Response to Submissions on ACCC Issues Paper - GasNet Australia

Dated 12 June 2002

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1 Introduction

1.1 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.

On 19 April 2002 the Commission published its issues paper relating to the proposed GasNet Access Arrangement and the proposed VENCorp Access Arrangement. As part of that issues paper, the Commission invited public submissions in relation to these Access Arrangements.

This Response sets out GasNet's response to the issues raised in public submissions lodged with the Commission.

1.2 Public Submissions

This Response addresses issues raised in the following public submissions, as received by the Commission on or before 3 June 2002:

(a) VENCorp Submission dated 13 May 2002 ("**VENCorp Submission**");

(b) BHP Billiton Submission dated May 2002 ("**BHP Billiton Submission**");

(c) Origin Energy Limited Submission dated May 2002 ("**Origin Submission**");

(d) Energex Retail Submission dated 9 May 2002 ("**Energex Submission**");

(e) Pulse United Energy Submission dated 16 May 2002 ("**Pulse Submission**");

(f) AGL Energy Sales and Marketing Submission dated 9 May 2002 ("**AGL Submission**");

(g) Department of Natural Resources and Environment (Energy Policy) Submission dated 20 May 2002 with attachments ("**DNRE Submission**"); and

(h) Duke Energy Australia Pty Ltd Submission dated 13 May 2002 ("**Duke Submission**").

Public submissions received after that date are not addressed in this Response. GasNet reserves the right to make further submissions in relation to these or any other public submissions.

1.3 Terminology

Given the complexity of the gas industry, a number of the participants have used different expressions and definitions, even in relation to the same issues. For simplicity, this Response adopts the conventions established in GasNet's Submission, in particular the glossary in section 11.1 of the Submission.

2 Reference Service Proposal

2.1 Summary of GasNet Proposal

In its Access Arrangement and Submission, GasNet described its proposals in relation to the Services Policy. The key elements of GasNet's proposal are as follows.

(a) As the GNS is a market carriage system, Users and Prospective Users of the GNS are offered a single consolidated Reference Service comprising the transportation of gas through the GNS via the Market Carriage system under the MSO Rules (which is, in effect, a combination of the availability of the GNS, which VENCorp sources from GasNet under the Service Envelope Agreement, and the market and system operation services provided by VENCorp).

(b) VENCorp, as operator of the GNS under the MSO Rules, is responsible for the provision of the Reference Service.

(c) For the purpose of Reference Tariff calculation, the Reference Service comprises two components:

  (i) the VENCorp Services, which VENCorp provides itself (these are dealt with in the VENCorp Access Arrangement); and

  (ii) the Tariffed Transmission Service, being the benefit of the availability of the GNS. In order to provide this component, VENCorp relies on the Service Envelope Agreement with GasNet.

2.2 Issues raised in submissions

Description of the Reference Service

As part of their submissions, each of VENCorp and DNRE included legal advice they had obtained in relation to GasNet's description of the Reference Service. The issues raised in those advices include whether GasNet provides a Service to VENCorp and whether VENCorp is a User within the meaning of the Code.

Maintaining the status quo

VENCorp states in its submission that it wishes to maintain the 'status quo' in the sense that each of GasNet and VENCorp should describe a Reference Service in its Access Arrangement.

GasNet's ability to charge tariffs

VENCorp, Energex and Pulse question how GasNet can assert that it does not provide a Reference Service yet it is seeking approval for its Reference Tariffs.

Tariffs applying to the Reference Service

BHP Billiton suggested that there needs to be an aggregation of the costs to be incurred for the aggregated reference service and that these costs need to be broken down so that proper comparisons of KPIs can be made and appropriate benchmarking can be conducted. BHP Billiton also suggested that the aggregated terms and conditions applying to the aggregated service need to be presented.

Rights of shippers

BHP Billiton questioned whether the rights of shippers would be affected by the proposed changes to the description of the service.

Access dispute process

VENCorp suggested that if GasNet does not define its Reference Service and the terms and conditions in its access arrangement prospective Users would be precluded from recourse to GasNet via the access dispute process in the Code. Pulse also argued that if GasNet's service is not deemed to be a Reference Service, Users would not have direct recourse to GasNet in the event of non-performance.

Alteration of services

VENCorp also expressed concern that GasNet may be able, as a result of its services not being specified in its access arrangement, to alter its services such that they were in conflict with the statutory functions of VENCorp as operator of the PTS.

GasNet's regulatory obligations

VENCorp suggests that there needs to be a clear commitment from GasNet to continue to make the PTS available for VENCorp and other Users. It is further suggested that GasNet's regulatory obligations should be better aligned with those of network service providers, although no explanation is given as to why this may be desirable.

Availability of Service Envelope Agreement

Energex submitted that the Service Envelope Agreement should be made public.

2.3 GasNet's response

Description of the Reference Service

GasNet has engaged Mallesons Stephen Jaques to provide legal advice in relation to the issues raised by VENCorp and DNRE. A copy of the

Mallesons letter of advice has been provided to the Commission. In that advice, Mallesons conclude that GasNet's proposed treatment of the Services Policy complies with the requirements of the Code.

In relation to the other issues identified above, GasNet makes the following comments.

Maintaining the status quo

As indicated in GasNet's Submission, GasNet considers that the way in which the Reference Services are structured in the current Access Arrangements does not accurately reflect the underlying commercial and regulatory arrangements. On this basis, GasNet considers that it is not appropriate to maintain the current structure (or "status quo") simply because that it the way it has been done in the past.

GasNet's ability to charge tariffs

GasNet rejects the suggestion that it must provide a Reference Service directly to a User in order to be able to recover a tariff. Such an argument ignores the fact that under the current Access Arrangements GasNet is not empowered to charge Users directly (unless otherwise agreed between GasNet and the User). VENCorp has the direct legal and commercial relationship with Users under the Gas Transportation Deeds pursuant to which VENCorp directs Users to pay charges to GasNet. The charges payable by Users under the Gas Transportation Deed are owed by Users to VENCorp, not to GasNet.

Tariffs applying to the Reference Service

In relation the issues raised by BHP Billiton, GasNet considers that the information presented in both GasNet's and VENCorp's Access Arrangement Information and GasNet's Submission provide sufficient information on the various components of the tariff and that together the VENCorp and GasNet Access Arrangements set out all the terms and conditions relating to the provision of the Reference Service.

Rights of shippers

As indicated in GasNet's Submission, the proposed changes to the description of the Reference Service will have no substantive impact on Users shipping gas via the GNS. The Gas Transportation Deeds between shippers and VENCorp will remain in place and gas will continue to be transported through the GNS via the market carriage system under the MSO Rules.

GasNet's current Access Arrangement confers no greater rights on VENCorp than it already has under the terms of the Service Envelope Agreement. Shippers will continue to have the benefit of the availability of the GNS which VENCorp sources from GasNet under the Service Envelope Agreement.

Access to dispute resolution process

GasNet's proposed changes to the Services Policy will have no material effect on the access of Users to an enforceable dispute resolution process. Access

disputes are likely to arise in one of two ways - between GasNet and VENCorp (ie as owner and operator respectively) or disputes involving third party Users (ie shippers using the GNS).

(a) In relation to disputes between GasNet and VENCorp, the Service Envelope Agreement sets out a detailed dispute resolution process that is binding on both GasNet and VENCorp. Indeed, overlaying a regulatory access dispute mechanism may simply serve to complicate any dispute resolution at this level.

(b) In relation to disputes involving third party Users, these disputes would involve one or more of the MSO Rules, the Gas Transportation Deeds between Users and VENCorp or the VENCorp Access Arrangement. The current GasNet Access Arrangement only addresses services as between GasNet and VENCorp, and therefore is not relevant to disputes involving third party Users. The Extensions and Expansions Policy contained in GasNet's Access Arrangement deals with coverage of new facilities and VENCorp's rights to obtain access to any additional capacity. Third party connection rights are dealt with under the MSO Rules.

Alteration of services

Under the Service Envelope Agreement, GasNet is required to make the Gas Transmission System available to VENCorp in accordance with the terms of the agreement. GasNet cannot unilaterally "alter its services". Any changes to the Service Envelope Agreement would have to be agreed between the parties. On this basis, GasNet considers that VENCorp's concerns in relation to GasNet "altering" the service are unfounded.

GasNet's regulatory obligations

In relation to VENCorp's concern that there should be a clear commitment from GasNet to continue to make the PTS available for VENCorp and other Users, GasNet considers that this commitment is already clearly and unambiguously dealt with in the Service Envelope Agreement.

Availability of Service Envelope Agreement

The Service Envelope Agreement is, and always has been, available to the public. A copy of the agreement is located on the Commission's website.

3 Merging the PTS and WTS

3.1 Summary of GasNet's proposal

GasNet is proposing to merge the PTS Access Arrangement and the WTS Access Arrangement into a single Access Arrangement from 1 January 2003. The steps for merging the two Access Arrangements are set out in GasNet's Submission. One of the steps will require the termination of the WTS Agreement between GasNet and TXU.

3.2 Issues raised in submissions

Contractual arrangement with TXU

Duke expressed concern that any new contractual arrangements entered into with TXU in relation to its use of the WTS should not provide benefits above and beyond those which are currently enjoyed by TXU.

3.3 GasNet's response

As discussed in GasNet's submission, TXU has indicated that it is prepared to consider terminating the WTS Agreement provided it can reach satisfactory agreement with VENCorp and GasNet in relation to obtaining equivalent capacity rights under an AMDQ credit certificate allocation. GasNet understands that VENCorp and TXU have come to a satisfactory arrangement on this issue.

The criteria for the termination of the WTS Agreement are set out in the WTS Agreement and GasNet intends to effect the termination accordingly. However, ultimately the terms of the termination are a bilateral commercial arrangement between GasNet and TXU only.

4 Inclusion of SWP

4.1 Summary of GasNet's proposal

GasNet proposes to increase its Capital Base from 1 January 2003 to include the capital costs associated with the SWP by employing the economic feasibility test in the Code. GasNet has proposed a stand-alone tariff that recovers the actual capital costs over the life of the SWP.

4.2 Issues raised in submissions

Appropriate test to apply

Origin expressed the view that SWP should be included in the Capital Base on the basis that it satisfies the system wide benefits test set out in the Code. They further suggested that system wide benefits of the SWP should, to the extent allowed by the Code, be reflected in establishing the appropriate reference tariff for the pipeline.

Derivation of the tariff

BHP Billiton seeks more information about the calculation of the stand-alone tariff. In particular, BHP Billiton seeks a build-up of the cost components including capital costs, WACC, capex and all elements of opex.

Relationship with K factor

BHP Billiton questioned the application of the K Factor to the stand-alone tariff on the SWP and Energex expressed concern that the redundant capital risk on the SWP should not be transferred to other users via the K Factor.

Demand for forward and backhaul flows on the SWP

BHP Billiton expressed concern with the level of information provided by GasNet on the amount of demand for forward and backhaul flows of gas in both the past and the future on the SWP.

4.3 GasNet's response

Appropriate test to apply

GasNet agrees with Origin that the SWP passes the system wide benefits test. However, the system wide benefits test is not the only test which applies to a roll-in application under the Code. As set out in GasNet's submission, GasNet is of the view that the SWP satisfies both the system wide benefits test and the economic feasibility test.

Derivation of tariffs

In relation to the issue of the derivation of tariffs for the SWP, GasNet has provided information on:

(a) the capital costs associated with the SWP (see section 5.6 and schedule 3 of GasNet's Submission);

(b) forecast gas loads on the SWP (see section 9.3 of GasNet's Submission); and

(c) cost allocation procedures for the SWP (see section 5.7.4 of schedule 3 of GasNet's Submission).

As discussed in section 17.3 of this Response, GasNet submits the Code does not require it to provide sufficient data to enable replication of the tariff calculations. GasNet considers that it has provided sufficient information to allow Users and Prospective Users to understand the methodology used to derive the stand-alone SWP tariff.

Relationship with K factor

This issue is discussed in section 6.3 of this Response.

Demand

The forecast peak day injections are contained in table 9.5 of GasNet's Submission.

5 Dandenong LNG facility

5.1 Summary of GasNet's proposal

GasNet owns and operates the liquefied natural gas (LNG) storage facility at Dandenong, Victoria. Services provided by means of the LNG facility (including liquefication and gasification services) are not covered by the current GasNet Access Arrangement. However, the current Tariff Order regulates:

(a) LNG services provided to VENCorp for system security purposes (this is defined as a "scheduled excluded transmission service", for which a fixed annual fee is payable); and

(b) other LNG services provided to retailers (these are regulated as excluded transmission services, for which GasNet must charge on a "fair and reasonable basis").

As with the current Access Arrangement, GasNet's proposed Access Arrangement does not include the LNG services.

5.2 Issues raised in submissions

Should the LNG facility be regulated?

Both Pulse and Energex expressed the view that the LNG security reserve taken by VENCorp should continue to be regulated post December 2002.

5.3 GasNet's response

GasNet considers that the LNG service is a competitive service and should not be regulated under its Access Arrangement. The LNG service is not a core transportation service and competes with other "peak" load services, including underground storage, incremental injections under the MSO Rules (for example by producers or retailers) and customer load shedding.

Further, gas liquefaction and storage technology has advanced significantly in recent years (particularly in the case of 'mini-LNG' systems), and there is no barrier to the construction of new LNG facilities.

In any event, GasNet considers that the LNG service is outside the scope of the National Gas Code. The National Gas Law specifically excludes from the definition of "pipeline" any "tanks, reservoirs… used to… change natural gas (other than odourisation facilities) such as a processing plant". GasNet considers that the process of liquefaction is a "change" to natural gas.

6 Tariff Design

6.1 Summary of GasNet's proposal

GasNet proposes to retain the Cost of Service Methodology for revenue determination, which is the methodology used in the current PTS and WTS Access Arrangements. Under this approach, the revenue to be generated from the sales (or forecast sales) of all services over the regulatory period is, subject to the Code, equal to the costs (or forecast costs) of providing all the services, where the costs in this instance includes a return to capital. In addition, GasNet proposes to retain the existing "price path" form of regulation.

The proposed discounted weighted average tariff to apply over 2003 to 2007 shows an increase of 11%[1] in real terms over the 2002 published tariffs. This increase is due primarily to:

(a) an increase in the underlying WACC parameters;

(b) rectification of errors in the Capital Base;

(c) the carry-forward of the accumulated K-factor carryover relating to the First Access Arrangement Period; and

(d) the benefit sharing allowance arising from efficiencies made in the First Access Arrangement Period.

GasNet proposes injection tariffs levied on the 10 peak injection days and withdrawal tariffs based on volumes delivered. A separate tariff is proposed for each of the five injection zones and for each of the 14 withdrawal zones. Within each withdrawal zone there are separate tariffs for Tariff V and Tariff D customers. GasNet is also proposing a new storage refill tariff, a cross system withdrawal tariff, matched withdrawal tariffs and prudent discounts for customers in certain geographical locations.

6.2 Issues raised in submissions

Magnitude of tariff increase in 2003

Concern was expressed in a number of submissions at the magnitude of the increase in tariffs in 2003.

Level and method of charging the injection tariff

Duke expressed concern at the divergence between the level of injection charges at different injection points.

Some submissions expressed concern at the retention of charges based on peak flows as this is seen as administratively difficult.

Duke also questioned the cause of the increase in the Longford injection tariff.

Removal of peak withdrawal charges

A number of submissions supported the removal of peak charges, however, one submission argued for the retention of peak charges on the basis that they send a price signal to which customers can respond.

Cross System Tariff

A number of submissions queried the application of the cross system tariff. In particular, AGL questioned whether the structure of the tariffs would result in GasNet obtaining a windfall gain if there are significant north to south gas flows.

[1] This excludes the SWP which is charged on a stand alone basis.

K Factor

A number of concerns have been raised in relation to the application of the K Factor to the WTS and the SWP.

6.3 GasNet's response

Magnitude of tariff increase in 2003

The primary reasons for the increase in tariffs in 2003 are listed above and a detailed justification of these reasons is set out in GasNet's Submission. GasNet stands by its assertions and believes the tariff increase represents a fair and reasonable increase in the circumstances.

In addition, the magnitude of the initial tariff depends on the setting of the X-Factor, given that the tariff path must recover the NPV of the target revenue. GasNet has selected an X-Factor which it believes reasonably balances the tariff changes at the commencement of the next and the subsequent Access Arrangement Periods.

Level and method of charging the injection tariff

In response to the issues raised relating to the divergence between the level of injection charges at different injection points, GasNet acknowledges that greater equalisation of charges may be desirable. However, GasNet is constrained by the requirements in the Code for efficient cost allocation. This has led to a significantly higher injection charge at Port Campbell. GasNet notes that a lower Port Campbell injection tariff would be obtained if the Commission accepts the arguments advanced by GasNet and some retailers in relation to the system wide benefits provided by the SWP.

In relation to the retention of charges based on peak flows, GasNet has attempted to draw a balance between administrative simplicity and cost-reflective tariffs. The arguments presented in the GasNet Submission justify the removal of peak charges from withdrawal pipelines. This is consistent with the lack of congestion expected over the forecast period on laterals (withdrawal pipelines are served from multiple sources and therefore are unlikely to become congested). However, GasNet has retained peak charges on injection pipelines on the basis that if congestion were to occur, it is more likely to occur on the injection pipelines For example, GasNet projects the SWP to become constrained in 2006 and 2007.

The revenue that is recovered from peak charges in the current Access Arrangement is approximately 65% of total revenues (excluding the SWP). Under the new proposal, where peak charges are levied only on injection pipelines, the share of revenue associated with peak flows (including the SWP) is reduced to approximately 28%. This is a significant move to a simpler system, which still retains an appropriate level of peak pricing signals.

The increase in the Longford tariff arises because GasNet has allocated the direct operating costs of the pipeline and the Gooding compressor (including fuel) to the injection charge. In the current Access Arrangement there are no operating costs allocated to injection charges. In addition, the volumes

forecast to be carried on the pipeline are marginally lower than in the current Access Arrangement.

Removal of peak withdrawal charges

GasNet believes it is not appropriate to send a price signal unless there is a reasonable prospect of congestion over the near to medium term. There is no economic benefit if customers reduce their peak usage when spare capacity is available in the withdrawal pipelines.

Cross System tariff

As a point of clarification, it should be noted that the cross system tariff does not apply to flows to the northern zones, as the costs for transmission through the Metro zone are already included within the tariffs for the northern zones.

GasNet will not benefit from any revenues from cross-system tariffs because any revenues are returned (with interest) to all users in lower tariffs through the K-Factor mechanism. The intent of the cross-system tariff is to send an appropriate price signal to users. In the absence of a cross-system tariff, the tariff from Port Campbell to Longford and vice versa, is very low compared to the tariff from Port Campbell or Longford to the northern zones. This does not reflect the actual use of the system.

Average Revenue Control (K Factor)

The average revenue control which applies under the current Access Arrangement reflects the integrated network features of the GNS. In particular, all participants benefit from the full network availability and, while GasNet is subject to overall volume risk, it does not bear the full allocation risk (ie the location of individual injections and withdrawals).

GasNet has set tariffs for the SWP and the WTS extensions which aim to recover the incremental costs of each investment. The K-Factor mechanism will apply to shortfalls or excesses in flows on these pipelines.

In GasNet's view, the average revenue control should be evaluated in the following terms:

(a) Does the pipeline company have the opportunity to earn a reasonable return on its investment, in light of the risk profile implied by the price control mechanism?

(b) Is the tariff cost-reflective and economically efficient. That is, is it sending the appropriate price signal to users?

(c) Is the price control mechanism consistent with the Code?

The risk profile is determined by the nature of the price control method. At one extreme, GasNet could have proposed a revenue cap, which would expose GasNet to cost risk but not to volume risk. At the other extreme, prices in each tariff zone would not be not adjusted over the term of the Access Arrangement. Under this model, GasNet's revenues would be at risk on the volumes for each tariff component in every zone. The average revenue control, which has been adopted by GasNet, falls in between these two

extremes. It exposes GasNet to the risk of variations in the total annual volume. This proposal is a reasonable sharing of volume risk with users, and is integral to the GasNet submission. It is also consistent with the integrated nature of the GasNet network.

With respect to the SWP flows and the WTS volume, the risks are significantly higher than on other parts of the system. Firstly, the injections into the SWP at Port Campbell are highly susceptible to changes in supply decisions by Retailers and producers. Moreover, being the balancing source for peak supply, the volumes are very sensitive to weather variations and the magnitude of the use of LNG in the peak shaving role. Secondly, the volumes on the WTS are at risk of bypass, despite the offer of prudent discounts. Therefore, GasNet believes that the K-Factor corrections must be applied to these zones in order to maintain a reasonable balance of risk consistent with the risk exposure under the current Access Arrangement.

The tariff actually faced by users is appropriate because it is derived from the target revenue of each asset and a reasonable forecast of demand. This ensures that, despite the K-Factor corrections from time to time, Users will face an efficient tariff.

Lastly, GasNet believes that its proposal is fully consistent with the Code. The test in section 8.16 (b)(i) requires that the Anticipated Incremental Revenue exceed the New Facilities Investment. The Anticipated Incremental Revenue is the present value of the reasonably anticipated future revenue.

GasNet has made a reasonable forecast of the flows through these systems, and has demonstrated that the forecast revenues recover the incremental investment. The fact that there are partial risk mitigation measures which operate if the actual volumes differ from the forecast volumes does not diminish the fact that the Code test is satisfied based on the reasonably anticipated flows.

7 Zone definition

7.1 Summary of GasNet's proposal

GasNet proposes to change the definition of withdrawal zones in its Access Arrangement by defining them by reference to the identity of the Custody Transfer Meters (CTMs) rather than by reference to postcodes. The revised GasNet Access Arrangement also includes a procedure for amending zones within the Access Arrangement Period.

7.2 Issues raised in submissions

Costs and FRC

Both VENCorp and Pulse suggested that the redefinition of the zones by CTM would require VENCorp to modify its billing and settlement systems and that this would impose additional costs above those included in VENCorp's Access Arrangement Information. Pulse also indicated that the proposed change from post-codes to CTMs has not been anticipated and therefore not incorporated into industry planning for full retail contestability (FRC).

Consultation in relation to proposed zone changes

VENCorp expressed the view that there should be a public consultation process if GasNet proposes to amend any zones during the Access Arrangement Period.

Errors in MIRN designations

VENCorp identified an error in the Culcairn withdrawal and injection MIRNs.

7.3 GasNet's response

Zone Definition

GasNet has defined a transmission withdrawal zone by means of a group of custody transfer meters that are physically related to segments of the pipeline network. This means that the applicable transmission tariff for a given user will be the tariff that applies to the zone which contains the custody transfer meter which supplies that customer.

GasNet believes this is the only reasonable definition of a tariff zone, since it is based on the physical reality of the gas transportation system. The purpose of defining separate zones in the first place (rather than a simple postage stamp tariff which applies to all location in Victoria) is to reflect the costs of the physical assets which supply given consumers. These physical assets are divided into groups of asset segments, and the tariff at each meter or group of meters is calculated from the costs of the relevant physical assets used in supplying gas to these meters.

The definition of zones by post code is a device which enables individual consumers to be allocated to each zone, by a retailer, in a manner which is convenient and simple to administer when retail contestability is in full operation. The issue of post code definition is in fact more an issue of customer allocation to zones, rather than an issue of zone definition.

GasNet understands that Tariff-D customers are currently allocated to tariff zones on a case-by-case basis, based on the physical location of each Tariff-D customer within the zonal system. This method has been successfully applied during the introduction of retail contestability to the Tariff-D markets. At present the majority of Tariff-V customers are not contestable, but when they become contestable later this year, VENCorp will employ the post code method to allocate consumers to the appropriate zones. This procedure will underlie the allocation of gas to each retailer for each transmission withdrawal zone.

GasNet has no particular concern with how VENCorp allocates customers to the measured gas flows through each zone, provided it is done efficiently, and provided it does not lead to disputes between retailers which may delay the settlement of charges. For example GasNet accepts the allocation methods employed by VENCorp at each injection point, which are done without any input from GasNet other than supplying the overall meter readings.

However, GasNet has discussed the allocation of post codes to zones with VENCorp, and believes a revised set of post code allocations can be provided

with little difficulty. Given that VENCorp has expressed a preference for post-codes to assist in the implementation of full retail contestability, GasNet will prepare an amendment to the Access Arrangement which specifies these post codes, and an appropriate change process which does not impede the administration of contestability. At present the post code allocations within the current Tariff Order can only be changed with the approval of the Commission. GasNet will discuss the appropriate involvement of the Commission in the administration of a change process before it submits its proposed amendments.

Consultation in relation to proposed zone changes

GasNet notes VENCorp's concern in relation to the provision of the revised Access Arrangement dealing with the amendment of zones. GasNet does not envisage that there will be any need to change to zones during the Access Arrangement Period. However, it does require some flexibility to alter zones if unforseen circumstances arise. The proposal contained in GasNet's Access Arrangement requires the approval of the Commission before a change is made. It is within the discretion of the Commission to withhold its approval pending consultation. The proposal as put by GasNet gives the Commission the discretion to decide its course of action based on the materiality of the proposed changes.

Errors in MIRN designations

GasNet will make the relevant amendments to the draft Access Arrangement to correct the errors identified by VENCorp in relation to the Culcairn MIRNs.

8 Pass Through

8.1 Summary of GasNet's proposal

GasNet proposes to include in its revised Access Arrangement a set of pass through rules which would permit GasNet to apply to the Commission to pass through within-period cost changes relating to:

(a) change in taxes events;

(b) regulatory events; and

(c) insurance events.

The key features of GasNet's proposal is that these events are all beyond GasNet's control and any pass through is subject to approval by the Commission.

8.2 Issues raised by submissions

Pass through trigger

Both Pulse and VENCorp expressed concern that GasNet has widened the definition of events that qualify for pass through treatment from predominantly Tax Events to include Insurance Events and Regulatory

Events. Pulse suggested that this has the effect of including more elements of rate-of-return regulation and is antithetical to the incentive regulation that underpins the Code. Origin was of the view that the pass through should work both ways to cover a decrease in costs as well.

Pass through process

VENCorp questioned the procedure applying to the determination of whether a pass through event has occurred. In particular, it questioned whether the 20 day period given to the Commission to consider a pass through application was sufficient. VENCorp also stated that the process "*appears open-ended and lacks transparency*".

Consultation with market

VENCorp, Origin and Energex suggest that there should be a consultation process with industry participants in relation to any pass-through application.

8.3 GasNet's response

Pass through trigger

The Regulatory Events described in GasNet's draft Access Arrangement reflect a series of events which might affect the revenue or costs of GasNet. GasNet could, as an alternative to the pass through mechanism, include an extra allowance in its revenue requirement to cover the risks of these events occurring. However, GasNet considers that it is more efficient to deal with such events by way of pass-through.

GasNet has described the nature of the risks which it seeks to pass through in the Submission.[2] The common feature of these events is that they are all beyond GasNet's control. For example, there may be a blow out in insurance premiums or a change to regulations which result in the derating of a pipeline. Such costs are potentially very significant.

GasNet's pass through proposal does include a "negative pass through" mechanism. Under section 6.3(f) of the proposed GasNet Access Arrangement, the Commission must, in considering any application by GasNet for a positive pass through amount, take into account the effect of any previous pass through event (which would include negative pass through events). GasNet has not included a specific obligation to make a pass through application for negative pass through events because:

(a) such a mechanism would encourage disputes in that Users would be incentivised to raise a dispute each time a regulatory or tax change occurred; and

(b) the pass through events are asymmetric in that positive pass through events are far more likely than negative pass through events.

[2] See section 9.9 of GasNet's Submission.

Pass through process

Under GasNet's proposals, the Commission would have 20 days to notify GasNet of its approval or otherwise to the relevant pass through. GasNet submits this is a reasonable amount of time for the Commission to consider the merits of the passthrough application. The 20 day period is consistent with the period contained in the pass through provisions of the Tariff Order.

GasNet disagrees with VENCorp's assertion that the proposal is appears open-ended and lacks transparency. The pass through mechanism sets out a clearly defined procedure for determining whether a pass through event has occurred and how the pass through amount is to be applied. GasNet also notes that the pass through procedure is consistent with the current pass through arrangements contained in the Tariff Order.

Consultation with market

In relation to the issue of consultation, GasNet considers that the Commission, who is responsible for administering GasNet's tariffs, is in the best position to determine the merits of a pass through application. This also ensures that there is efficiency and consistency in the decision making process.

9 Prudent Discounts and Matched Rebates

9.1 Summary of GasNet's proposal

GasNet is proposing to introduce prudent discounts for the Latrobe, Wodonga and Western Zone and the Dandenong Bypass.

9.2 Issues raised in submissions

The public submissions were generally supportive of the proposals for prudent discounts. The main issues raised in the submissions have dealt with the following.

Prudent discounts at VicHub

Duke Energy has raised the prospect that gas could be injected at the existing injection point at Longford, and withdrawn at the VicHub (which is a short distance downstream of the existing injection point). Under the proposed new tariffs, the injector would pay the Longford injection charge, (rebated for withdrawal in the Latrobe zone), plus a withdrawal charge for the Latrobe zone (which is already the subject of a prudent discount). In addition, the withdrawing party will also pay the VENCorp charges. Duke believes that these charges are not cost reflective and suggest that a prudent discount would be appropriate for the VicHub.

Prudent discounts at Port Campbell

Origin suggested that any matched transfers between the Iona storage plant and the proposed SEA Gas Pipeline should also qualify for a prudent discount.

Matched rebates

Duke has queried the application of matched rebates for injections at VicHub. Duke has noted that a hub trader will make all injections at VicHub, although these injections may be contracted to other Retailers. If one of these Retailers makes a withdrawal of this contracted gas in the Latrobe, Tyers or Lurgi zone, then there is no apparent matching of injections with withdrawals, and hence no rebate on the Longford injection charge. This is seen to disadvantage the hub trader.

VENCorp prudent discounts

VENCorp suggest that it should continue to charge the VENCorp tariff on a postage-stamp basis and that GasNet alone should offer prudent discounts. In support of this view VENCorp argues that:

(a) this approach is consistent with GasNet having the commercial relationship with users;

(b) the implementation of prudent discounts by GasNet is efficient and simpler;

(c) both GasNet and Users are indifferent to who offers the discount;

(d) VENCorp charges are not sufficient to enable a substantive discount; and

(e) VENCorp tariffs should be the same for all Users as the VENCorp services are essentially the same, irrespective of location.

9.3 GasNet's response

Prudent discounts at VicHub

Both the GasNet and VENCorp withdrawal charges at VicHub recover only overhead operating costs. These costs are allocated on a postage stamp basis to all withdrawals from the system. However there is an apparent anomaly in this approach at VicHub. GasNet is willing to work with VENCorp to design an appropriate prudent discount at VicHub.

Prudent discounts at Port Campbell

It was recently announced that the SEAGas Pipeline will go ahead. There is a possibility that this pipeline will connect to the SWP a short distance downstream of Iona. This scenario was not assumed in the GasNet forecast, since the connection arrangements at Port Campbell have not been finalised.

If gas from the WUGS facility at Port Campbell is withdrawn at this proposed connection point for export to South Australia, then the exports will bear the SWP withdrawal charge, although the Port Campbell injection charge will be rebated. The SWP withdrawal charge recovers only the overheads from GasNet operating costs, which are charged on all withdrawals on a postage-stamp basis. The withdrawals would also incur the full VENCorp charges.

This is a similar situation to that which might arise at VicHub. GasNet is willing to work with VENCorp to design an appropriate prudent discount at Port Campbell.

Matched rebates

GasNet agrees with Duke's observations in relation to the application of the matched rebates to a hub trader. GasNet is willing to allow a matched rebate if the hub injector and the withdrawing retailer both confirm in writing that a contractual matching arrangement is in place. GasNet will prepare an amendment to the Access Arrangement to reflect this.

VENCorp prudent discounts

In response to the issue raised in the VENCorp submission on whether GasNet alone should be responsible for prudent discounts, GasNet makes the following observations.

Firstly, VENCorp is in a commercial relationship with Users through the MSO Rules and the Gas Transportation Deeds and accordingly should attempt to minimise the potential for economic inefficiencies if part of the transmission system is bypassed (ie. unnecessary duplication and higher tariffs for Users). However, GasNet is concerned that VENCorp has no commercial incentive to offer prudent discounts, since VENCorp does not face volume risk (ie. if volumes are reduced, VENCorp can adjust tariffs upwards so it is held whole over the period of the Access Arrangement).

Secondly, while VENCorp does provide the same service to all Users, some Users do not require or value the services provided by VENCorp. For example, many of the benefits of being connected to the gas market can be obtained even after a bypass is constructed, by simply maintaining a (substantially unused) connection to the GNS. The User on the bypass is also not subject to curtailment by VENCorp if there is congestion on the GNS.

Thirdly, the VENCorp charges are not insignificant. The Tariff-D charge for a large bypass customer is approximately $0.042/GJ, and higher if there are Tariff-V customers involved. This does not include the charge for un-accounted-for gas which varies from $0.014/GJ to $0.027/GJ. It is unlikely that this cost would be avoided if a customer left the system. These costs may be compared to the bypass tariff for the Latrobe zone of approximately $0.12/GJ. Hence VENCorp could make a significant contribution to a prudent discount if it were required.

GasNet agrees that for the current discount proposals, a VENCorp contribution is not required, and that the current proposals are simpler to administer. However, VENCorp may be required to offer a contribution to a prudent discount at VicHub and Iona (as discussed elsewhere).

However, GasNet is concerned that if a bypass threat arises during the term of the Access Arrangement, VENCorp has no commercial incentive to participate in a prudent discount. GasNet proposes that VENCorp include a clause in their Access Arrangement that requires VENCorp to negotiate a prudent discount in good faith, and to be subject to the decision of an arbitrator if agreement with GasNet cannot be reached.

10 Asset lives

10.1 Summary of GasNet's proposal

The economic lives for the majority of the system assets are consistent with the estimates made for the First Access Arrangement Period. However, the SWP is accorded a longer life reflecting the recent construction date and the anticipated long-term value of a connection between the metropolitan area and WUGS. Also, the economic life of the Longford pipeline has been reduced slightly consistent with recent forecasts of the effect of the growth of interstate exports on the depletion of Bass Strait reserves.

10.2 Issues raised in submissions

Information to substantiate assets lives

Both BHP Billiton and Origin requested further information to substantiate GasNet's proposals for the shortened life of the Longford pipeline and the long life on the Otway supplied system. Origin was of the view that new sources and discoveries of gas will not have a substantial impact on the economic life of the GNS to the extent indicated in GasNet's submission.

10.3 GasNet's response

GasNet has released its consultant's report on Economic Life. This report presents the detailed arguments for the economic life of each pipeline group. The consultant separated the Longford pipeline and the SWP from the rest of the system, since these pipelines are subject to distinctly different influences over their economic lives.

The Longford pipeline has a reduced life because the consultant expects the Bass Strait gas fields to be depleted more rapidly as exports of gas to NSW and Tasmania grow over time. This is despite making an allowance for undiscovered gas resources in Bass Strait. After the depletion of the Bass Strait reserves the residual value of the pipeline for supply to customers en route is negligible.

The SWP has been given a longer life. This is principally because the pipeline is relatively new. Furthermore, the consultant did not reduce the life in anticipation of depletion of the Otway fields because in his view the SWP will have on-going value as a connection to an underground storage facility. That is, even when gas is imported from northern Australia, there will still be considerable value in a connection to a local storage facility.

11 Capital Base

11.1 Summary of GasNet's proposal

For the purpose of calculating the Capital Base for the commencement of the Second Access Arrangement Period, GasNet proposes to include certain assets (including easements) which were included in the original GHD valuation but were excluded from the Capital Base determined by the Commission.

11.2 Issues raised in submissions

Inclusion of easements

A number of the submissions rejected GasNet's proposal to include easements in the rolled forward Capital Base on the basis that the Code does not allow the Commission to re-open the Capital Base. Pulse expressed the view that easements are not normally considered as part of an owner's asset base and the definition of "pipeline" in section 2 of schedule 1 of the *Gas Pipelines Act* 1997 (SA) does not include any land or easements.

11.3 GasNet's response

GasNet's accepts that the Code does not permit the Commission to undertake a revaluation of the initial GasNet Capital Base. However, as indicated in its Submission, GasNet considers that the Code does allow the Commission to verify whether the Capital Base was correctly identified. GasNet's arguments on this point are set out in detail in the GasNet Submission.

In relation to the issue raised by Pulse, GasNet considers that both the definition of "pipeline" in the Gas Pipelines Access (South Australia) Act 1997 and the definition of "Capital Base" in the Code are sufficiently broad to include easements. In particular:

(a) the general principles in section 8 of the National Gas Code confirm that the overarching requirement of Reference Tariffs is that they should be based on the efficient cost of the relevant services. It is clear that the cost of easements is an inescapable cost of pipeline services;

(b) nothing in the National Gas Code expressly excludes easements from the Capital Base;

(c) the Capital Base is defined as the value of the capital assets that form the Covered Pipeline. Easements are either:

  (i) so intimately connected with a pipeline that they are a part of the pipeline; or

  (ii) even if they are not part of the pipeline, the value of the easements attaches to the pipeline; and

(d) the Commission has recognised land access acquisition costs as part of the capital costs of a pipeline (for example, in the 2001 Moomba-Adelaide Pipeline Final Decision, the Commission accepted native title payments).

12 Capital Expenditure

12.1 Summary of GasNet's proposal

The actual capital expenditure incurred by GasNet in the First Access Arrangement Period was $199.6 million. A portion of this capital expenditure ($40.4 million) relating to the Interconnect Assets, has already been incorporated into the Capital Base. GasNet proposes to include in its

Capital Base an additional $102.0 million (as spent) of the remaining capital expenditure. The GasNet Submission provides a detailed justification for the inclusion of these projects in the Capital Base.

GasNet has forecast recoverable capital expenditure of $87.0 million (nominal) for the Second Access Arrangement Period. The main items of capital expenditure are the partial looping of the pipeline between the Brooklyn compressor station and Lara, the Gooding compressor station refurbishment and the Lurgi pipeline refurbishment.

12.2 Issues raised in submissions

Justification for historical capex

BHP Billiton asserted that "*there is insufficient detail provided to demonstrate that the changed use of capex has resulted in the outcomes expected at the time of setting the current access arrangement*".

Justification for forecast capex

BHP Billiton also suggested that there needs to be a quantitative analysis to support the contemplated augmentation of the network, including a probable return for the capital expended.

Energex stated that "*we urge the ACCC to ensure that GasNet's claims do not "gold plate" the forecast CAPEX program*".

12.3 GasNet's response

Justification for historical capex

In relation to historical capital expenditure, GasNet has provided a detailed justification of the costs incurred for the Interconnect and SWP projects in the two revision applications made by GasNet to the Commission. The Commission has already accepted that the expenditure on the Interconnect was prudently incurred. In relation to the SWP, the Commission has accepted that the SWP was prudent in a technical and engineering sense. The remaining investments were required to maintain the ability of the system to deliver services. These projects were relatively small and involved the maintenance of existing assets.

As indicated in the GasNet Submission, GasNet has completed some of the projects originally forecast, while it has not completed others, choosing instead to achieve its service obligations by implementing alternative capital projects. The main project which was planned but not undertaken was the Brooklyn Loop. GasNet has included an extensive discussion of why this project did not proceed, and how an equivalent outcome was achieved by other means.

However, GasNet does not believe there is any implicit requirement in the Code for a company to undertake all planned capital expenditure. For example, circumstances can change in a way which removes the need for a specific project. It is inappropriate and inefficient to construct assets simply because they were reasonably anticipated up to five years earlier. Moreover, the Commission would not approve the roll-in of a planned asset if during the

Access Arrangement Period it was found that the investment was no longer required or prudent.

GasNet considers that there is sufficient information contained in the submission to demonstrate that the actual capital expenditure incurred by GasNet in the First Access Arrangement Period was an efficient means of delivering the required level of service and capacity. GasNet reiterates that the actual capital expenditure in the first Access Arrangement period was in excess of the allowance in the tariff.

Justification for forecast capex

In relation to forecast capital expenditure, the Code requires a financial justification of all planned investments. GasNet has provided a detailed description of each of the major projects it proposes to undertake and a justification as why the expenditure must be incurred. However the justification of maintenance capital expenditure, which is the majority of GasNet's planned capital expenditure, cannot be evaluated in terms of a probable return for the capital expended.

13 WACC

13.1 Summary of GasNet's proposal

GasNet's proposals in relation to the Rate of Return apply the well established WACC and CAPM methodologies employed by the Commission and other regulators to derive a real pre-tax WACC of 8.22%.

In relation to the WACC parameters, GasNet proposes amounts that are generally within the range adopted by the Commission in recent regulatory decisions. However, in relation to a number of parameters (such as the equity beta) GasNet proposes marginally higher returns.

13.2 Issues raised in submissions

Increase in asset beta

Origin expressed the view that there are no unique circumstances applying in the Second Access Arrangement Period that would justify GasNet claiming a higher asset beta than the First Access Arrangement Period. Further, Origin suggest that some of the initial risks have been mitigated by the revised demand forecasts and the proposed amendments to the operation of the K Factor.

13.3 GasNet's response

GasNet's arguments in support of its increased asset beta are set out in detail in the GasNet Submission. As discussed in the Submission, there are a number of important circumstances which justify the increased asset beta. In relation to the specific issues raised by Origin, while the revised demand forecast does address some of the risk between periods, it does not of itself, address the risk of unanticipated trends in demand within each Access Arrangement period.

14 Operating costs

14.1 Summary of GasNet's Proposals

Over the Second Access Arrangement Period, GasNet's operating costs remain relatively flat. However, there are some variations from year to year, particularly in relation to pipeline maintenance costs. GasNet has also included an allowance of $0.4 million to expand its general marketing activities.

14.2 Issues raised in submissions

Marketing allowance

BHP Billiton expressed the view that there was no justification for the planned expenditure on marketing.

14.3 GasNet's response

GasNet has proposed to spend approximately $0.4 million per annum on marketing and business development. This is an order of magnitude less than the expenditures planned by each of the gas distributors. This difference reflects the fact that a transmission business has a different focus to a distribution business. A transmission business principally deals with larger projects and large customers and retailers, whereas distribution companies receive the bulk of revenues from the smaller but more numerous residential and commercial loads.

GasNet has a strong incentive to encourage gas consumption, since revenues are directly tied directly to the annual flows. Initially, GasNet had anticipated that the Retailers would undertake the bulk of marketing activity, and the original operating cost budget for the First Access Arrangement Period did not allow for this function. Whilst the Retailers are active in marketing, it is apparent that the margin earned by the Retailers from a new load is significantly less than the revenue gained by GasNet through the transmission tariff, particularly in the high tariff zones. Likewise the loss of a customer has a greater effect on GasNet. Hence GasNet has the greater financial interest in retaining and gaining large customers, and should therefore devote the appropriate resources to marketing activity.

GasNet has not developed a specific marketing plan for this activity. This is because the workload is case specific and will change over time. The marketing activity is likely to revolve around power station development, cogeneration projects, and large gas-using industrial plants. In order to support and assist in the development of these projects, GasNet must commit significant time and effort, since for every one project that goes ahead there are a dozen which do not.

15 Demand Forecasts

15.1 Summary of GasNet's proposal

Section 4 of GasNet's Access Arrangement Information contains a summary of GasNet's demand (withdrawal) forecasts. The VENCorp APR provided

the basis for the forecast annual volumes for the Second Access Arrangement Period. However, GasNet has made a slight modification to the published VENCorp forecast to take into account a warming trend.

Details of GasNet's supply (injection) forecasts are contained in Schedule 6 of the GasNet Submission. In formulating the supply forecasts, GasNet has relied on information published by VENCorp in the Annual Planning Review, supply plans and contracts announced in the press, confidential discussions with industry participants and reasonable assumptions as to the outcome of the competitive gas supply process.

15.2 Issues raised in submissions

Annual demand forecast

One submission requested a break down of the gas volumes into power generation loads and other loads. Another noted a sudden increase in the Latrobe zone volume from 2001 to 2002 following a significant decrease from 2000 to 2001.

Warming trend in the annual demand forecast

A number of submissions questioned the existence of the warming trend identified by GasNet in its Submission. In particular, Origin and VENCorp questioned the reliance placed on the urban heat island hypothesis.

Exports and storage refills

VENCorp has included forecasts of WUGS refill in its submission, which are not provided in the VENCorp APR.

A number of submissions have queried GasNet's assumption that there will be no export volumes at Culcairn or Iona. VENCorp has provided its own forecast for Culcairn exports of 500TJ/year.

Supply forecasts

A number of submissions questioned why there was no forecast of Yolla injections at Pakenham, despite the fact that there is a prudent discount offered at Pakenham

15.3 GasNet's response

Annual demand forecast

GasNet has used the base load and power generation load forecasts provided in the VENCorp APR. The base load forecast is in Table 2.4 and Table 3.2, and the power generation load forecast is in Table 2.6 of that document. In both cases GasNet has selected the medium scenario.

In relation to the Latrobe zone volumes, the 2000 and 2001 results are actual metered flows. The 2002 forecast assumes a return to the historical trend. The flows to the individual meters within this zone are customer specific and, therefore, are confidential. However, a detailed analysis can be provided to the ACCC on request.

Warming trend in the annual demand forecast

As indicated in the GasNet Submission, GasNet commissioned a report from the CSIRO which sought to ascertain the cause of the historical warming trend identified in the VENCorp APR and to make an informed assessment as to whether the trend would continue. None of the submissions has presented a credible scientific critique of this report.

The authors of the CSIRO report indicate that there are identifiable physical factors at work which have led to the observed historical warming trend, and that these factors can reasonably be expected to continue. The CSIRO identified two contributing factors to the observed warming trend, namely the urban heat island effect, and the enhanced Greenhouse effect. The authors present a range of possible warming outcomes over the forecast period 2001-2007, and they state that the mid-point of this range is consistent with the warming trend observed in the historical record. GasNet has extrapolated this historical trend for the forecast period.

An analysis of the CSIRO report shows that at the midpoint of the range of possible warming, the main contributor is the enhanced Greenhouse effect (0.09 C/year), with some warming from the continued growth in the urban heat island (0.06 C/year). These results are based on the output of sophisticated Greenhouse climate models, and projections of population growth in Melbourne.

Some submissions have rejected the warming forecast on the basis of doubts about the relevance of an urban heat island. However, none of the submissions have challenged the reality of the enhanced Greenhouse effect, despite the fact that this is the main cause for the warming trend in the CSIRO scenario.

The discussion of the urban heat island in some submissions has presented a simplified view of the actual research conducted by the CSIRO. The CSIRO report has analysed Melbourne data against grided temperature data from rural weather stations in order to extract the local urban effect from the regional changes. Furthermore, the CSIRO report refers to other research in the literature on this issue. Based on this evidence, there is little doubt that as a city grows, an urban heat island grows in intensity and extent. The relevant variable is not the absolute value of the heat island at the city centre and the city outskirts, but rather the increase in the temperature at each location in the Melbourne urban region. The projection made by the CSIRO allows for continued growth in the heat island as Melbourne's population grows.

VENCorp does not believe the difference in the VENCorp and GasNet forecast is material. However VENCorp can adjust its tariff upwards during the five year Access Arrangement period to recover revenues as required. GasNet will suffer a net loss if the actual weather is warmer than forecast.

The actual weather data reveals that total annual EDD has been below the trend line for the last four years. Data for 2002 shows that the cumulative EDD from January to mid-May is running 20% below than the standard profile over this period. GasNet believes that there is a significant risk to revenues even after allowing for a warming trend.

Exports and storage refills

GasNet did not provide a forecast of refill volumes because it is not relevant to GasNet revenues. GasNet has introduced a storage refill tariff which only recovers the cost of fuel required at the Brooklyn compressor station to refill the storage. Both the cost and the revenues from refill are excluded from the GasNet tariff model. Furthermore the refill volumes are explicitly excluded from the price-control model (see clause 4.2 of Schedule 4 of the draft GasNet Access Arrangement). Hence GasNet will be neither advantaged nor disadvantaged by variations in the storage refill volume from year to year.

With respect to the refill forecast provided by VENCorp in its Submission, GasNet disagrees with the forecast for the years 2006/2007 and 2007/2008. GasNet believes that the utilisation of WUGS in 2006 and 2007 will be reduced because of increased injections into the Victorian market from Thylacine and Geographe (or other discoveries in the Otway basin). This will lead to lower utilisation of WUGS and hence reduced refill volumes. It appears that VENCorp has not allowed for increased injections into Victoria from new Otway fields.

In relation to the issue of export volumes at Culcairn, GasNet notes that gas exports to NSW were 2.3 PJ in 2001[3]. These flows occurred intermittently and predominantly over the pre-winter period. GasNet believes that these are opportunistic flows which take advantage of the low off-peak tariff ($0.23/GJ) at Culcairn, and which avoid the high winter peak charges. GasNet does not believe these flows will occur from 2003 under the proposed flat rate tariff applying over the whole year ($0.77/GJ), given that this export volume must compete with the EGP.

The majority of exports to NSW are notional, since there are coincident injections into Victoria. There is always the incentive for exporters and importers to swap their transactions and avoid both the injection and the withdrawal charges. This is a relatively simple matter at Culcairn since the injection and withdrawal volumes for a given retailer are deemed to be equal to the retailer's nomination[4], hence a gas swap is very simple to implement between injecting and withdrawing parties.

Currently the injection and withdrawal charges are relatively low, and there is little incentive for the retailers and traders to manage a gas swap. However when a flat charge of $0.77/GJ is applied to exports, there will be a stronger incentive on the Retailers to effect a gas swap. As a guide to what can happen at Culcairn, GasNet notes that Duke Energy is establishing a gas hub at Longford. All transactions through the hub will be in the name of the hub trader, and not in the name of the individual Retailers who are contracting with the hub trader. This allows for gas swaps and minimisation of transmission charges with little effort.

Considering the significant savings available from a gas swap arrangement, GasNet believes it is most reasonable to assume that gas swaps will become the standard device at export points where the predominant flow is expected

[3] The flows in 2000 occurred primarily before the EGP came on stream in December.

[4] Imbalances are managed by VENCorp and EAPL and do not affect the Retailers.

to be into Victoria. Hence it is most reasonable to forecast only the total inflows at each point.

With respect to possible exports from the GNS at Longford and Iona a similar situation arises. At VicHub GasNet has forecast injection volumes of 35 TJ/day. While it is possible that gas could be exported to NSW, this would be co-incident with the injections. As discussed above, the hub trader has the opportunity to minimise gas transmission charges by managing a gas swap arrangement.

At Port Campbell, GasNet has forecast injections of up to 250 TJ/day into the GNS. These are sourced from the WUGS, Minerva and the local on-shore fields. GasNet expects that the predominant exports to South Australia will be made directly from the gas processing plants at Port Campbell and surrounds. As discussed above, since there are likely to be large net injections into Victoria at Port Campbell, it is reasonable to expect that retailers will avail themselves of commercial gas swap arrangements.

Supply forecast

GasNet provided an extensive discussion and justification for the supply forecast in Schedule 6 to the Submission. The supply assumptions are based on information from VENCorp and from discussions with suppliers. However, there is no definitive source of reliable information since most details of the supply developments are kept commercially confidential.

A number of submissions queried the fact that there is no forecast of Yolla injections at Pakenham, despite the fact that there is a prudent discount offered at Pakenham. GasNet was of the view that the Yolla development was unlikely to go ahead, and hence there is no forecast of injections at Pakenham. However, in the event that gas from Yolla is injected at Pakenham, GasNet would be faced with a significant bypass threat in the absence of a prudent discount. GasNet chose to apply for a contingent prudent discount at the time of this revision, rather than make a revision application for a prudent discount after the Access Arrangement is approved.

Since GasNet submitted its revised Access Arrangement, there have been further developments in relation to the Yolla project. However, it is still possible that the project could be delayed or abandoned. If it becomes evident that the project will proceed, then the assumptions which underlie the supply forecast will need correction. This will have an impact on final injection tariffs.

16 Extensions and Expansions Policy

16.1 Summary of GasNet's proposal

Clause 5.1 of the revised Access Arrangement provides than any extension to, or expansion of, the GNS will be covered by the Access Arrangement unless GasNet gives notice to the ACCC stating that the extension will not form part of the Access Arrangement. GasNet proposes to remove the restriction contained in its current Access Arrangement which requires all pipeline extensions less than 10 km in length or less than $5 million in cost to be covered.

16.2 Issues raised in submissions

Coverage of expansions

In its Submission, VENCorp expressed concern that all *expansions* be covered by GasNet's access arrangement.

Exclusion of extensions

Energex expressed the view that "*GasNet should not have unilateral rights to determine whether future extensions should be covered".*

16.3 GasNet's response

Coverage of expansions

In relation to the first issue identified above, it appears that VENCorp have misunderstood the extensions and expansions provisions in the revised Access Arrangement. Clause 5.1(a) clearly states that any extension or expansion of the GNS will be covered by the Access Arrangement. Clause 5.1(c) allows GasNet to exclude an *extension* from the Access Arrangement. It does not allow expansions to be excluded from the Access Arrangement. Therefore, all expansions will be covered by the Access Arrangement.

Exclusion of extensions

GasNet considers that it is essential that it has the flexibility to exclude extensions from coverage under the access arrangement. This ensures that new pipelines are in the same regulatory position as would arise if the pipeline was constructed by other tenderers for a project. Since small pipelines are generally service lines to one customer, there is not likely to be an access dispute. However, if open access becomes an issue in the future, there is always the option to declare the pipeline and seek coverage, in which case, a dedicated access arrangement would be prepared by the owner of the lateral (ie GasNet or the winning tenderer). In relation to longer extensions, GasNet submits that it should have the option to propose a tailored access arrangement for that extension, if it is declared.

The issue raised by Energex is one aspect of a broader issue of where to draw the line between coverage and regulation on the one hand and private commercial negotiations on the other. In general, the practice in Australia has been not to cover smaller pipelines unless there is a manifest cause for concern. The GasNet proposal is consistent with this attitude.

17 Information requirements

17.1 Summary of GasNet's proposal

The Code requires that a proposed access arrangement be accompanied by Access Arrangement Information. Section 2.6 of the Code specifies that the Access Arrangement Information must contain such information that in the opinion of the Regulator would enable Users and Prospective Users to understand the derivation of the elements in the proposed Access

Arrangement and to form an opinion as to the compliance of the Access Arrangement with the provisions of the Code.

Under section 2.7 of the Code, the Access Arrangement Information may include any relevant information but must include at least the categories of information described in Attachment A.

GasNet lodged its draft GasNet AA Information in relation to the GNS with the Commission on 27 March 2002.

17.2 Issues raised in submissions

Confidentiality of documents

BHP Billiton objected to GasNet claiming confidentiality in relation to Annexures 2, 3, 4, 5, 6, 7 and 9. BHP Billiton has formally requested the Commission to review GasNet's claims for confidentiality in respect of each of those annexures and has requested that the Commission release the material for public assessment.

Errors in information provided

BHP Billiton indicate that there needs to be a review to ensure the accuracy of the information provided. BHP Billiton point to schedule 7 of the GasNet Submission as an example of an error suggesting that the columns in the table are headed incorrectly.

Derivation of tariff elements

BHP Billiton made a general comment that "*it did not understand the derivation of the tariff elements in the proposed AA and AAI submissions".*

Information regarding capital costs

BHP Billiton stated that GasNet should be required to provide the information in terms of Category 2 of Attachment A, in particular "*the asset values for each pricing zone, service or category of asset, and data on depreciation and accumulated depreciation"**.***

Demand forecasts

BHP Billiton requested the following information:

(a) gas demand for each of the zones;

(b) data on MDQ, and 5 and 10 day average maximum demands for each zone; and

(c) data "*to recognise the implicit change in the shape and demand profile over the period to reflect the changed uses of gas in the Victorian market*".

Details of zones

BHP Billiton requested that additional information in relation to the *"total volume over which the costs are to be spread, the number of customers, the value of the capital assets involved, planned capex for each zone, the various elements of non-capital items (operations and maintenance, marketing costs, administration and overhead costs, etc), the age of the assets and the depreciation rate proposed"*

BHP Billiton suggests that "*based on this information GasNet should prepare separate calculations underpinning the proposed tariffs in each zone"*.

BHP Billiton also requested that GasNet provide a description or map of the proposed zones.

Efficacy of the proposed tariffs

BHP Billiton requested that GasNet provide "*calculations demonstrating the efficacy of the proposed tariff to achieve the target revenue and demonstrating that there will be no cross subsidy either explicit or implicit between WTS, SWP and PTS*".

International benchmarking

BHP Billiton requested that GasNet provide international benchmarking of its costs.

17.3 GasNet's response

Confidentiality of documents

On 15 May, GasNet made available annexures 2, 3, 4 and 5. The only annexures which have not been disclosed are annexures 7 and 9. Annexure 7 deals with the valuation of non-insured risks and contains information about GasNet which is commercially sensitive. Accordingly, GasNet considers that this report should remain confidential. Annexure 9 contains data from GasNet and a wide sample of Australian and international gas transmission companies. The identifiers that refer to the benchmark comparison companies in each table have been randomised so that the identity of any individual company cannot be deduced. Hence GasNet is willing to remove the confidentiality restriction on this report.

Errors in information provided

BHP suggest that there are errors in the information provided by GasNet. The only example provided by BHP to support this assertion is the heading contained in schedule 7 of GasNet's submission. BHP state that the headings "appear to be the same thing, yet there are different numbers in each column". However, the SWP can flow gas in both directions. The first column of the table in schedule 7 relates to gas flowing from WUGS into the GNS and the second column relates to gas flowing into WUGS from the GNS.

Derivation of tariff elements

GasNet's response to each of the specific information requirements referred to in the BHP Billiton Submission is detailed below. However, in response to BHP Billiton's general comment on derivation of tariffs, GasNet submits that the Code does not require it to provide sufficient data to enable replication of tariff calculations. In the Final Decision, the Commission noted that,

> "*Of contention is whether service providers only need to provide sufficient information to allow users and prospective users understand the methodology used (for example, allocation of costs), or whether users and prospective users are given sufficient financial data to allow them to replicate the service provider's tariff calculations. It is the Commission's opinion that the Victorian Access Code does not require the service provider to provide such information to enable users and prospective users to replicate the service provider's tariff calculations."*[5]

Subject to the comments made below, GasNet considers that it has met the requirements of sections 2.6 and 2.7 of the Code.

Information regarding capital costs

GasNet has provided information on asset values by category of asset (Table 2-4 of AA Information), depreciation (section 3.3 of AA Information) and accumulated depreciation (Table 2-3 of AA Information).

Demand forecasts

GasNet considers that it has provided sufficient information in relation to forecast annual volumes by zone (see Table 4-4 of the GasNet AA Information). Information or peak days volumes for each withdrawal zone have not been provided as it is not used as a billing parameter for the tariffs. GasNet has relied on the forecasts published by VENCorp (with a slight adjustment for the warming trend). VENCorp is in the best position to provide the data (including customer numbers) requested by BHP Billiton.

Details of zones

As indicated above, GasNet does not consider that the Code requires it to provide information which would allow the duplication of tariffs for each zone. GasNet submits that it has met the information requirements contained in Attachment A in relation to the volume forecasts, the value of assets, forecast capital expenditure, operating and maintenance costs and depreciation costs.

In relation to BHP Billiton's request for maps of the proposed zones, GasNet will include these maps in the AA Information.

Efficacy of proposed tariffs

GasNet has provided detailed information in its Submission in relation to cost allocation and tariff setting.

[5] ACCC, *Victorian Gas Transmission,* 6 October 1998, p 124.

GasNet considers that it has provided sufficient information to allow Users to form a view as to the compliance of the Access Arrangement with the Code.

International benchmarking

GasNet commissioned a detailed benchmarking report from international consultants Cap Gemini. The report contains data from GasNet and from a wide sample of Australian and international gas transmission companies. A summary of the benchmarking report is contained in section 6.2 of GasNet's AA Information and in section 8.4.5 of GasNet's Submission.

18 Description of GasNet's system

18.1 GasNet's Proposal

Currently, GasNet has two Access Arrangement, one relating to the WTS and the other relating to the SWP. As a result of the interconnection of the WTS and the PTS, GasNet considers that there are considerable advantages in merging the WTS and PTS Access Arrangements. GasNet has adopted a new term "GNS" to describe the merged transmission system. The term "GNS" is defined in GasNet's Access Arrangement as "*GasNet's transmission system, being the Gas Transmission System as defined in the Service Envelope Agreement.*".

18.2 Public submissions

VENCorp suggested that the term "Principal Transmission System" should be retained in order to avoid confusion. VENCorp suggests that "*there is an ongoing and compelling need for a clear delineation of definitions relating to the Gas Industry Act and those assets covered by the access arrangements of VENCorp and GasNet. VENCorp considers that the use of the definition "Principal Transmission System" to be the most appropriate means of achieving this clarity*".

18.3 GasNet's response

GasNet agrees with VENCorp that there needs to be a clear and consistent approach taken to the definition of the relevant system in each of the legal and regulatory documents. However, GasNet considers that the use of the term "Principle Transmission System" to describe GasNet's system is potentially confusing. The term "Principal Transmission System" has traditionally been used to describe only that part of the PTS which runs from Longford to Melbourne and north from Melbourne to New South Wales. It has not, in the past, included the WTS or the SWP.

VENCorp notes in its submission that "*the Service Envelope Agreement utilises its own definition of Gas Transmission System, which is effectively equivalent to the definition of Principal Transmission System, as per VENCorp's access arrangement*".

GasNet has adopted a similar approach to defining the term "GNS" by linking it to the definition of "Gas Transmission System" in the Service Envelope Agreement. The meaning given to the GasNet system is effectively the same as the meaning given to the system in VENCorp's Access Arrangement. The

only difference is that GasNet refers to the system as the GNS and VENCorp refers to the system as the PTS.

GasNet considers that there is no inconsistency between the description of GasNet's system and the Service Envelope Agreement or the Gas Industry Act 2001 as suggested by VENCorp in its submission. There is no other motive behind the adoption of the term "GNS" other than to make it clear that the GNS system extends beyond the system traditionally described as the PTS and includes all pipelines that fall within the description of the Gas Transmission System under the Service Envelope Agreement.