GasNet, *Email to the AER*, 29 February 2008.

³⁶³ GasNet, *Email to the AER*, 19 March 2008, *Email to the AER*, 20 March 2008

³⁶⁴ GasNet, *Email to the AER*, 28 March 2008

³⁶⁵ ACCC, *Conversation with VENCORP staff*, 20 March 2008

³⁶⁶ VENCORP, *email to the AER enclosing April 2007 Network Planning Report*, 8 June 2007.

- For example, if a Euroa CS was required only after another 10 years (i.e. to 2019) to maintain pressures in the Northern zone, then the marginal cost tariff of building it now to facilitate exports would lead to the export marginal cost tariff rising to around \$0.65/GJ.³⁶⁷

Considerations on proposed fully allocated tariff — GasNet provided the ACCC on March 28 2008 with its best estimate of a fully allocated tariff of \$0.83/Gj.³⁶⁸ The ACCC considers this tariff may be higher than it otherwise needs to be because with its submission:³⁶⁹:

- GasNet did not include volume forecasts which reflect the take or pay arrangements it has entered into (i.e. 16 TJ/d) at a 100 per cent load factor, in contrast to its considerations in relation to the marginal cost tariff that on the basis of take or pay contracts forecasts should be increased to 5.85 PJ per year.³⁷⁰
- Additional volumes above take or pay arrangements have not been factored in. That is, GasNet appears not to have accounted for possible volumes on days when more than 17 TJ/d of exports are possible. (the ACCC notes that there were 52 such days last year where exports were greater than 17TJ/d, including towards the end of the year)³⁷¹

Considerations on proposed prudent discount - The ACCC's consideration of the existence of competitive tariffs on other networks and bypass risk are discussed below in the context of GasNet's proposed \$0.50/GJ export tariff being marginally higher than its argued marginal cost tariff (\$0.498/Gj).³⁷²

The ACCC has considered all of the information which GasNet has provided. The ACCC has reviewed authorised MDQ contractual arrangements pertaining to

³⁶⁷ This figure would fall to around \$0.55/GJ, if 5.85 PJ per year (16 TJ/d) of volumes were assumed reflective of AMDQ contracts entered into. Currently the calculation is done on the basis of 5PJ a year.

³⁶⁸ Previous GasNet models received indicate that there is only a marginal, insignificant difference between a tariff calculated using either of the AA2 zone gate or AA3 proposed volume distance cost allocation approach. GasNet, Models accompany submission, dated 14 March 2008

³⁶⁹ GasNet has provided models to the ACCC with its proposed Access Arrangement which indicate that the calculation of the Export tariff on a fully allocated approach will lead to an almost equivalent result whether a zone gate or a volume-distance approach is taken.

³⁷⁰ Although GasNet has entered into take or pay contracts for 16TJ/d commencing in 2008 it has included volume forecasts below the volumes implied by such take or pay terms, particularly for 2008/09. See also, Volume chapter, chapter 5.4.4.

³⁷¹ GasNet, *Email to the AER*, 29 February 2008; VENCORP, *Email to the ACCC enclosing 2007 withdrawal volumes by TUoS zones*, 14 February 2008. Over 2007 there were few instances of imports into the PTS which prevented the physical flow of export gas. The ACCC understands the expectation going forward is that predominantly gas will be withdrawn from the PTS. VENCORP, *email to the AER enclosing April 2007 Network Planning Report*, 8 June 2007.

³⁷² GasNet, *Email to the AER*, 29 February 2008.

volumes through the Interconnect which attract the export tariff.³⁷³ In relation to available tariffs on the EGP, the ACCC has given published, verifiable information more weight.

GasNet has noted it does not have market knowledge on likely prices of gas entering the MSP through the Cooper Basin (in comparison to Gippsland Basin gas prices) or as to the likely commercial market of its retailer customer in NSW. The ACCC has considered available evidence.

For two reasons the ACCC is of the opinion that no case for a prudent discount exists having considered s. 8.43 (a) of the code:

The nature of the market in which a User or Prospective User of a Reference Service or some other Service operates, or the price of alternative fuels available to such a User or Prospective User, is such that the Service, if priced at the nearest Reference Tariff (or, if the Service is not a Reference Service, at the Equivalent Tariff) would not be used by that User or Prospective User [emphasis added]

First, in effect, GasNet has captured a market to the extent of its volume forecasts, whereby users have agreed to pay for volumes on take or pay terms at the reference tariff (that is, regardless of whether the reference tariff is discounted or not). Second, in addition, the evidence available indicates that the likely volumes which GasNet has forecast could all be met in a market centred on Uranquinty Power Station and nearby towns including Wagga Wagga for which no other network by-pass risk has been demonstrated.

(i) Terms of AMDQ contracts

In accordance with Authorised MDQ contracts, as GasNet has noted, users are now bound to pay whatever reference tariff the ACCC approves.³⁷⁴ GasNet claims however the consideration of a prudent discount formed part of the commercial negotiation and it remains appropriate to offer a prudent discount. However, noting s. 8.43 (a) of the code, the ACCC considers this to be a case where in accordance with commercial agreements services will be taken up by users, (i.e. authorised MDQ holders), regardless of the offer of a prudent discount. This is because take or pay contracts have been agreed to for the AA period at the reference tariff. In these circumstances s. 8.43(a) precludes a prudent discount being granted because whether the tariff is the marginal cost tariff or a fully allocated tariff, flows are likely to occur in accordance with take or pay arrangements.

(ii) By-pass risk from Competitive tariffs through other networks

The ACCC does not consider GasNet has provided evidence that volumes forecast would be by-passed even if a fully allocated tariff is \$0.83/GJ. The withdrawal tariff argued to be required to compete with the cost of delivery on other networks varies considerably depending on different delivery locations (markets) in NSW/ACT to Sydney, Canberra (less pipeline kilometres via the EGP) and Wagga Wagga (less

³⁷³ *ibid.*

³⁷⁴ *ibid.*

pipeline kilometres via the PTS).³⁷⁵ Section 8.43(a) of the code refers to the nature of the market in which users operate. The ACCC notes that this likely market is shaped by GasNet's volume forecasts. For the AA3 period:

- GasNet has based its volume forecast on a proportion of flows occurring in accordance with 16 TJ/d of Authorised MDQ take or pay contract arrangements. That is usage by users who hold these contracts.³⁷⁶
- GasNet proposes, based on these contracts, the most likely customers for the export volumes are the proposed Uranquinty power station, near Wagga Wagga, and other end users in country NSW through a retailer.³⁷⁷

The ACCC considers there is sufficient likely load around the Wagga Wagga region including at the proposed Uranquinty Power Station located nearby to take up gas volumes in excess of the 5 PJ forecast in GasNet's proposed AA and the 6.25 PJ/year implied by full utilisation of Authorised MDQ contractual rights.³⁷⁸

On the basis of published EGP tariffs, GasNet's submission does not clearly support the need for a discount in order for it to retain a competitive advantage over the EGP to service Wagga Wagga based on its assumed load factors on other pipelines.³⁷⁹

GasNet has also proposed that the ACCC consider by-pass risk from the MSP pipeline. GasNet's 'competitive tariff' against MSP delivery to Wagga Wagga assumes equal "ex-basin" prices.³⁸⁰ GasNet has not factored in ex-basin prices

³⁷⁵ Withdrawal tariffs required to service the Canberra and Sydney markets are confidential.

³⁷⁶ *ibid.*

³⁷⁷ *ibid*; GasNet, *Submission*, p. 102, models provided with Submission.

³⁷⁸ Evidence of gas demand (around Wagga Wagga): (1) *Wagga Wagga Access Arrangement Information*, 1 January 2006; (2) Submission to the Independent Price and Regulatory Tribunal : Justification Statement : Regulated Retail Gas Price Proposal 1 January 2005 available at < <http://www.countryenergy.com.au> > viewed on 5 March 2008. Uranquinty Power Station demand: (1) GasNet, *Models provided to the ACCC with its Submission: Forecast Tables.xls* April 2007; (2) VENCORP, *Email to the ACCC gas power generation gas usage data 2001-2007*, 27 June 2007. GasNet has included an increase of 2.5 PJ of load in its withdrawal volume forecasts at Culcairn consequent on the Uranquinty Power Station being commissioned. The ACCC notes that the size of the Uranquinty Power Station implies that it could consume much more than 2.5PJ year of gas comparing it to the usage of Newport Power Station (500MW) on the PTS over 2001-2006 averaging 7PJ.

³⁷⁹ GasNet's methodology to calculate a required Culcairn tariff to compete with the EGP leads to price competition comparisons which are confidential. Published information on tariffs on the EGP, Reference Tariffs, Evidence of contracts including contracts over AA3 < <http://www.alinta.net.au/operations/transmission/egp/assetDetails/transServices/default.aspx> ; <http://www.alinta.net.au/operations/transmission/egp/assetDetails/currentTariffs/downloads/080303EGPTariffs.pdf> > viewed on 5 March 2008. Additionally on this website, very high average tender prices for small quantities for 1 January – 30 April and 1 May – 15 August appear of \$1.54/GJ and \$7.35/GJ.

³⁸⁰ GasNet, *Submission in Response: confidential attachment 6*, op.cit., GasNet, *Email to the AER*, 29 February 2008.

between gas coming from Moomba and gas from the Victoria. Some available evidence suggests however that Moomba gas prices are typically higher in comparison to gas prices available from the Victorian spot market or through long term contracts with Victorian producers.³⁸¹ Additionally, the ACCC is aware that recently ActewAGL and AGL have applied to the NSW regulator for “special circumstance” increases of regulated prices of more than CPI. The reasons stated for the need for such price increases are:

- The need to establish alternative supply arrangements with Cooper basin producers as a result of loss of transportation capacity on the EGP (i.e. to deliver gas from Victoria) and
- changes in MSP contractual arrangements in 2007 that have led to increased costs.³⁸²

The magnitude of the proposed required increases suggests that Cooper Basin gas delivery may presently not be as competitive as delivery via the EGP (of Victorian gas).

Volumes above forecast

GasNet has noted that there is potential for flows in excess of volume forecasts because flows above authorised MDQ levels of 17 TJ/d can occur on certain days of the year. GasNet states that it has not included such forecasts but that additional flows are possible and a prudent discount is required for those possible flows to eventuate.³⁸³ The ACCC has considered above that potential load around Wagga Wagga exceeds presently forecasted volumes and that flows to Wagga Wagga have not been shown to require a prudent discount.

Summary

The ACCC considers that in the context of GasNet’s Culcairn export volume forecasts because firstly, the terms of the take or pay contracts entered into and secondly, the nature of the potential market near Wagga Wagga for which delivery over the PTS is shorter in comparison to other pipelines that no prudent discount has been justified.

³⁸¹ Victorian spot market prices, Cooper basin producer prices: Energy Quest, *Energy Quarterly Reports* 2006 -2008;

Indicative long term contract prices in Victoria: McLennan Magassanik Associates, *Report to Gas Market Leaders Group and MCE standing committee of officials : Gas Market Options cost benefit analysis* pp. 53,54

<http://www.mce.gov.au/assets/documents/mceinternet/GasMarketOptionsCBAFinalReport20060626121510%2Epdf> viewed 17 March 2008.

³⁸² Actew AGL, *Letter to the Independent Pricing and Regulatory Tribunal*, 21 February 2008; AGL, *Letter to the Independent Pricing and Regulatory Tribunal*, 31 January 2008 see <http://www.ipart.nsw.gov.au> viewed 17 March 2008.

³⁸³ GasNet, *Email to the AER*, 29 February 2008

Accordingly, the ACCC requires the revised AA to be amended.

Amendment 22

Before the proposed revised access arrangement can be approved, GasNet must amend the proposed revised access arrangement to remove the prudent discount from its export tariff (as proposed in section 11.6.2 of the revised access arrangement submission).

Further, given the nature of the AMDQ contracts GasNet has entered into since lodging its proposed AA and its comments on likely flows as a result of these contracts the ACCC considers in chapter 5.4.4 that GasNet must re-forecast its export volumes. An increase in forecast volumes would have a downwards impact on the tariff.

6.1.4.6. Matched rebates

In the draft decision the ACCC concluded that as it proposed to not approve the postage stamp tariff for tariff-V users, GasNet's reasons for removing the matched rebates to tariff-V users no longer apply. The ACCC considers that matched rebates continue to be consistent with the code requirements that tariffs be cost reflective to the maximum extent that is commercially and technically reasonable. Accordingly, the ACCC considers that matched rebates be maintained for tariff-V users for the AA3 period as this is consistent with ss. 8.38 and 8.42 of the code.

Amendment 23

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3(b) of schedule 1 of the proposed revised access arrangement to include matched rebates for tariff-V users in the North Hume, Murray Valley, Interconnect and Wodonga withdrawal zones for gas injected at Culcairn.

6.1.4.7. Cross-system withdrawal tariff

In its draft decision, the ACCC noted that the cross system tariff recognises the additional cost of carriage across the system for where a zone is not supplied from the nearest injection point. Accordingly, the ACCC considered it appropriate for GasNet to apply an additional levy recognising the additional cost of transportation. Since the ACCC does not approve GasNet's proposed cost allocation methodology, the level of the cross system tariff is likely to change. The ACCC requires GasNet to recalculate the cross system tariff in accordance with its existing cost allocation methodology.

Amendment 24

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3(e) of schedule 1 of the proposed revised access arrangement so that the cross system tariff is calculated consistent with the AA2 cost allocation methodology.

6.1.4.8. Storage refill tariffs

In its draft decision, the ACCC concluded that the information provided by GasNet justified an increase in the storage refill tariffs to \$0.20/GJ for underground storage at Port Campbell and of \$0.15/GJ for the LNG storage facility. The ACCC maintains that GasNet's proposed refill tariffs will provide sufficient opportunity to recover the costs of this service in accordance with s. 8.1(a) of the code.

6.1.4.9. Introduction of Geelong withdrawal zone

In its draft decision, the ACCC considered GasNet's proposal to introduce a new Geelong withdrawal zone consistent with s. 8.42 of the code. However, given the ACCC's requirement that GasNet calculate specific direct cost unit rates to allocate direct costs, the ACCC considered it more appropriate to allocate costs to the Geelong withdrawal zone based on specific direct cost unit rates. Further given the ACCC's requirement that GasNet retain zonal tariffs for tariff-V users, the ACCC requires GasNet calculates a Geelong zonal withdrawal tariff for tariff-V users.

Amendment 25

Before the proposed revised access arrangement can be approved GasNet must:

- Allocate direct costs to the Geelong withdrawal zone based on specific direct cost unit rates and
 - Calculate a Geelong zonal withdrawal tariff for tariff-V users.
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6.1.4.10. Under-recovery of approved revenue and adjustment to 2008 tariffs

As the ACCC's further final approval of GasNet's revised AA will be made in finalised in May 2008, GasNet has continued to charge its approved transmission tariffs for 2007. GasNet's revised AA, however, will apply from the 1 January 2008 to 31 December 2012. Accordingly, adjustments will need to be made to the 2008 approved tariffs to ensure that the total target revenue is recovered for 2008 as the 2007 tariffs are lower than those expected to be approved for 2008. GasNet has submitted three possible options to recover this shortfall in approved revenue. These include:

- spread recovery of revenue shortfall over whole of AA period or
- spread recovery of revenue shortfall over remainder of 2008 or
- process a wash-up for months already charged at lower rate.

GasNet submits that the first two options require adjustments to the approved 2008 tariffs. The first option would result in all tariffs for the remainder of the AA period being above those approved but there would be no adjustment required for the

annual tariff transition from 2008 to 2009 tariffs. Under the second option tariffs would return to the approved levels for 2009 but this would require a further adjustment for the annual transition from 2008 to 2009 tariffs.

GasNet submits that under the third option tariffs for those months of 2008 that had already been invoiced at the 2007 rates would be adjusted up to the approved 2008 tariff rates and an invoice for the difference in charges would be issued. This option would mean that no adjustment to the methodology for transition from 2008 to 2009 tariffs is required.

GasNet submits that it considers the third option is preferred. GasNet considers that since the months that will have been invoiced at the 2007 tariff rates prior to the Final Approval of the new tariffs are likely to be only the non-winter months of January, February and March, the total adjustment to customers invoices is likely to be reasonably small.

Under the third option GasNet proposes to calculate the withdrawal wash-up by calculating the difference between each relevant month based on the 2007 and 2008 tariffs. GasNet advises that the difference between the output of these calculations will be calculated using the same methodology as is used to generate the invoices resulting from the Month+118 day adjustment that VENCORP routinely provides. The total adjustment for each Market Participant will be invoiced and each Market Participant will be provided with backup information showing the adjustments by month and TUoS Withdrawal Zone.

GasNet submits that for injection tariffs GasNet currently invoices Market Participants for Injection Charges on a forecast basis for the first 10 months of the regulatory year. The forecast charges currently being invoiced are those used in 2007 (without any adjustments). GasNet proposes to develop a forecast for 2008 based on the approved tariffs and injection volume forecasts and will invoice the difference between what Market Participants have paid for the relevant months and what is expected to be paid based on the new forecast. GasNet advises that it will provide a detailed reconciliation between the charges previously invoiced and the new charges by Injection Zone.

GasNet comments that it has a degree of freedom allowed under the AA in the method of charging for Injection charges, subject to agreement with individual Market Participants, and would be prepared to exercise this freedom to fit in with the needs of Market Participants. Thus, if the Commission approves the continuation of the top 10 winter peak day charging basis to injection tariffs, GasNet could incorporate all of the adjustment in the normal annual wash-up in November and December.

The ACCC considers GasNet's proposed recovery of revenue under its third option resulting from the difference between the approved 2007 and 2008 tariffs is appropriate and given that any wash-up applies to the non-winter months such that any tariff increases should not be moderate. Accordingly, the ACCC approves GasNet's proposed 'wash up' for the months already charged at the 2007 tariffs.

6.2. Reference tariff path

6.2.1. Introduction

Section 8.3 of the code provides discretion to service providers in how the reference tariffs may be varied within an AA period. This allows the service provider to select from four different approaches, or choose from any combination or variation of these approaches. For the AA3 period, GasNet proposed to apply a combination of a reference tariff control formula approach and trigger event approach to varying its reference tariffs. This differs from GasNet's current approach for varying reference tariffs, which is best described as a combination of both a price path and a cost of service approach.

Under GasNet's proposed control for AA3 GasNet may earn revenue (adjusted target revenue) over the five year period based on:

- a pre-determined average yield/GJ for each year of the period (based on target revenue and target volumes) and
- a total volume (the adjusted achieved volume) which is a volume determined by removing the impact of cold weather from actual outcomes, but bounded within 5.5 per cent above or below the pre-determined (weather normalised) target volume.

The target revenue is adjusted each year of the period (adjusted target revenue) to reflect the adjusted achieved volume.

In addition to the revenue control GasNet proposed to apply a $(CPI - X)$ constraint of either zero or -2.8 per cent for each tariff (as per schedule 1 of GasNet's proposed AA). GasNet also proposed a re-balancing control of $(1+Y)$ on each component of its transmission tariffs, where Y is set at 2 per cent. Accordingly, under GasNet's proposal no component of the transmission tariffs can be increased by more than $(CPI-X)(1+Y)$. GasNet proposed that zero X factors to apply to the following tariffs:

- withdrawal tariff-D at Warrnambool, Koroit and Culcairn
- system export tariff at SEA Gas pipeline
- withdrawal for storage at LNG and WUGS and
- matched withdrawal tariff-D at Metro southeast.

For the AA3 period, GasNet proposed an average tariff of \$0.401/GJ in 2008. This is an increase of 36 per cent when compared to the 2007 average tariff of \$0.294/GJ.

In its draft decision, the ACCC noted that the increase in GasNet's proposed average tariff for 2008 compared to 2007 is the result of:

- the proposed increase in capex and opex for the AA3 period
- the proposed lower forecast volumes over the AA3 period compared to the AA2 period

- an actual average tariff in 2007, which is lower than the initial approved ACCC forecast average tariff for 2007 as forecast at the commencement of AA2 in 2003.

Based on the ACCC's proposed amendments to GasNet's revenue requirement and volumes in its draft decision, the ACCC estimated that the average tariff for 2008 would be \$0.3426/GJ. This amounts to a 16 per cent increase in the average 2008 tariff, instead of a 36 per cent average tariff proposed by GasNet, if an X factor of -2.8 per cent is adopted.

In its draft decision, the ACCC estimated that in the event that GasNet is able to demonstrate capex for all of the Northern zone, the Warragul loop and the Pakenham loop is reasonably expected to satisfy the requirements of the code, the difference between the actual average tariff in 2007 and 2008 would increase from 16 per cent to 21 per cent (assuming an X factor of -2.8 per cent).

In its draft decision, the ACCC considered an X factor of -2.8 per cent appropriate as it would effectively manage the transition between the AA2 and AA3 periods as well as between the AA3 and AA4 periods. Given the uncertainties surrounding expenditures and volumes for the AA4 period, the ACCC considered it more appropriate to minimise tariff shock between the AA2 and AA3 periods and to apply an increasing price path over the period. The ACCC considered that this would minimise price shock to users, whilst still allowing GasNet to recover its revenue. The ACCC concluded in its draft decision that GasNet's proposed X factor of -2.8 per cent for the majority of tariffs provides a reasonable balance between the interests of users and prospective users and GasNet's legitimate business interests.

6.2.2. Response to draft decision

Origin Energy states that after the ACCC highlighted GasNet's proposed revenue control mechanism that it is comfortable that GasNet will have the capability to avoid price shocks that would otherwise have emerged between the AA3 and AA4 periods.³⁸⁴

6.2.3. Conclusion

The ACCC received no submissions regarding the proposed X factor of -2.8 per cent. As per the draft decision, the ACCC concludes for this final decision that an X factor of -2.8 per cent is appropriate. This will result in a lower step change between 2007 and 2008 than an X factor of zero; it will also more effectively manage the transition between AA3 and AA4.

In this final decision, the ACCC has calculated an average tariff for 2008, based on an X factor of -2.8 per cent, of \$0.446/GJ. The increase in the ACCC calculated average tariff for the final decision compared to the draft decision is a result of the following factors:

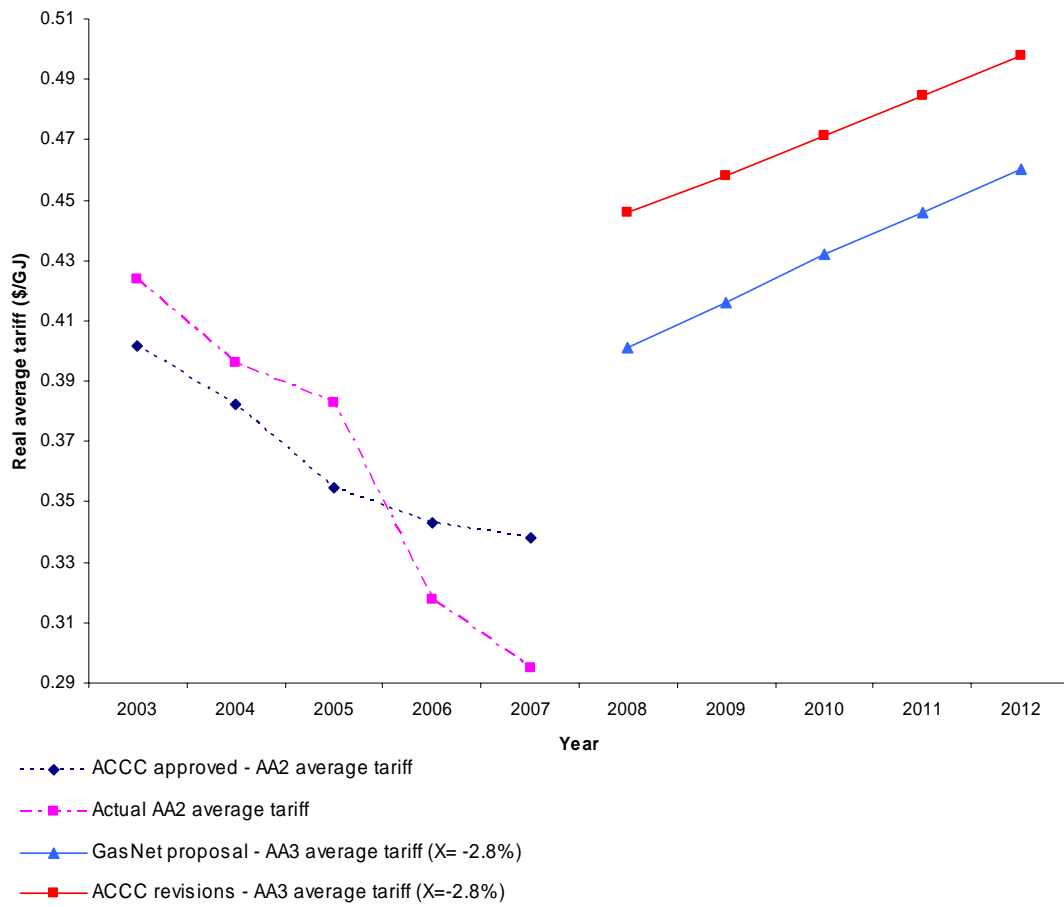
³⁸⁴ Origin Energy, *Submission in Response*, 13 December 2007, p. 3.

- approval of additional capex based on further information received from GasNet. This includes the approval of GasNet's proposed Northern zone capex necessary to address the anticipated breach of the minimum system pressure requirements and restore their export capacity through the Interconnect
- an increase in the risk free rate as driven by the large increase in the debt premium from the proposed 114bps to 299bps and
- a reduction in the forecast volumes between the draft decision and the final decision to reflect updated VENCORP forecast as per their Annual Planning Report.

Figure 6.2.1 sets out the average tariff movement for the AA3 period based on this final decision, adopting an X-factor of -2.8. In order to compare the estimated average tariff movement between the AA2 and AA3 periods, this figure also shows the movement in GasNet's actual average tariff over the AA2 period and the ACCC approved initial AA2 forecast average tariff movement at the commencement of the AA2 period. This initial ACCC approved forecast average tariff shows the expected movement in tariffs during the AA2 period in the absence of volume forecast error (k factor adjustment) if the tariff path had been followed. That is, in 2003 users would have expected an average tariff of around \$0.3379/GJ for 2007 and not the actual tariff of \$0.2947/GJ.

The ACCC maintains the draft decision to accept GasNet's proposed tariff movement over the AA3 period. In particular as discussed in the draft decision, the ACCC considers that given uncertainty regarding GasNet's expenditures for the AA4 period and in order to minimise tariff shock between the AA2 and AA3 periods, GasNet's proposed X factor of -2.8 per cent provides a reasonable balance between the interests of users and prospective users and GasNet's legitimate business interests.

Figure 6.2.1: Tariff path



6.3. Reference tariff variation policy

6.3.1. Introduction

Section 8.3 of the code provides discretion to service providers' in how the reference tariffs may be varied during an AA period to recover revenue. This discretion is subject to s. 8.3A of the code (reference tariff variation method) and the relevant regulator being satisfied that the proposed methodology is consistent with the objectives of s. 8.1 of the code.

In accordance with s. 8.3 of the code, the tariff variation methods available to the service provider include:

- cost of service
- price path
- reference tariff control formula approach
- trigger event adjustment approach and
- any variation or combination of these.

Section 8.3A of the code states that if a reference tariff varies within an AA period, then it must do so in accordance with the requirements and procedures set out in ss. 8.3B–8.3H of the code. Under these sections of the code, the service provider is required to provide information to the relevant regulator (for the purposes of assessment) upon the occurrence of a specified event or when it otherwise intends to vary a tariff in accordance with an approved reference tariff variation method. The relevant regulator's power to allow, or disallow a variation and specify a variation which is consistent with the reference tariff variation method are set out, as is the relevant regulator's requirement to publish reasons. The code allows the relevant regulator to specify its own variations, if a specified event occurs and the service provider does not serve a notice.

GasNet's proposed AA contains a reference tariff variation policy comprising a price control formula incorporating a pass through event allowance as well as a procedure for the timing of when variations are to routinely be applied for.³⁸⁵

6.3.1.1. Price control formula (incorporating pass through event allowance)

The key similarities and differences between the AA2 price control formula and AA3 proposed price control formula are summarised below.

Similarities:

GasNet has retained an average revenue yield form of control based on forecast annual withdrawal volumes, that:

³⁸⁵ Price control formula (including pass through events) as set out in clause 6, schedule 4 of the Access Arrangement; Procedure for tariff variations as set out in schedule 3 of the Access Arrangement.

- As for AA2, consistent with an average revenue yield allowance approach, allows for over/under recoveries against allowed revenue (based on the allowed revenue yield) to be repaid/recovered through annual tariff adjustments smoothed over the remainder of the AA period.
- Subject to the exception mentioned under differences below, incorporates a side constraint (Y must be less than 2 per cent) on individual tariff movements within the AA period so that individual tariffs cannot move by more than CPI-X+2 from one regulatory year to the next.
- Incorporates a pass through event component which can be negative or positive.

Differences:

- Instead of the un-capped exposure to total annual volume outcomes different to forecast which AA2 incorporated, for AA3 the risk/reward for volume outcomes is capped at plus/minus 5.5 per cent. Hence total revenue for GasNet, for the AA3 period is bounded at the allowed revenue per GJ in this decision plus/minus 5.5 per cent over the period³⁸⁶
- GasNet has incorporated a cold weather/EDD normalisation formula to make GasNet revenue neutral to variances between forecast and actual EDD and as part of this formula, allowance is made for the correlation of fuel gas costs to EDD outcomes
- For the AA3 period, the individual tariff control (Y) is proposed to be relaxed where evidence of actual and forecast parameters submitted as part of an annual notice show that a “Y of 2%” across the remainder of the period would still result in GasNet under recovering against allowed revenue. In the case of this change no supporting submission was received
- Inclusion of the Murray Valley tariff and storage refill tariffs within the general price control formula which were both excluded from the price control formula in AA2. In the case of these changes no supporting submission was received³⁸⁷

6.3.1.2. Procedure for applying tariff variations

GasNet’s proposed AA, under schedule 3 contains a procedure for tariff variations to be submitted to the regulator.³⁸⁸ The key similarities and differences between the AA2 proposed procedure and the AA3 proposed procedure are summarised below.

Similarities:

- An end of year adjustment approach through the period is retained

³⁸⁶ In addition, pass through events which occur intra-period may influence total revenue/payments.

³⁸⁷ ACCC, *Draft Decision : Revised Access Arrangement by GasNet Australia Ltd for the Principal Transmission System*, 14 November 2007, op.cit., pp. 206-211.

³⁸⁸ This incorporates a pass through statement mechanism approach under section 6 of the Access Arrangement.

- An approach to providing a submission of the pass through statement in advance of a submission of tariff variations encompassing other outcomes against forecast (volumes, EDD, inflation, pass throughs).

Differences:

- The pass through amounts are required to be approved before a notice including tariff variations is submitted, whereas, for AA2 the timing for approval of the tariff variation coincided with the timing for approval of the pass through amount.
- Includes new provisions to set a framework for GasNet to be able to specify a ‘start date’ for tariffs to apply should it submit an un-scheduled revision.³⁸⁹

Submissions received prior to the draft decision considered that the nature of changes to GasNet’s price control formula should result in an adjustment to the WACC. TRUenergy and AGL specifically noted that the new price control formula reduced GasNet’s revenue volatility to weather outcomes.³⁹⁰ No other submissions on the price control formula or tariff variation procedures were received.

Whilst the ACCC approved GasNet’s proposed AA price control formula incorporating the bounding of revenue risk and weather normalisation to EDD outcomes, various amendments were proposed to the inputs into the price control formula in the draft decision. These proposed amendments included that:

- AMDQ revenue should be accounted within GasNet’s regulated revenue stream (chapter 5.5 of the draft decision)
- fuel gas should be treated as a pass through (chapter 5.1 of the draft decision)
- Murray Valley volumes should be treated outside the price control formula (chapter 6.1 of the draft decision)
- storage refill volumes should be treated outside the price control formula (chapter 5.4 of the draft decision)
- the price control formula should be adjusted to account for the possibility that further expansions above 17TJ/d at Culcairn may either be covered or non-covered (chapter 8.5 of the draft decision)
- incorrect temperature sensitivities should be replaced³⁹¹ and
- within the CPI-X+Y price control, Y should be capped at 2 per cent over the entirety of the AA period.³⁹²

³⁸⁹ ACCC, *Draft Decision*, op. cit., pp.211-212.

³⁹⁰ TRUenergy, *Submission to the Issues Paper*, op. cit., p. 9; AGL, op. cit., p. 2. Submissions relating to the WACC are considered in chapter 4 of the draft decision.

³⁹¹ ACCC, *Draft Decision*, op. cit., pp. 217-218.

³⁹² *ibid.*,pp. 218-221.

GasNet had confirmed that it had included incorrect temperature sensitivities in its Access Arrangement information, which it would replace.³⁹³

The ACCC in the draft decision considered that on balance there was a stronger case, having considered the requirements of the code in terms of the interests of users, prospective users and GasNet, for GasNet to be precluded from imposing a Y of greater than 2 per cent on any individual tariff over the AA period.³⁹⁴

The ACCC also considered in the draft decision that a number of aspects of the procedure for applying to vary reference tariffs intra-period did not meet with s. 8.3B-H of the code. The ACCC indicated that GasNet's process for intra-period variations was not code compliant, setting out the reasons why, as well as indicating that the timeframes suggested for submission/consideration of proposals to the ACCC was insufficient. The ACCC undertook to discuss changes to achieve code compliance prior to the final decision.³⁹⁵

6.3.2. Proposed amendments

The proposed amendments 23, 24, 25, 26, 27 and 28 (reproduced below) expressed the ACCC's draft decision noted above.

Proposed amendment 23

Before the proposed revised access arrangement can be approved, GasNet must insert the following directly below the heading 'AR' in schedule 4.2 of the proposed revised access arrangement:

'For the avoidance of doubt, actual revenue includes revenue derived from authorised maximum daily quantity/credit certificates as allocated under the Market and System Operations Rules.'

Proposed amendment 24

Before the proposed revised access arrangement can be approved, GasNet must amend the formula in schedule 4.6 of the proposed revised access arrangement to read:

$WAAV = actual\ VW + TS \times (target\ EDD - actual\ EDD)$

³⁹³ GasNet, *Email to the AER*, 25 June 2007.

³⁹⁴ *ibid.*

³⁹⁵ ACCC, *Draft Decision*, *op.cit.*, pp. 222-225.

Proposed amendment 25

Before the proposed revised access arrangement can be approved, GasNet must amend the definition of VW in schedule 4.6 of the proposed revised access arrangement to read:

‘VW is the actual volume withdrawn from the PTS excluding:

- any volume withdrawn from a non-covered expansion of withdrawal capacity at Culcairn
 - any transmission refills at the Western Underground Storage or Liquefied Natural Gas facility at Dandenong and
 - forecast volumes for the incremental Murray Valley tariff.’
-

Proposed amendment 26

Before the proposed revised access arrangement can be approved, GasNet must amend the definition of VATR in schedule 4.4 of the proposed revised access arrangement to remove from TR and TV as defined therein revenues and volumes associated with:

- any transmission refills at the Western Underground Storage or Liquefied Natural Gas facility at Dandenong and
 - the incremental Murray Valley tariff.
-

Proposed amendment 27

Before the proposed revised access arrangement can be approved, GasNet must amend Table 7-1 in cl. 7.1 of its revised access arrangement information to include the temperature sensitivities used by VENCORP for its annual demand forecasts in its 2006 Gas Annual Planning Report.

Proposed amendment 28

Before the proposed revised access arrangement can be approved, GasNet must amend schedule 4.1(a)(ii)(B) of the proposed revised access arrangement and remove all the words which follow ‘Y is 2%’.

6.3.3. Response to the draft decision

GasNet’s response to the ACCC draft decision and submissions on the treatment of AMDQ revenue within the price control formula are discussed in chapter 5.5.1 of this final decision. GasNet’s response to the ACCC draft decision and submissions on whether Murray tariff volumes should be included in the price control formula are discussed in Chapter 6.1 of this final decision. GasNet’s response to the draft decision and submissions in relation to the proposed expansions policy for the AA3 period in relation to expansions at Culcairn are discussed in chapter 8.5 of this final decision. GasNet’s response to the draft decision and submissions on the treatment of fuel gas as a pass-through are discussed in chapter 5.2 of this final decision. No submissions were received in response to the draft decision as to the treatment of

storage refill volumes as discussed in chapter 5.4 of this final decision. Also, GasNet has not commented on the draft decision's proposed amendment to the treatment of Y in its CPI-X+Y price path. Prior to the draft decision, GasNet recognised that the EDD sensitivities included in its AAI are incorrect.³⁹⁶

No submissions were received on the draft decision in regard to the price control formula / procedure for applying for tariff variations by parties other than GasNet.

6.3.4. Conclusions

6.3.4.1. Price control formula (incorporating pass through event allowance)

As discussed in other parts of this final decision (see above), the draft decision proposed amendments 24 (removal of fuel gas from the WAAV calculation in the price control formula), 25 and 26 (removal of Murray Valley / storage refill volumes from the price control formula but the inclusion of possible Culcairn export volumes) will be required for this final decision. Proposed amendment 23 (dealing with the inclusion of AMDQ revenue) will no longer be required.

In the draft decision, an amendment was proposed having considered the code, the interests of users, prospective users and GasNet to preclude GasNet from exceeding, within CPI-X+Y tariff adjustments, a Y greater than 2 per cent on any individual tariff over the AA period. GasNet has not provided any submissions supporting its proposed relaxation of the 'individual tariff control' or responded to the ACCC's reasons for requiring an amendment. Accordingly, this final decision requires that GasNet amend its revised AA.

Also, as proposed for the draft decision, correcting the error in relation to TJ/EDD sensitivities in the price control formula requires as an amendment for this final decision. GasNet has acknowledged the existing figures in its proposed AAI are incorrect.³⁹⁷

GasNet is required to amend its AA and AAI as follows to incorporate the amendments discussed above.

Amendment 26

Before the proposed revised access arrangement can be approved, GasNet must amend the formula in schedule 4.6 of the proposed revised access arrangement to read:

$$\text{'WAAV} = \text{VW} + \text{TS} \times (\text{target EDD} - \text{actual EDD})\text{'}$$

³⁹⁶ GasNet, *Email to the ACCC*, 25 June 2007.

³⁹⁷ GasNet, *Email to the ACCC*, 25 June 2007.

Amendment 27

Before the proposed revised access arrangement can be approved, GasNet must amend the definition of VW in schedule 4.6 of the proposed revised access arrangement to read:

‘VW is the actual volume withdrawn from the PTS excluding:

- any volume withdrawn from a non-covered expansion of withdrawal capacity at Culcairn
 - any transmission refills at the Western Underground Storage or Liquefied Natural Gas facility at Dandenong and
 - forecast volumes for the incremental Murray Valley tariff.’
-

Amendment 28

Before the proposed revised access arrangement can be approved, GasNet must amend the definition of VATR in schedule 4.4 of the proposed revised access arrangement to remove from TR and TV as defined therein revenues and volumes associated with:

- any transmission refills at the Western Underground Storage or Liquefied Natural Gas facility at Dandenong and
 - the incremental Murray Valley tariff.
-

Amendment 29

Before the proposed revised access arrangement can be approved, GasNet must amend Table 7-1 in cl. 7.1 of its revised access arrangement information to include the temperature sensitivities used by VENCORP for its annual demand forecasts in its 2006 Gas Annual Planning Report.

Amendment 30

Before the proposed revised access arrangement can be approved, GasNet must amend schedule 4.1(a)(ii)(B) of the proposed revised access arrangement and remove all the words which follow ‘Y is 2%’.

Procedure for reference tariff variation

In response to ACCC comments in the draft decision on GasNet’s proposals in schedule 3 and section 6 of the AA, as well as other related provisions, GasNet and the ACCC have agreed to changes to its proposed revised access arrangement.³⁹⁸ These changes are considered by the ACCC to be necessary for the reasons set out in the draft decision including:

³⁹⁸ GasNet, *Email to the AER*, April 2 2008

- providing sufficient time to review tariff proposals and
- complying with the procedures set out in sub-sections 8.3B-H of the code.

Accordingly, GasNet is required to amend its AA and AAI as follows:

Amendment 31

Before the proposed revised access arrangement can be approved GasNet must delete clause 6 of the revised access arrangement and replace it with:

6 Pass Through Events**6.1 Pass Through Event statement**

- (a) Subject to clause 6.4, in relation to each Regulatory Year (t) GasNet must, at least 50 Business Days before the start of that Regulatory Year (i.e. during Regulatory Year (t-1)), give a statement to the Regulator stating whether or not there are any Pass Through Events that:
- (i) have a financial effect on GasNet in the current or previous Access Arrangement Period; or
 - (ii) are reasonably anticipated to have a financial effect on GasNet in Regulatory Year (t),
- which have not been previously notified to the Regulator under this clause.
- (b) GasNet may replace the statement under 6.1(a) at any time prior to submitting a notice to vary tariffs under Schedule 3.
- (c) If the statement provided to the Regulator under clause 6.1(a) identifies one or more Pass Through Events, then the statement must include, in relation to each of these Pass Through Events:
- (i) details of the Pass Through Event concerned;
 - (ii) the date the Pass Through Event took or will take effect;
 - (iii) the financial effects or anticipated financial effects of the Pass Through Event on GasNet; and
 - (iv) the Preliminary Pass Through Amount GasNet proposes in relation to the Pass Through Event, which must be set in accordance with the criteria in clause 6.2(a) below.
- (d) A statement given under clause 6.1(a) must include documentary evidence (if available) which substantiates the financial or anticipated financial effects of the Pass Through Event. GasNet must use best endeavours to ensure that such information is available.
- (e) For the avoidance of doubt, a statement under clause 6.1(a) above does not constitute a notice for the purposes of section 8.3B of the Code.

6.2 Pass Through Amount Criteria

- (a) GasNet may only apply a pass through amount to the Transmission Tariffs if:

- (i) a Pass Through Event has occurred or will occur; and
- (ii) the financial effect or anticipated financial effect of the pass through amount on GasNet in the Third Access Arrangement Period and subsequent Access Arrangement Periods associated with the Pass Through Event concerned will result in GasNet being economically neutral taking into account:
 - (A) the financial effect to GasNet associated with the Tariffed Transmission Service attributable to the Pass Through Event concerned, and the time at which the financial effect arises;
 - (B) in relation to a Change in Taxes Event, the impact of any change in another tax which was introduced as complementary to the Change in Taxes Event concerned;
 - (C) the effect of any other previous Pass Through Events which have not previously been applied to the Transmission Tariffs in accordance with the Code or this Access Arrangement;
 - (D) in relation to a Counterparty Default Event, the recovery of any outstanding amounts; and
 - (E) any other relevant factors.

(b) A Pass Through Amount may be positive or negative.

6.3 How does GasNet apply a Pass Through Amount?

- (a) A Pass Through Amount must be applied by GasNet in accordance with Schedule 4.

6.4 Pass Through Amounts which incorporate a forecast

For the purposes of calculating the benefit sharing allowance under clause 7.2 and in applying the Price Control Formula in Schedule 4, a Pass Through Amount which incorporates a forecast will be updated so as to reflect the actual Pass Through Amount (when known).

6.5 Immaterial Pass Through Amounts

GasNet is not required to prepare a statement under clause 6.1(a) if the aggregate of all Pass Through Amounts for Regulatory Year (t) is between \$-50,000 and \$50,000.

Amendment 32

Before the proposed revised access arrangement can be approved GasNet must delete schedule 3 of the revised access arrangement and replace it with:

3.1 Proposed tariffs

- (a) GasNet may vary its Transmission Tariffs in accordance with the price control formula in schedule 4 and sections 8.3B to 8.3H of the Code subject to the following:
- (i) For each Regulatory Year GasNet must, at least 30 Business Days before the start of the Regulatory Year ((that is, during Regulatory Year (t-1)), give the Regulator a notice.
 - (ii) This notice must contain GasNet's proposed variations to the Transmission Tariffs, the proposed effective date for those variations, and, in relation to proposed Pass Through Amounts (if any), the information required to be provided in a statement under clause 6.1(a).
 - (iii) The proposed variations to the Transmission Tariffs must demonstrate compliance with the relevant principles and formulae in Schedule 4, and, in relation to a Pass Through Amount, section 6.2 of the Access Arrangement.
- (b) The minimum notice period for the purposes of section 8.3D(b)(i) of the Code shall be the period ending on the last day before the start of the Regulatory Year in which the Transmission Tariffs are to apply.
-
-

Amendment 33

Before the proposed revised access arrangement can be approved GasNet must delete the definitions of Pass Through Amount and Service Envelope Agreement in clause 9 of the revised access arrangement and replace it with:

Pass Through Amount means the pass through amount specified by GasNet in a notice under section 8.3B of the Code:

- (a) which is allowed under section 8.3D of the Code because of effluxion of time; or
- (b) as varied by the Regulator under section 8.3E of the Code.

Service Envelope Agreement means the agreement of that name entered into between VENCORP, GasNet (NSW) and GasNet dated 2 November 2006, as amended from time to time.

Amendment 34

Before the proposed revised access arrangement can be approved GasNet must insert a further definition in clause 9 of the revised access arrangement:

Preliminary Pass Through Amount means the amount or amounts that GasNet proposes as the financial or anticipated financial effect of the Pass Through Event in its statement under clause 6.1(a)

Amendment 35

Before the proposed revised access arrangement can be approved GasNet must delete clause 7.3 of the revised access arrangement and insert:

7.3 Pass through carry forward

If:

- (a) a Pass Through Event has occurred;
- (b) the Pass Through Event has a financial effect on GasNet in the Third Access Arrangement Period; and
- (c) GasNet has not given a statement under clause 6.1(a) or a notice under section 8.3B of the Code during the Third Access Arrangement Period in relation to that Pass Through Event,

then GasNet may include a Pass Through Amount in relation to that Pass Through Event in a statement under clause 6.1(a) (or an equivalent) and a notice under section 8.3B of the Code in the Fourth Access Arrangement Period.

Amendment 36

Before the proposed revised access arrangement can be approved GasNet must delete clause 1.7(c)(i)(B) under Billing Parameters and insert:

- (B) the Winter Injection Volume for Regulatory Year “t” is based on a prorata allocation across each Shipper based on injections from the previous year of the annual Winter Injection Volume applied as part of the annual tariff adjustment to Transmission Tariffs in accordance with Schedule 3 for Regulatory Year “t”.

Amendment 37

Before the proposed revised access arrangement can be approved GasNet must under clause 4.3 of schedule 4 of the revised access arrangement delete the words following PTA and insert:

is the Pass Through Amount and

6.4. Reference tariff principles

Chapter 6.4 of the draft decision provided a detailed overall assessment of the compliance of GasNet's reference tariff policy and reference tariffs' with the principles in ss. 8.1 and 8.2 of the code.

The ACCC considers that GasNet by adopting the amendments specified in this final decision, the reference tariff and reference tariff methodology will satisfy the factors in s. 8.2 of the code and be consistent with the objectives in s. 8.1 of the code, applied with reference to s. 2.24 of the code.

7. Performance and incentives

7.1. Incentive mechanisms

7.1.1. Introduction

The code's general tariff principles provide that, where appropriate, the reference tariff should be designed to provide the service provider with the ability to earn greater profits (or less profits) than anticipated between AA periods if it outperforms (or underperforms) against the benchmarks that were applied in setting the reference tariff. More specifically, s. 8.1(f) of the code refers to an incentive to reduce costs and to develop the market for reference and other services. Section 8.2(d) of the code allows an incentive mechanism to be incorporated into the reference tariff policy that the regulator is satisfied is appropriate and consistent with s. 8 of the code. Section 8.4 of the code allows the service provider to retain some or all of the benefits arising from efficiency gains under the incentive mechanism. In addition to these broad provisions s. 8.44 of the code sets out particular guidance on the use of incentive mechanisms.

GasNet proposed to amend the fixed principle in clause 7.2 of its AA that will affect the carry-over of allowances to apply in the AA4 period, namely through the removal of fuel gas costs and revenue from refill tariffs from the calculation of carry-over amounts (on the basis that these costs are un-controllable) and requiring the regulator use its discretion in considering whether to apply negative carry-over amounts.

GasNet also proposed a related amendment to require the regulator to, amongst other things, 'use' actual operating costs in 2011 as a basis for setting expenditure benchmarks for the AA4 period, rather than 'take into account' these costs as per the current fixed principle.

In its draft decision, the ACCC rejected changes to the operation of the carry-over mechanism on the basis that they would reduce the effectiveness of the mechanism in providing an incentive to reduce opex. The ACCC accepted the removal of fuel gas costs, including revenue from refill tariffs on the basis that they were uncontrollable. The draft decision also considered that for clarity, GasNet's amendments should state that fuel gas costs arising from refill tariffs should be excluded from the benefit sharing calculation.

7.1.2. Proposed amendments

Proposed amendment 29 (reproduced below) expressed the ACCC's draft decision noted above.

Proposed amendment 29

Before the proposed revised access arrangement can be approved, GasNet must

- remove cl. 7.2(i) of the proposed revised access arrangement and
 - replace 'use' with 'take into account' in cl. 7.2(h)(ii) of the proposed revised access arrangement.
-

7.1.3. Response to the draft decision

GasNet maintains that its AA should provide for the regulator to use its discretion in applying negative carry-over amounts, stating that this discretion is incentive enough for it to minimise costs in each year of the AA period.

No other comments were received on this aspect of the draft decision.

7.1.4. Conclusion

The ACCC reaffirms its draft decision that introducing a requirement for the regulator to use its discretion would create an opportunity for GasNet to argue against applying negative carry-overs regardless of whether they had arisen due to uncontrollable events or its own in-efficiencies. In particular, attempts to distinguish the cause of changes in expenditure would introduce unnecessary complexity and burden. In this context, the incentive on GasNet to minimise its costs is weakened.

Accordingly, the ACCC considers that the possibility of not applying negative carry-over amounts would compromise the proper functioning of the incentive mechanism and is therefore considered inconsistent with the requirements of ss. 8.1(f) and 8.46(b) of the code.

The ACCC also reaffirms its draft decision to replace ‘use’ with ‘take into account’ in cl. 7.2(h)(ii) of the proposed revised AA.

Amendment 38

Before the proposed revised access arrangement can be approved, GasNet must

- remove cl. 7.2(i) of the proposed revised access arrangement and
 - replace ‘use’ with ‘take into account’ in cl. 7.2(h)(ii) of the proposed revised access arrangement.
-

7.2. Key performance indicators

7.2.1. Introduction

Attachment A of the code requires service providers to disclose any industry key performance indicators (KPIs) used to justify ‘reasonably incurred’ costs.

GasNet submitted two KPIs:

- operating costs (opex) as a percentage of the optimised replacement costs (ORC) and
- operating costs per km.

GasNet submitted that the KPIs indicated that GasNet fell in the middle of the range of pipelines in the sample. In its draft decision, the ACCC proposed lower operating costs than those forecast by GasNet. Consequently, in terms of the opex/ORC ratio GasNet shifted from the middle to the lower end of the range of the pipelines in the sample. In terms of the opex/km ratio GasNet still fell in the middle of the range.

7.2.2. Response to draft decision

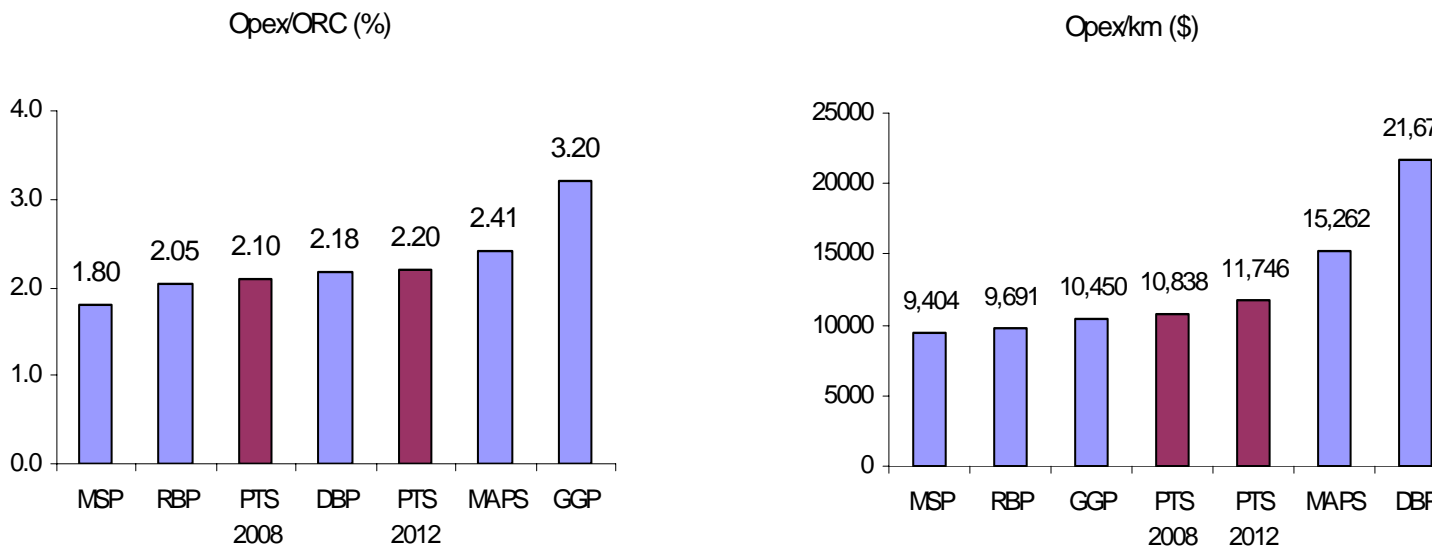
No submissions were received on this aspect of the draft decision.

7.2.3. Conclusion

In previous decisions on the AAs for various pipelines the ACCC has commented on the limitations of KPIs. Different characteristics among pipelines make direct comparisons problematic. At best KPIs may be a useful tool as a broad indicator of comparative efficiency.

In this final decision the ACCC has approved higher operating costs than those proposed in the draft decision. In particular the ACCC has decided not to reduce GasNet’s overheads by \$2m per annum. The corresponding KPIs are shown in Figure 7.2.1. In terms of the opex/ratio, GasNet shifts from the lower end to the middle of the range in the sample. As GasNet is integrated into the APA Group its actual overheads may be lower than forecast. The ACCC has decided that any synergies achieved should be treated as any other efficiency gains. Accordingly, the actual KPIs for GasNet may be lower than indicated in Figure 7.2.1.

Figure 7.2.1: KPIs based on ACCC’s approved operating costs



8. Non-tariff elements

This chapter considers the non-tariff elements of GasNet's proposed access arrangement (AA). Non-tariff elements, among other things, refer to a policy on the trading of capacity, queuing for spare and developable capacity as well as terms and conditions.

The code sets out the minimum elements that must be included in an AA as well as principles for establishing the reference service and the other elements and policies to be set out in the AA. It should be acknowledged however, that service providers and their customers may agree to different or more detailed arrangements in their gas haulage contracts. The ACCC's role is to ensure that proposed terms and conditions of the AA are reasonable and do not prevent the efficient provision of the pipeline's services.

The day to day operation of the pipeline is also subject to technical regulation which ensures the safe operation of the pipeline.

8.1. Services policy

8.1.1. Introduction

GasNet proposed to retain its existing services policy in cl. 3.2 for its proposed AA. Clauses 3.1, 3.2 and 3.3 of the current AA state that GasNet will make the tariffed transmission service available to VENCORP at the reference tariffs, on the terms and conditions in accordance with those set out in the service envelope agreement (SEA) and the Market and System Operations Rules (MSO rules).

The draft decision noted that under s. 10.1 of the code, VENCORP is required to submit a revised AA as the operator of the PTS. However, the Victorian Government advised that the obligation for VENCORP to submit an AA will be removed, affecting the arrangements between GasNet and VENCORP, and the existing arrangements with users of the PTS. That is, users will be required to enter into bilateral contracts for the gas transportation service with GasNet instead of VENCORP.

Given that GasNet's proposed services policy for AA3 would not have reflected these new arrangements, the ACCC required GasNet to revise its services policy to reflect that GasNet rather than VENCORP has the direct legal relationship with users, and will provide gas transportation services directly to users.

8.1.2. Response to draft decision

In response GasNet notes that it has now considered the amendments proposed by the Victorian Government requiring GasNet to enter into gas transportation agreements directly with users of the PTS. It does not consider, however, that such agreements equate to providing gas transportation services directly to users, but rather represent a

mechanism for the recovery of GasNet's revenues. It notes that the legal and operational interfaces between GasNet and VENCORP remain unchanged.

GasNet notes a recent change to the MSO rules requiring Market Participants to have an agreement for the payment of GasNet's transmission charges. Previously there was a requirement for a person to have such an agreement as a condition of registering as a market participant. To address the risk of participants receiving gas transmission services before they enter into an agreement to pay for those services, GasNet proposes a revised definition of the Tariff Transmission Service, namely:

Tariffed Transmission Service means making available the PTS to VENCORP on the same terms as those set out in the Service Envelope Agreement and entering into agreements with users in accordance with section 5.3.1(aa) of the MSO Rules.³⁹⁹

8.1.3. Conclusion

The ACCC does not agree with GasNet's comments regarding the changes to contractual arrangements between itself, VENCORP and users of the PTS (see section 8.2.3). The ACCC does accept, however, GasNet's proposed revised definition of the Tariffed Transmission Service as a means to address changes in the requirements of Market Participants.

8.1.4. Assessment

Amendment 39

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.2 of the proposed revised access arrangement to reflect that GasNet will provide gas transportation services directly to users.

³⁹⁹ GasNet, *Response to the Commission's Draft Decision on Proposed Access Arrangement for the Principal Transmission System*, (Submission in Response), December 2007, p. 65.

8.2. Terms and conditions

8.2.1. Introduction

Section 3.6 of the code requires an AA to include the terms and conditions on which a service provider will supply each reference service. These terms and conditions must, in the regulator's opinion, be reasonable. In assessing whether the proposed revised terms and conditions are reasonable, the relevant regulator is guided by s. 2.24 of the code.

GasNet's revised AA proposed that the terms and conditions on which GasNet will supply the tariffed transmission service are the same as those set out in the SEA and the MSO rules.

The ACCC noted that under the SEA, VENCORP agrees that GasNet be paid directly for users of the transportation service. VENCORP also had GTDs with users, which requires users to pay GasNet directly for the gas transportation service. The draft decision noted that these GTDs will expire in December 2007 and GasNet will need to GTDs in its revised AA, given that VENCORP no longer is required to have GTDs with users.

The ACCC in its draft decision also indicated that it understood that GasNet would propose interim GTDs as part of its proposed AA, which would commence in January 2008 and expire in Jun 2008. The ACCC also understood that GasNet would propose a long term agreement.

The draft decision concluded that as the standard terms and conditions of a revised agreement will form part of the terms and conditions under which GasNet will supply the reference service, the relevant regulator will need to approve these agreements if the revised agreement is included in the AA. To enable a revised agreement to be approved, the ACCC proposed that GasNet include a trigger event for a revision in accordance with s. 3.17(b)(ii) of the code, where a trigger event would be a submission of a revised agreement to the relevant regulator for approval. Accordingly, the ACCC required GasNet to include an agreement as part of its revised AA and GasNet should consider including a trigger event in its AA as a result of re-negotiating a long term agreement or alternatively may seek revisions to its AA during the period.

8.2.2. Response to draft decision

GasNet submits that these agreements will not constitute an agreement by GasNet to provide transportation services but simply a mechanism for GasNet to recover its tariffs. GasNet states that as such these agreements do not set out the terms and conditions on which the reference service will be supplied, these are instead set out in the SEA and MSO rules. GasNet therefore considers that the ACCC does not have the power under s. 3.6 of the code to approve the terms and conditions of the gas transportation agreements.

GasNet also submits that it does not believe that the ACCC can require GasNet to submit the gas transportation agreements for approval under s. 3.17(b)(ii) of the code. In particular, GasNet states that:

Under s. 3.17(b)(ii), the ACCC can only require that GasNet submit a new revised access arrangement. Although the ACCC can require that revisions be submitted after a “specific major event”, it cannot merely require that GasNet submits one part of the Access Arrangement for review.⁴⁰⁰

GasNet further submits that the ACCC can only require an earlier revisions date if required having regard to the objectives in s. 8.1, which relate to reference tariffs. GasNet queries how an early revisions date so the ACCC could review an agreement which has nothing to do with the amount of reference tariffs could be required under the s. 8.1 objectives.

8.2.3. Conclusion

The ACCC considers that gas transportation agreements form part of the terms and conditions under s. 3.6 of the code. In particular, the transportation agreement provides terms and conditions on which GasNet will supply the tariffed transmission service to users and should therefore be included in GasNet’s revised AA. For the AA2 period, VENCorp provided these agreements to users and an approved agreement was included in VENCorp’s AA.

As GasNet acknowledges the main change arising from amendments to the legislative regime and the MSO rules relates to the removal of the requirement for VENCorp to submit an AA, is that GasNet and not VENCorp will now enter into agreements directly with users. The ACCC does not agree that gas transportation agreements simply provide a mechanism for the recovery of GasNet’s tariffs. Whilst these agreements do not constitute an agreement by GasNet to transport gas by a user they form the term and conditions on which users may transport gas. The existing deed already recognises it does not impose an obligation on GasNet to provide transmission services to user.⁴⁰¹

GasNet has indicated that it will propose a gas transportation agreement to users and has provided the ACCC with the principles to be included in a proposed agreement. The ACCC has reviewed these principles. However, the ACCC notes that affected parties have not had an opportunity to comment on GasNet’s proposed agreement. Given that affected parties have not had an opportunity to comment on any proposal, the ACCC considers that the standard terms and conditions of the existing agreements should be included in the revised AA.⁴⁰² GasNet has subsequently provided a ‘term sheet’ which outlines the principles that will apply to GasNet and users, these include, term, payment, limitations, force majeure, termination and dispute resolution procedures (refer to Appendix C of this decision).

⁴⁰⁰ GasNet, *Submission in Response*, op. cit., p.67.

⁴⁰¹ Refer to Appendix C: Gas Transportation Deed Principles.

⁴⁰² The MSO rules were amended on 6 December 2007 such that where the existing VENCorp agreement for the payment of transmission charges have expired and the users continue to pay these charges, it is assumed that the agreement has not expired.

As these principles reflect the terms and conditions of the existing agreements, the ACCC proposes to include these principles in GasNet's revised AA.

Amendment 40

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.3 of the proposed revised access arrangement to reflect the principles in Appendix C of this final decision.

8.3. Capacity management policy

8.3.1. Introduction

Section 3.7 of the code requires an AA to include a statement that the covered pipeline is to operate under either a contract carriage capacity management system or a market carriage capacity management system. If the pipeline is to operate as a market carriage pipeline then consent from the relevant minister must be obtained and provided to the relevant regulator and a trading policy is not required.

Clause 8.1 of the GasNet's second AA states that the PTS is a market carriage pipeline. Accordingly, it does not include a trading policy which is not required under the code if the pipeline is to operate as a market carriage system as noted above.

The ACCC proposed to accept that the current capacity management policy of market carriage continues to apply to the PTS.

8.3.2. Response to the draft decision

No submissions were received on this aspect of the draft decision.

8.3.3. Conclusion

The ACCC reaffirms the draft decision to accept that the current capacity management policy of market carriage continues to apply to the PTS.

8.4. Queuing policy

8.4.1. Introduction

Pursuant to ss. 3.12 to 3.15 of the code, an AA must include a queuing policy. This policy is to be used to determine the priority given to users and prospective users for obtaining access to a covered pipeline and seeking dispute resolution under s. 6 of the code.

VENCorp is responsible for the queuing policy for the PTS in accordance with s. 5.3 of the MSO rules. The ACCC noted in the draft decision that the Victorian Government will amend the *Gas Industry Act 2001* (Vic) such that VENCorp is no longer required to submit an AA under the national gas access regime. The ACCC understood that notwithstanding VENCorp's requirement not to submit an AA, VENCorp will continue to have responsibility for a queuing policy for the PTS as specified in the MSO rules.

However, to avoid ambiguity as to the responsibility for a queuing policy, the draft decision required GasNet to amend its proposed revised AA to refer to VENCorp's responsibility to provide a queuing policy in accordance with s. 5.7 of the MSO rules.

8.4.2. Proposed amendment

Proposed amendment 31 (reproduced below) expressed the ACCC's draft decision noted above.

Proposed amendment 31

Before the proposed revised access arrangement can be approved, GasNet must:

- amend cl. 8.2 of the proposed revised access arrangement to be consistent with s. 5.7 of the MSO rules and
 - to reflect that the responsibility for complying with the obligations imposed under ss. 3.12–3.15 of the code is allocated to VENCorp.
-

8.4.3. Response to the draft decision

No submissions were received on this aspect of the draft decision.

8.4.4. Conclusion

As noted in the draft decision, VENCorp is responsible for the queuing policy for the PTS in accordance with s. 5.3 of the MSO rules. The ACCC also notes that the Victorian Government has amended the *Gas Industry Act 2001* (Vic) such that VENCorp is no longer required to submit an AA under the national gas access regime. The ACCC understands that notwithstanding VENCorp's requirement not to submit an AA, VENCorp will continue to have responsibility for a queuing policy for the PTS as specified in the MSO rules.

The ACCC reaffirms its draft decision that to avoid ambiguity as to the responsibility for a queuing policy, the ACCC requires GasNet to amend its proposed revised AA to refer to VENCorp's responsibility to provide a queuing policy in accordance with s. 5.7 of the MSO rules.

Amendment 41

Before the proposed revised access arrangement can be approved, GasNet must:

- amend cl. 8.2 of the proposed revised access arrangement to be consistent with s. 5.7 of the MSO rules and
 - to reflect that the responsibility for complying with the obligations imposed under ss. 3.12–3.15 of the code is allocated to VENCORP.
-

8.5. Extensions and expansions policy

8.5.1. Introduction

Section 3.16 of the code requires an AA to have an extensions and expansions policy. The policy must set out the method to determine whether any extension to or expansion of the system's capacity will be treated as part of the covered pipeline. A service provider is also required to specify the effect on the reference tariff if an extension or expansion is treated as part of the covered pipeline. If the service provider agrees to fund new facilities if certain conditions are met, the extensions and expansions policy must outline the conditions under which the service provider will fund those new facilities and provide a description of those new facilities.

GasNet has, as it did for the AA2 period proposed an extensions and expansions policy which provides that:

- extensions to its network will not be covered where written notice is given to the Regulator and
- expansions to its network will automatically be covered.

However, for AA3, GasNet proposed an exception to this policy in relation to expansions:

If it is an expansion is required to increase withdrawals at Culcairn over and above the current capacity of 17 TJ /day and GasNet gives written notice to the Regulator before the expansion comes into service that the expansion will not be covered.⁴⁰³

Prior to the draft decision one submission was received in relation to the extensions proposal and three submissions commented on GasNet's proposal in relation to expansions at Culcairn.

TRUenergy submitted that small extensions should be covered within the policy based on its experience in tendering for small projects. Its experience is that other parties are reluctant to bid against GasNet who priced low.⁴⁰⁴

In relation to expansions at Culcairn, TRUenergy also considered that evidence presented to the Australian Competition Tribunal in 2001 supported the potential for competition between the EGP and the Interconnect. It concluded therefore that GasNet's proposal for future expansions at Culcairn to be uncovered was acceptable.⁴⁰⁵ AGL considered that to the extent that the EGP provides competition to gas flows north to NSW via Culcairn, it is acceptable for GasNet to propose this arrangement.⁴⁰⁶ Origin

⁴⁰³ GasNet, *Submission*, op.cit., p.112

⁴⁰⁴ TRUenergy, *submission to the issues paper*, 27 June 2007 p.10

⁴⁰⁵ *ibid.*

⁴⁰⁶ AGL, *submission to issues paper* 26 June 2007, p.3.

considered GasNet had provided no compelling reason to put aside coverage for expansions beyond 17 TJ/day at Culcairn. It considered this may set a precedent for other withdrawal zones and believes this issue is more appropriately handled within the existing regulatory framework.⁴⁰⁷

In the draft decision, the ACCC noted that for extensions:

- businesses continued to have the opportunity to compete against the incumbent for extension work and
- TRUenergy had not provided any evidence of market power being exercised by GasNet.

The ACCC considered that to depart from the AA2 approach of allowing GasNet the election as to whether extensions are uncovered, the ACCC would require more substantial evidence which demonstrated GasNet's ability to exercise market power in the market for small pipeline extensions. The ACCC suggested possible evidence may include tender proposal documents and incumbent invoices for work done. No such further information has subsequently been provided.⁴⁰⁸

In relation to expansions, the ACCC considered the form of the proposed Culcairn exception to the policy that all expansions would be covered should be amended to require GasNet to seek the regulator's approval before the decision to construct an expansion beyond 17 TJ/d at Culcairn is made. This amendment was required because:

- primarily it was concluded that market power factors may change over time such that an assessment of market power would be better informed at the time of a proposal
- it was noted that GasNet had provided little evidence to show that in relation to expansions at Culcairn, market power would not be a concern
- bearing in mind that market power factors may change over time, the relevance of the 2001 analysis submitted by TRUenergy was questioned and
- it was also noted that GasNet had not satisfactorily explained how such a proposal would operate in conjunction with the market carriage system and VENCORP's role to operate such a system.⁴⁰⁹

Having noted the potential for detrimental consequences to users and competition if at the time of an expansion there was significant market power, the ACCC considered an amendment to GasNet's expansion policy proposal was required in order to account for the possibility of significant market power impacting on the interests of users and prospective users (s. 2.24(e) of the code and the public interest (s. 2.24(f)) of the code.⁴¹⁰ It was noted that the proposed revisions continued to protect GasNet's

⁴⁰⁷ Origin, *submission to issues paper*, 9 July 2007, p.3.

⁴⁰⁸ ACCC, *Draft Decision 14 November 2007* p.262.

⁴⁰⁹ *ibid.* pp. 258-261.

⁴¹⁰ *ibid.* The ACCC referred to the findings on the effect of significant market power by the Australian Competition Tribunal: *Application by Epic Energy South Australia Pty Ltd [2003] A Comp T 5*.

legitimate business interests (s. 2.24(a)) of the code because it did not preclude GasNet from having future expansion uncovered upon application intra-period.

8.5.2. Proposed amendments

Proposed amendment 32 (reproduced below) expressed the ACCC's draft decision noted above.

Proposed amendment 32

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 5.1(c) of the proposed revised access arrangement to read:

‘An expansion required to increase withdrawals at Culcairn over and above the current capacity of 17 TJ/day will be covered unless the Regulator, before the decision to construct the New Facility is made by the Service Provider, agrees that it should not be covered.’

8.5.3. Response to the draft decision

The only response received to the draft decision on this issue was from GasNet. It submits that:

- there is sufficient information for the ACCC to decide that GasNet is not able to exercise market power on the Interconnect now or in the future. It considers it is inconsistent to suggest that if EGP tariffs are unregulated and MSP tariffs are largely unregulated that tariffs on the Interconnect need to be regulated.
- GasNet's application for a prudent discount suggests it does not have market power. (see chapter 6.1.4)
- the EGP can be expanded at low cost, whereas the Interconnect requires expensive looping
- the only difference between proposed unregulated services on the Interconnect and regulated services would be the tariff treatment. It stated it does not intend to operate outside of the market carriage system (operated by VENCORP) and that it would agree to include any expansions within the ambit of the Service Envelope Agreement to ensure that VENCORP operates the system under a consistent set of rules.⁴¹¹

8.5.4. Conclusions

The ACCC received no further comments on the extensions policy after the draft decision. The ACCC does not propose any amendments to GasNet's extensions policy.

8.5.4.1. Expansions Policy

The ACCC continues to consider that GasNet's proposal in relation to the Culcairn exception will not satisfy s. 2.24 (e) and s.2.24(f) of the code.

⁴¹¹ GasNet, *Submission in Response*, op. cit., p.67.

The ACCC does not agree with GasNet that it is necessarily inconsistent to regulate PTS tariffs if in the past coverage of the EGP has been removed and also partial coverage of the MSP. The markets the PTS and the EGP mostly serve may differ from the market of the PTS (i.e. Wagga Wagga). The conditions which existed when past coverage decisions were made do not form a basis for considering the current market.

The ACCC has reviewed information submitted by GasNet in relation to competitive tariffs available via both the EGP and the MSP as contained in its response to the draft decision and also in subsequent information provided by GasNet.⁴¹² The ACCC has analysed on gas user locations and published tariffs. Whether GasNet will have market power will be affected by many factors including:

- assumptions as to where the market is and
- likely competing network tariffs (inclusive of pipeline load factor assumptions) and other supply cost assumptions (including ex-basin costs)⁴¹³

However, the ACCC considers that these factors would not be expected to remain constant until GasNet proposes an expansion.

The size of any future expansion and user locations at the time of that expansion will be relevant to assessing market power, since it will inform where the likely market(s) are. Information from GasNet and other available information indicate GasNet presently has a significant likely customer load at the Uranquinty Power Station and through a retailer a customer load around the Wagga Wagga area sufficient to meet present volume forecasts.⁴¹⁴ Gas demand may grow in this area in the future including if other major gas users locate in this area.

Recent published tariffs on the EGP, including contracts entered into which cover the AA3 period, do not provide a clear case of competitiveness with the PTS for delivery to markets such as Wagga Wagga.⁴¹⁵ In the case of competition from the MSP, GasNet has not provided any evidence of the price of gas leaving the Moomba basin for carriage along the MSP in comparison to the price of gas from the Gippsland Basin / Victorian spot market. In chapter 6.1.4, the ACCC has noted that available evidence suggests ex-basin Moomba prices may be higher.

⁴¹² *ibid.* pp. 62, 63, 67 and Confidential Attachment 6, *email from GasNet*, 1 February 2008, *email from GasNet*, 29 February 2008.

⁴¹³ ACCC, *Draft Decision : Revised Access Arrangement by GasNet Australia Ltd for the Principal Transmission System*, 14 November 2007, *op.cit.*, p. 259 set out further factors which would impact on the likelihood of significant market power.

⁴¹⁴ Customer load (Wagga Wagga) Wagga Wagga Access Arrangement Information, 1 January 2006 and other customers with reticulated gas load around Wagga Wagga viewed on 5 March 2008 at <<http://www.countryenergy.com.au>>.

⁴¹⁵ Published information on tariffs on the EGP viewed on 5 March 2008. Tariffs on the EGP ranging from over 90 cents in \$2008 (contracts) to over \$1 (published tariffs for 2008): <http://www.alinta.net.au/operations/transmission/egp/assetDetails/transServices/default.aspx> <http://www.alinta.net.au/operations/transmission/egp/assetDetails/currentTariffs/downloads/080303EGPtariffs.pdf>. see also Chapter 6.1, Export Tariffs.

For both network tariffs and basin prices, it is difficult to predict the prices which GasNet may experience any competition from in the future. In particular, it is difficult to predict future terms of contracts on the EGP. It is difficult also to predict at some time in the future what the comparative cost of Queensland coal seam methane gas would be if it was delivered from Queensland into NSW networks and then onto NSW customers. Finally, it is difficult to predict the likely price of gas to be delivered from the Gippsland basin along the PTS into NSW when long term Gippsland Basin contracts are scheduled for renewal in 2009-10.⁴¹⁶

GasNet has noted that the cost of expansion of the Interconnect requires expensive looping whilst the EGP can be expanded at low cost. GasNet has not however provided any evidence to support this conclusion. The comparative costs of expanding the Interconnect with the EGP would depend on the size and timing of any expansion at the Interconnect and the comparative costs of expanding the EGP (which is approaching full compression) at that time.⁴¹⁷

The ACCC notes that GasNet has provided further information on how it considers an uncontracted expansion could co-exist within VENCorp's operation of the Victorian market carriage system. It has indicated a willingness to include expansions within the ambit of the Service Envelope Agreement to ensure VENCorp operates the system under a consistent set of rules. The ACCC considers that notwithstanding this advice, if GasNet proposes an unregulated expansion, confirmation from GasNet and VENCorp as to their views on the workability of arrangements would be necessary.

It remains the ACCC's consideration that, consistent with the draft decision, GasNet can not reasonably demonstrate it will not have market power for exports at some undefined future point in time. The ACCC is concerned that GasNet's proposed AA requires the ACCC to speculate as to future market developments. The ACCC considers the proposed amendment will facilitate less speculation regarding future competition at Culcairn. Any proposal to expand the network above 17TJ/d would be made closer to the date of commissioning when more up to date information regarding market factors impacting on competition can be analysed. The ACCC considers its proposed amendment is required having considered the principles in s. 2.24 of the code and specifically to prevent the potential for market power to be exercised⁴¹⁸

⁴¹⁶ COAG Energy Market Review Final Report, *Towards a truly National and Efficient Energy Market*, December 2002. It is noted that long term Gippsland Basin contracts are understood to be expiring soon. This event may lead to a change in the comparative costs of supply from Gippsland in 2009/10.

⁴¹⁷ In relation to the EGP, it will have a capacity available of 93TJ from late 2008. Its capacity when fully compressed is 108 TJ. See Alinta, *News Release 22 June 2007*; viewed March 5 2008 at < <http://alintagas.com.au/investor/newsRoom/newsReleases/2007/source/070622.pdf>>..

⁴¹⁸ In particular, subsections 2.24 (a),(e),(f) of the code.

Amendment 42

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 5.1(c) of the proposed revised access arrangement to read:

‘An expansion required to increase withdrawals at Culcairn over and above the current capacity of 17 TJ/day will be covered unless the Regulator, before the decision to construct the New Facility is made by the Service Provider, agrees that it should not be covered.’

8.6. Review of the access arrangement

8.6.1. Introduction

Section 3.17 of the code requires an AA to include a date when the service provider must submit revisions to the AA (revisions submission date) and the date when the revisions are expected to take effect (revisions commencement date).

In deciding whether these two dates are appropriate, the relevant regulator must consider the objectives contained in s. 8.1 of the code. Having done so, the relevant regulator may require an amendment to the proposed AA to include earlier or later dates. The relevant regulator may also require that specific major events be defined as a trigger that would require the service provider to submit revisions before the revisions submission date in accordance with s. 3.17(ii) of the code.

In the draft decision, the ACCC concluded that the revisions submission date and the revisions commencement date meet the requirements of the code.

8.6.2. Response to the draft decision

No submissions were received on this aspect of the draft decision

8.6.3. Conclusion

The ACCC is satisfied that these dates are consistent with the code.

9. Final decision

Under s. 2.13(b) of the code, the ACCC proposes not to approve GasNet's revised access arrangement for the PTS in its current form. This final decision states the amendments (or nature of the amendments, as appropriate), which have to be made in order for the ACCC to approve the proposed revised access arrangement at the relevant sections of this final decision. The proposed amendments are also listed below.

GasNet must submit amended revisions to the ACCC by 21 May 2008.

10. Amendments

Amendment 01

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 2.1 of its proposed revised access arrangement information to reflect table 3.1.2 of this final decision.

Amendment 02

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 2.1 of the proposed revised access arrangement information to reflect table 3.2.1 of this final decision for roll-in to the capital base.

Amendment 03

Before the proposed revised access arrangement can be approved, GasNet must:

- amend cl. 3.6 of the proposed revised access arrangement information to reflect table 3.3.2 of this final decision.

Amendment 04

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 4.6 of the proposed revised access arrangement and retain the definition of partially redundant assets as it appears in the second access arrangement.

Amendment 05

Before the proposed revised access arrangement can be approved, GasNet must amend the rate of return in cl. 3.2 of the proposed access arrangement information to reflect the ACCC's estimates set out in table 4.1.2 of this final decision.

Amendment 06

Before the proposed revised access arrangement can be approved, GasNet must include:

- a board resolution to self-insure (i.e. a copy of the signed minutes recording resolution made by the board); and
- confirmation that the service provider is in a position to undertake credibly self-insurance for those events.

Amendment 07

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.5.2 of the proposed revised access arrangement information to reflect table 5.1.2 of this final decision.

Amendment 08

Before the proposed revised access arrangement can be approved, GasNet must:

- amend the definition of an Insurance Event in cl. 9.1 of its proposed revised access arrangement to only cover circumstances where GasNet is required to pay a deductible in connection with a claim under an insurance policy and
- remove the definition of Minimum Insurance Level from in cl. 9.1 of its proposed revised access arrangement

Amendment 09

Before the proposed revised access arrangement can be approved, GasNet must include:

- variations to its fuel gas costs from the yearly forecast costs as a pass-through event, and
- as a condition, that GasNet must tender for its fuel gas requirements.

Amendment 10

Before the proposed revised access arrangement can be approved, GasNet must amend the definition of a Pass Through Event in cl. 9.1 of its proposed revised access arrangement to remove the reference to an Asbestos Event.

Amendment 11

Before the proposed revised access arrangement can be approved, GasNet must amend its revised access arrangement so that cl. 1.2 and 1.3 of schedule 1 reflect final injection and withdrawal tariffs which incorporate VENCORP 2007 APR volume forecasts for the AA3 period. GasNet must also amend its proposed revised Access Arrangement Information to reflect VENCORP 2007 APR forecasts under clause 4 and Schedule 2.

Amendment 12

Before the proposed revised access arrangement can be approved, GasNet must amend its revised access arrangement:

so that the final injection / withdrawal tariffs set out in cl. 1, 2 and 1.3 of schedule 1 of the proposed revised access arrangement reflect the annual GPG forecasts in table 5.4.1.

GasNet must also amend its proposed revised access arrangement information at clause 4 and schedule 2 to incorporate the annual GPG forecasts in table 5.4.1.

Amendment 13

Before the proposed revised access arrangement can be approved, GasNet must amend its revised access arrangement so that the final injection / withdrawal tariffs set out in cl 1.2 and 1.3 of schedule 1 incorporate volume forecasts for Exports at Culcairn based on

most recent information including the terms of take or pay arrangements entered into. GasNet must also amend clause 4 and schedule 2 of its proposed revised access arrangement information.

Amendment 14

Before the proposed revised access arrangement can be approved, GasNet must include top-ten peak day volume forecasts for each injection zone in cl. 4 of the proposed revised access arrangement information.

Amendment 15

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.7 of the proposed revised access arrangement information to reflect table 5.5.2 of this final decision.

Amendment 16

Before the proposed revised access arrangement can be approved, GasNet must amend the revised access arrangement:

- So that the final withdrawal tariffs as set out in cl. 1.3 of schedule 1 of the proposed revised access arrangement reflect the allocation of costs to withdrawal zones based on the asset group annual and peak direct cost unit rates as these are derived in the modelling for the AA2 period and
- So that final injection tariffs as set out in cl. 1.2 of schedule 1 of the proposed revised access arrangement reflect the allocation of costs associated with each injection pipeline segment directly to the relevant injection pipeline consistent with the modelling for the AA2 period.

Amendment 17

Before the proposed revised access arrangement can be approved, GasNet must amend the revised access arrangement so that carryover K-factor carry-over is included in the Echuca and Southwest withdrawal zones and the Pakenham injection tariff.

Amendment 18

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3 of schedule 1 of the revised access arrangement to include a Murray Valley Tariff which recovers 100 per cent of the MVP incremental costs directly from the MVP lateral pipeline plus some contribution to common costs.

Amendment 19

Before the proposed revised access arrangement can be approved, GasNet must retain the zonal withdrawal tariffs for tariff-V users and remove the withdrawal tariff-V set out in cl. 1.3(b) of schedule 1 of the proposed revised access arrangement.

Amendment 20

Before the proposed revised access arrangement can be approved, GasNet must amend the proposed revised access arrangement to maintain the current injection tariff structure, where the peak period applies to the top 10 peak days during the winter period, instead of applying the charge over the whole winter period as proposed in cl. 1.2 of schedule 1 of the proposed revised access arrangement.

Amendment 21

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3(g) of schedule 1 of the proposed revised access arrangement to remove the prudent discount for tariff-D users at Pakenham.

Amendment 22

Before the proposed revised access arrangement can be approved, GasNet must amend the proposed revised access arrangement to remove the prudent discount from its export tariff (as proposed in section 11.6.2 of the revised access arrangement submission).

Amendment 23

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3(b) of schedule 1 of the proposed revised access arrangement to include matched rebates for tariff-V users in the North Hume, Murray Valley, Interconnect and Wodonga withdrawal zones for gas injected at Culcairn.

Amendment 24

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 1.3(e) of schedule 1 of the proposed revised access arrangement so that the cross system tariff is calculated consistent with the AA2 cost allocation methodology.

Amendment 25

Before the proposed revised access arrangement can be approved GasNet must:

- Allocate direct costs to the Geelong withdrawal zone based on specific direct cost unit rates and
- Calculate a Geelong zonal withdrawal tariff for tariff-V users.

Amendment 26

Before the proposed revised access arrangement can be approved, GasNet must amend the formula in schedule 4.6 of the proposed revised access arrangement to read:

$$\text{'WAAV} = \text{VW} + \text{TS} \times (\text{target EDD} - \text{actual EDD})\text{'}$$

Amendment 27

Before the proposed revised access arrangement can be approved, GasNet must amend the definition of VW in schedule 4.6 of the proposed revised access arrangement to read:

‘VW is the actual volume withdrawn from the PTS excluding:

- any volume withdrawn from a non-covered expansion of withdrawal capacity at Culcairn
- any transmission refills at the Western Underground Storage or Liquefied Natural Gas facility at Dandenong and
- forecast volumes for the incremental Murray Valley tariff.’

Amendment 28

Before the proposed revised access arrangement can be approved, GasNet must amend the definition of VATR in schedule 4.4 of the proposed revised access arrangement to remove from TR and TV as defined therein revenues and volumes associated with:

- any transmission refills at the Western Underground Storage or Liquefied Natural Gas facility at Dandenong and
- the incremental Murray Valley tariff.

Amendment 29

Before the proposed revised access arrangement can be approved, GasNet must amend Table 7-1 in cl. 7.1 of its revised access arrangement information to include the temperature sensitivities used by VENCORP for its annual demand forecasts in its 2006 Gas Annual Planning Report.

Amendment 30

Before the proposed revised access arrangement can be approved, GasNet must amend schedule 4.1(a)(ii)(B) of the proposed revised access arrangement and remove all the words which follow ‘Y is 2%’.

Amendment 31

Before the proposed revised access arrangement can be approved GasNet must delete clause 6 of the revised access arrangement and replace it with:

6 *Pass Through Events*

6.1 *Pass Through Event statement*

- (a) Subject to clause 6.4, in relation to each Regulatory Year (t) GasNet must, at least 50 Business Days before the start of that Regulatory Year (ie during Regulatory

Year (t-1)), give a statement to the Regulator stating whether or not there are any Pass Through Events that:

- (i) have a financial effect on GasNet in the current or previous Access Arrangement Period; or
- (ii) are reasonably anticipated to have a financial effect on GasNet in Regulatory Year (t),

which have not been previously notified to the Regulator under this clause.

- (b) GasNet may replace the statement under 6.1(a) at any time prior to submitting a notice to vary tariffs under Schedule 3.
- (c) If the statement provided to the Regulator under clause 6.1(a) identifies one or more Pass Through Events, then the statement must include, in relation to each of these Pass Through Events:
 - (i) details of the Pass Through Event concerned;
 - (ii) the date the Pass Through Event took or will take effect;
 - (iii) the financial effects or anticipated financial effects of the Pass Through Event on GasNet; and
 - (iv) the Preliminary Pass Through Amount GasNet proposes in relation to the Pass Through Event, which must be set in accordance with the criteria in clause 6.2(a) below.
- (d) A statement given under clause 6.1(a) must include documentary evidence (if available) which substantiates the financial or anticipated financial effects of the Pass Through Event. GasNet must use best endeavours to ensure that such information is available.
- (e) For the avoidance of doubt, a statement under clause 6.1(a) above does not constitute a notice for the purposes of section 8.3B of the Code.

6.2 Pass Through Amount Criteria

- (a) GasNet may only apply a pass through amount to the Transmission Tariffs if:
 - (i) a Pass Through Event has occurred or will occur; and
 - (ii) the financial effect or anticipated financial effect of the pass through amount on GasNet in the Third Access Arrangement Period and subsequent Access Arrangement Periods associated with the Pass Through Event concerned will result in GasNet being economically neutral taking into account:
 - (A) the financial effect to GasNet associated with the Tariffed Transmission Service attributable to the Pass Through Event concerned, and the time at which the financial effect arises;

- (B) in relation to a Change in Taxes Event, the impact of any change in another tax which was introduced as complementary to the Change in Taxes Event concerned;
- (C) the effect of any other previous Pass Through Events which have not previously been applied to the Transmission Tariffs in accordance with the Code or this Access Arrangement;
- (D) in relation to a Counterparty Default Event, the recovery of any outstanding amounts; and
- (E) any other relevant factors.

(b) A Pass Through Amount may be positive or negative.

6.3 How does GasNet apply a Pass Through Amount?

(a) A Pass Through Amount must be applied by GasNet in accordance with Schedule 4.

6.4 Pass Through Amounts which incorporate a forecast

For the purposes of calculating the benefit sharing allowance under clause 7.2 and in applying the Price Control Formula in Schedule 4, a Pass Through Amount which incorporates a forecast will be updated so as to reflect the actual Pass Through Amount (when known).

GasNet is not required to prepare a statement under clause 6.1(a) if the aggregate of all Pass Through Amounts for Regulatory Year (t) is between \$-50,000 and \$50,000.

Amendment 32

Before the proposed revised access arrangement can be approved GasNet must delete schedule 3 of the revised access arrangement and replace it with:

3.1 Proposed tariffs

- (a) GasNet may vary its Transmission Tariffs in accordance with the price control formula in schedule 4 and sections 8.3B to 8.3H of the Code subject to the following:
 - (i) For each Regulatory Year GasNet must, at least 30 Business Days before the start of the Regulatory Year ((that is, during Regulatory Year (t-1)), give the Regulator a notice.
 - (ii) This notice must contain GasNet's proposed variations to the Transmission Tariffs, the proposed effective date for those variations, and, in relation to proposed Pass Through Amounts (if any), the information required to be provided in a statement under clause 6.1(a).

- (iii) The proposed variations to the Transmission Tariffs must demonstrate compliance with the relevant principles and formulae in Schedule 4, and, in relation to a Pass Through Amount, section 6.2 of the Access Arrangement.
- (b) The minimum notice period for the purposes of section 8.3D(b)(i) of the Code shall be the period ending on the last day before the start of the Regulatory Year in which the Transmission Tariffs are to apply.

Amendment 33

Before the proposed revised access arrangement can be approved GasNet must delete the definitions of Pass Through Amount and Service Envelope Agreement in clause 9 of the revised access arrangement and replace it with:

Pass Through Amount means the pass through amount specified by GasNet in a notice under section 8.3B of the Code:

- (a) which is allowed under section 8.3D of the Code because of effluxion of time; or
- (b) as varied by the Regulator under section 8.3E of the Code.

Amendment 34

Before the proposed revised access arrangement can be approved GasNet must insert a further definition in clause 9 of the revised access arrangement:

Preliminary Pass Through Amount means the amount or amounts that GasNet proposes as the financial or anticipated financial effect of the Pass Through Event in its statement under clause 6.1(a)

Amendment 35

Before the proposed revised access arrangement can be approved GasNet must delete clause 7.3 of the revised access arrangement and insert:

7.3 Pass through carry forward

If:

- (a) a Pass Through Event has occurred;
- (b) the Pass Through Event has a financial effect on GasNet in the Third Access Arrangement Period; and
- (c) GasNet has not given a statement under clause 6.1(a) or a notice under section 8.3B of the Code during the Third Access Arrangement Period in relation to that Pass Through Event,

then GasNet may include a Pass Through Amount in relation to that Pass Through Event in a statement under clause 6.1(a) (or an equivalent) and a notice under section 8.3B of the Code in the Fourth Access Arrangement Period.

Amendment 36

Before the proposed revised access arrangement can be approved GasNet must delete clause 1.7(c)(i)(B) under Billing Parameters and insert:

- (B) the Winter Injection Volume for Regulatory Year “t” is based on a prorata allocation across each Shipper based on injections from the previous year of the annual Winter Injection Volume applied as part of the annual tariff adjustment to Transmission Tariffs in accordance with Schedule 3 for Regulatory Year “t”.

Amendment 37

Before the proposed revised access arrangement can be approved GasNet must under clause 4.3 of schedule 4 of the revised access arrangement delete the words following PTA and insert:

is the Pass Through Amount and

Amendment 38

Before the proposed revised access arrangement can be approved, GasNet must

- remove cl. 7.2(i) of the proposed revised access arrangement and
- replace ‘use’ with ‘take into account’ in cl. 7.2(h)(ii) of the proposed revised access arrangement.

Amendment 39

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.2 of the proposed revised access arrangement to reflect that GasNet will provide gas transportation services directly to users.

Amendment 40

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 3.3 of the proposed revised access arrangement to reflect the principles in Appendix C of this final decision.

Amendment 41

Before the proposed revised access arrangement can be approved, GasNet must:

- amend cl. 8.2 of the proposed revised access arrangement to be consistent with s. 5.7 of the MSO rules and
- to reflect that the responsibility for complying with the obligations imposed under ss. 3.12–3.15 of the code is allocated to VENCORP.

Amendment 42

Before the proposed revised access arrangement can be approved, GasNet must amend cl. 5.1(c) of the proposed revised access arrangement to read:

‘An expansion required to increase withdrawals at Culcairn over and above the current capacity of 17 TJ/day will be covered unless the Regulator, before the decision to construct the New Facility is made by the Service Provider, agrees that it should not be covered.’

Appendix A: Submissions

The following interested parties provided submissions to the issues paper published by the ACCC on 24 May 2007.

Organisation	Date received
AGL	26 June 2007
TRUenergy	27 June 2007
Australian Paper	29 June 2007
Origin Energy	9 July 2007
Energy Users Association of Australia	6 August 2007
Energy Users Coalition of Victoria	10 August 2007

The following interested parties provided submissions to the draft decision published by the ACCC on 14 November 2007.

Organisation	Date received
TRUenergy	14 December 2007
TRUenergy Gas Storage	14 December 2007
Victoria Electricity	14 December 2007
Origin Energy	14 December 2007
International Power	14 December 2007
AGL	17 December 2007
Australian Pipeline Industry Association	18 December 2007
Australian Paper	19 December 2007
Energy Users Coalition of Victoria	20 December 2007
GasNet	20 December 2007
VENCorp	21 December 2007
Alinta	21 December 2007
Multinet	21 December 2007

Appendix B: Attachment A of the code

Information disclosure by a service provider to interested parties

Pursuant to s. 2.7 the following categories of information must be included in the access arrangement information. The specific items of information listed under each category are examples of the minimum disclosure requirements applicable to that category but, pursuant to sections 2.8 and 2.9, the relevant regulator may:

- allow some of the information disclosed to be categorised or aggregated and
- not require some of the specific items of information to be disclosed

if in the relevant regulator's opinion it is necessary in order to ensure the disclosure of the information is not unduly harmful to the legitimate business interests of the service provider or a user or prospective user.

Category 1: Information Regarding Access & Pricing Principles

- Tariff determination methodology
- Cost allocation approach
- Incentive structures

Category 2: Information Regarding Capital Costs

- Asset values for each pricing zone, service or category of asset
- Information as to asset valuation methodologies - historical cost or asset valuation
- Assumptions on economic life of asset for depreciation
- Depreciation
- Accumulated depreciation
- Committed capital works and capital investment
- Description of nature and justification for planned capital investment
- Rates of return - on equity and on debt
- Capital structure - debt/equity split assumed
- Equity returns assumed - variables used in derivation
- Debt costs assumed - variables used in derivation

Category 3: Information Regarding Operations & Maintenance

- Fixed versus variable costs
- Cost allocation between zones, services or categories of asset & between regulated/unregulated
- Wages & Salaries - by pricing zone, service or category of asset
- Cost of services by others including rental equipment
- Gas used in operations - unaccounted for gas to be separated from compressor fuel
- Materials & supply
- Property taxes

Category 4: Information Regarding Overheads & Marketing Costs

- Total service provider costs at corporate level
- Allocation of costs between regulated/unregulated segments
- Allocation of costs between particular zones, services or categories of asset

Category 5: Information Regarding System Capacity & Volume Assumptions

- Description of system capabilities
- Map of piping system - pipe sizes, distances and maximum delivery capability
- Average daily and peak demand at "city gates" defined by volume and pressure
- Total annual volume delivered - existing term and expected future volumes
- Annual volume across each pricing zone, service or category of asset
- System load profile by month in each pricing zone, service or category of asset
- Total number of customers in each pricing zone, service or category of asset

Category 6: Information Regarding Key Performance Indicators

- Industry KPIs used by the service provider to justify "reasonably incurred" costs
- Service provider's KPIs for each pricing zone, service or category of asset

Appendix C: Gas Transportation Deed Principles

All Market Participants are required under Clause 5.3.1 of the MSOR to have in place an agreement for the payment of transmission charges to a Transmission Pipeline Owner (TPO). GasNet is the TPO for the Gas Transmission System.

Until permanent Transmission Payment Deeds are agreed between GasNet and Market Participants, Gas Transportation Deeds (GTD) in similar form to those entered into by Market Participants with VENCORP under the previous arrangements are required.

The terms of the Gas Transportation Deed between GasNet and Market Participants are:

Term

The deed comes into effect when signed and expires on 31 December 2012.

Payment

- Market Participant promises to pay the regulated transmission charges
- Invoicing will be monthly by 20th Business Day
- Payment will be required by the later of month end in which the invoices are received or 10 Business Days after receipt of an invoice
- Interest is payable on overdue amounts

Limitations

GasNet's liability, if the VENCORP Market Services are not supplied, whether in whole or in part, either through the failure of GasNet to provide the Tariffed Transmission Service or otherwise, is limited to uplift payments under Clause 3.6.8 of the MSOR.

Where Tariffed Transmission Services are provided in part the Market Participant must pay for those services actually provided.

The Deed is for the purpose of establishing payment and security arrangements for the Tariffed Transmission Service and does not impose an obligation on GasNet to provide transmission services to a Market Participant.

Force Majeure

Parties may be excused for non-performance under the deed by reason of Force Majeure.

The party seeking relief must notify the other party and cooperate in efforts to mitigate and investigate the event or circumstance.

If the event or circumstance continues for 90 days, then either party may terminate the Deed upon 30 days notice.

Termination

The Deed may be terminated if:

- The Market Participant materially defaults in performance of its obligations or
- There is an insolvency event in relation to the Market Participant.

Either party may terminate the Deed if:

- The Shipper ceases to be a Market Participant or
- The Service Envelope between GasNet and VENCORP expires or is terminated.

Other

The Deed may be assigned by a party with the written consent of the other party. Disputes will be referred for resolution in accordance with the dispute Resolution Procedure in the Deed.

Appendix D: Consultant reports

Report	Date received
ACIL Tasman <i>Final report: GasNet GPG forecasts—Review of GasNet gas power generation forecasts within the 2008–12 access arrangement period</i>	13 August 2007
Ross Calvert Consulting Pty Ltd <i>GasNet Revised Access Arrangement—Assessment of Proposed Operating Expenditure Scope and Workload Changes</i>	14 September 2007
Sleeman Consulting <i>GasNet Principal Transmission System: Review of Proposed New Facilities Investments</i>	19 September 2007

Appendix E: Pipeline map

