GasNet Australia - Supplementary Submission

1 Background

On 27 March 2002, GasNet lodged with the Commission its proposed Access Arrangement and Access Arrangement Information for the period commencing 1 January 2003, together with a detailed submission ("**Submission**") in support of its proposed Access Arrangement. These were lodged under section 2.28 of the National Third Party Access Code for Natural Gas Pipeline Systems ("**Code**").

On 14 August 2002, the Commission released its Draft Decision on GasNet's Access Arrangement. In that decision, the Commission proposed not to approve GasNet's revisions in the form submitted in March 2002. The Commission set out a number of amendments that would have to be made to the revised Access Arrangement in order for it to approve GasNet's revisions. GasNet did not submit amended revisions in response to the Draft Decision.

The Commission released its Final Decision on 13 November 2002. In the Final Decision, the Commission confirmed its Draft Decision not to approve GasNet's proposed revisions and again set out the amendments (or nature of amendments) necessary for the Commission to approve the revised Access Arrangement.

The Commission required GasNet to submit revisions that comply with the Final Decision by 2 December 2002 (which the Commission subsequently extended to 6 December 2002).

2 GasNet departs from Final Decision

2.1 GasNet's proposed revisions (December 2002)

On 6 December 2002, GasNet submitted amended revisions to its proposed Access Arrangements, as required under section 2.40 of the Code. These revisions adopt all of the amendments specified by the Commission in its Final Decision, except for:

(a) a number of amendments relating to the rate of return; and

(b) amendment 26, relating to the allowance for asymmetric risks.

The effect of these departures is that the annual Total Revenue implicit in the GasNet proposal[1] is approximately $4.5 million higher than the annual Total Revenue implicit in the amendments specified in the Commission's Final Decision[2]. Further detail is provided in section 3 below.

GasNet believes that its proposed revisions contain the elements and satisfy the principles set out in sections 3.1 to 3.20 of the Code. In particular, GasNet believes that the Reference Tariffs contained in its revisions comply

[1] $82.6 million in 2003

[2] $78.1 million in 2003

with the Reference Tariff Principles described in section 8 of the Code (see section 3.4 of the Code).

2.2 Commission misunderstood its role

GasNet believes that the Commission has misunderstood its role under the Code, particularly in relation to the Reference Tariffs. Section 3.4 of the Code requires the Commission to determine whether GasNet's revisions comply with the Reference Tariff Principles in section 8. This has a number of consequences.

First, the Commission's focus should be on assessing GasNet's proposals against the Code requirements. Instead, the Commission set about building its own revenue model.

Although the Commission has provided an analysis of why it believes its proposal complies with the Code, the Commission has, in many areas, failed to provide any analysis as to why it believes GasNet's proposal does not comply with the Code. If the Commission intends to reject GasNet's proposal, then it is incumbent on the Commission to establish more than simply showing the Commission calculates a different outcome.

Second, the Reference Tariff Principles are, as GasNet has pointed out in its earlier Submission, broad and imprecise and, therefore, a range of tariff outcomes is likely to "comply" with them. Put another way, it is wrong to suggest there is only one unique answer that complies with the Reference Tariff Principles. However, this is exactly how the Commission has proceeded. Instead of assessing whether GasNet's proposals fall within the range of outcomes permitted by the Code, the Commission has incorrectly sought to impose its own single unique outcome.

Third, the Code requires the Commission to assess not only compliance with individual criteria in the Code, but also the overall impact of the revisions, particularly with reference to section 2.24 of the Code. The Commission has not, to date, done this.

2.3 GasNet's revisions comply with Code

GasNet submits that, when examined in the context of the likely range of outcomes that satisfy the Reference Tariff Principles, its proposed revisions clearly fall within this range and therefore comply with the Reference Tariff Principles.

This conclusion is supported by an overall analysis of the impact of GasNet's proposals.

(a) The Total Revenue proposed by GasNet differs from the Total Revenue proposed by the Commission by approximately 5.8%. Assuming the Commission's proposal is within the permissible range of the Reference Tariff Principles, then it is likely that GasNet's proposal is also within that range (especially given the imprecision of the Reference Tariff Principles).

(b) Although it is only a 5.8% difference (in Total Revenue), GasNet's legitimate business interests are adversely (and disproportionately) affected by the Commission's proposals. GasNet has significant fixed costs in operations, depreciation and interest payments. The revenue model adopted by the Commission implies an annual profit of approximately $22 million for GasNet's regulated business. In this context a 5.8% change in Total Revenue translates to a 20% change in annual profit.

(c) In contrast, a 5.8% change in Total Revenue translates to a change in the cost of delivered gas of:

(i) for industrial customers, approximately 0.5%[3] and

(ii) for domestic customers approximately 0.24% (or $1.20 per household per annum)[4].

3 GasNet's revised access arrangement

3.1 Summary

The main areas of difference between GasNet's proposal and the position adopted by Commission in the Final Decision are as follows:

(a) GasNet set the risk free rate by reference to 10 year Government bonds as opposed to the 5 year period adopted by the Commission;

(b) GasNet has used an equity beta of 1.16 as opposed to the an equity beta of 0.97 adopted by the Commission;

(c) GasNet has included an allowance of 25 basis points for debt raising costs as opposed to the 12.5 basis points allowed by the Commission; and

(d) GasNet has included approximately $500,000 for asymmetric risk whereas the Commission has allowed only $22,000.

In addition to complying with the overall requirements of the Code, GasNet considers that in each of these areas of difference, GasNet's Access Arrangement falls within the individual ranges of outcomes permitted under the Code for these elements.

3.2 Bond period

The Code provides little direct guidance as to the identification of the risk free rate and in particular, does not prescribe the use of either a 5 year or 10 year bond rate. The real issue for the Commission to determine is whether the 10 year bond rate adopted by GasNet is within the range of possible outcomes under the Code.

GasNet believes, on the basis of the submissions and expert reports previously provided, that a 10 year bond rate complies with the Code.

[3] Based on delivered cost of gas of $4.00 /GJ for industrial customers.

[4] Based on delivered cost of gas of $9.00 /GJ an annual consumption of 55 GJ for domestic customers.

In addition, although the Commission has previously adopted a 5 year bond rate, most other regulators in Australia have applied a 10 year bond rate. This suggests that the range of possible outcomes in relation to the bond rate is at least between 5 and 10 years.

3.3 Equity beta

As with the bond period, there is clearly a range of possible outcomes under the Code in relation to the equity beta. For the purposes of preparing its latest revisions, GasNet has adopted an equity beta of 1.16. This figure is consistent with the most recent decision of the Commission on the Moomba-Adelaide pipeline and is at the lower end of the range used by the Commission in previous decisions. GasNet considers that its proposal is clearly within the range of possible outcomes permitted by the Code.

3.4 Debt raising costs

The Commission accepted in its Final Decision that there were a range of possible outcomes in respect establishing benchmark debt raising costs. GasNet's proposed allowance for transaction costs has been calculated by reference to the actual debt raising costs it has incurred. GasNet is of the view that these costs represent the prudent and efficient cost incurred in raising debt for a company in GasNet's circumstances.

3.5 Asymmetric risk

The reference tariff principles set out in section 8 of the Code allow a service provider to recover the efficient costs of delivering the reference service. GasNet considers that the allowance for asymmetric risks included in its Access Arrangement is required in order to reflect the true efficient cost of delivery the reference service.

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Dated 6 December 2002

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