

Central Australia Business Unit
Santos Limited
ABN 80 007 550 923
Santos House Level 10
91 King William Street
Adelaide South Australia 5000
GPO Box 2319
Adelaide South Australia
Commercial
Direct Facsimile: 08 8224 7520
Direct Telephone: 08 8224 7895

20 September 2002

Ms Kanwaljit Kaur
Acting General Manager
Regulatory Affairs – Gas
ACCC
PO Box 1199
DICKSON ACT 2601

Dear Ms Kaur

ACCC's Draft Determination on GasNet Australia's Access Arrangement

In responding to the ACCC's Draft Decision on the access arrangements of GasNet in the Victorian gas transmission pipeline, Santos comments as follows:

1. Summary

- In regard to the South West Pipeline (SWP), Santos supports the proposed extension of economic life, proposed levelising of tariffs and roll-in of some of the SWP capital into the broader system. However, Santos believes that the Commission has understated the system-wide benefits of the SWP and should have rolled-in all of the SWP capital.
- Introduction of differential tariffs for different injection points, through matched withdrawal tariffs, is a sensible proposal by GasNet and the Commission.
- The proposed de-emphasis of peaking charges by GasNet, which has not been rejected by the Commission, is a retrograde step which we believe will detract from development of a competitive market and will be to the economic detriment of end-users.

2. Background to Santos' Position

Santos is unique in the gas producers supplying the Victorian market: it has interests in existing production and potential new supplies which can be delivered to all three injection points into the Victorian gas transmission system – at Iona (from onshore and offshore Otway Basin), at Longford (from offshore East Gippsland) and at Culcairn (from Moomba).

We believe that our views therefore consider the market as a whole, not simply one region, and so are more aligned to consumers generally than some of our competitors. Clearly the cost and terms of gas transmission in the GasNet system affects the competitiveness of gas supply by Santos, the costs to our customers and growth of the Victorian gas market.

Santos appreciates that, while the Commission has some discretion in accepting or opposing revisions to an access agreement, it is subject also to the requirements of the National Third Party Access Code for Natural Gas Pipelines ("the Code"). In using its discretion, however,

the Commission needs to do so with regard to the longer-term competitive issues raised by its decisions on the proposed Access Agreement from one access period to the next.

3. Victorian Market

Historically, the Victorian gas market has been almost exclusively supplied by production from Bass Strait. The gas pipeline network has been configured to reflect this reality. After the construction of the Inter-connect in 1998, the access arrangement continued to reflect the cost of supply from Longford even though (for instance) there may have been Victorian transport cost savings by sourcing gas from Culcairn for delivery to northern Victoria. The combination of physical facilities and access arrangements reinforced the sole producer's dominance and prevented basin-on-basin competition in the Victorian gas markets.

The Victorian gas market is now characterised by a diversifying production mix, with the Otway Basin/Western Underground Gas Storage (WUGS)/SWP system providing more peak deliverability for Victorian consumers than Bass Strait. There is also an active and highly prospective exploration and drilling program, with Origin, Woodside, Santos, OMV and partners providing actual and prospective competition to the Bass Strait joint venture.

This diversification of the production mix and the current exploration programme have been encouraged in part by the development of new pipelines – the Interconnect, the EGP and the SWP- to carry gas discoveries to the Victorian market. However, flows via these systems will take some time to build up to rival the level of flows from the original sole supplier of gas to the Victorian market, particularly given existing contractual commitments between the Bass Strait joint venturers and the incumbent retailers.

This prolonged build-up presents both new suppliers and the Commission with a significant issue: in the early years, low production volumes and shipping flows on new routes can result in high shipping costs per unit compared with more established, higher volume shipping routes. These high transport costs erect a barrier to effective supply side competition which has to be overcome by either the pipeliner / producer absorbing the early losses or the costs being allocated to all users, which requires the infrastructure in question to be rolled into the pipeliner's Access Arrangement. A pipeline owner whose income is largely regulated is likely to be reluctant to do the first (unless there is agreement that the losses will be recouped by longer term toll receipts and levelisation of tariffs). The second requires the Commission's approval and would mean marginal increases in tariffs to all users.

The submissions received from existing large users along the Longford to Metro pipeline and the Bass Strait joint venture partners expressed concern about the second: they opposed the possible roll-in of the Southwest Pipeline into the Asset Base in GasNet's Access Arrangement. However, we believe that competition will be enhanced by a roll-in, to the benefit of consumers.

We believe this highlights the Commission's challenge — to achieve a balance between a longer-term pro-competitive decision resulting in competitive shipping prices from different sources which could, however, in the short term increase tariffs marginally.

We believe the Commission should be encouraged to consider the implications of its decisions for the supply side of the industry. We are encouraged by the Commission's decision in the Draft Determination to roll-in around half of the SWP into GasNet's regulatory asset base. However, we think there is a strong case for rolling-in all of the Southwest Pipeline's capital costs, as outlined below.

4. Expected Tariffs Resulting From the Draft Determination

4.1 Assumptions on Tariffs

Table 1 contains estimates of GasNet's likely tariffs resulting from the ACCC's Draft Determination based on its directions to GasNet to revise its proposed tariffs in line with the proposed amendments to the original proposed Access Arrangement. In calculating these tariffs, we have made certain assumptions, including:

- The effect of the ACCC's Draft Determination, taken as a whole, has been to reduce GasNet's total required revenues to \$75 million from \$94 million
 - The required return on assets falls from \$40 million to \$31 million
 - Depreciation expense falls by \$1 million to \$16 million
 - O&M falls from \$37 million to \$28 million.
- These reductions have been spread across GasNet's assets on a postage stamp basis, resulting in an allocation to the anytime withdrawal and peak injection charges of 73% and 27% respectively
- The Port Campbell injection charge has been estimated in line with the ACCC's indication at \$2.00/GJ. The resulting effective SWP charge is around 10% higher than the charge for the Longford-Metro pipeline, as suggested by the Commission.

4.2 Estimated Tariffs

Table 1. Comparative Cost of Shipping. Selected Routes, (\$/GJ annual average)

Tariff D Customers

	Current Tariffs (\$/GJ)			GasNet Proposed Tariffs (\$/GJ)			ACCC Proposed Tariffs (\$/GJ)		
	Load Factor			Load Factor			Load Factor		
	100%	80%	60%	100%	80%	60%	100%	80%	60%
Longford to Metro	0.20	0.22	0.25	0.32	0.34	0.36	0.26	0.27	0.29
Longford to North Hume	0.65	0.75	0.91	0.95	0.97	0.99	0.76	0.77	0.79
Longford to Culcairn	0.58	0.67	0.81	0.78	0.80	0.82	0.62	0.64	0.66
Iona (Port Campbell) to Metro	0.28	0.32	0.40	0.37	0.40	0.45	0.28	0.30	0.32
Iona (Port Campbell) to Culcairn	0.66	0.77	0.95	0.83	0.86	0.90	0.63	0.64	0.66
Iona (Port Campbell) to Longford	0.22	0.26	0.31	0.30	0.33	0.38	0.21	0.22	0.24
Culcairn to Metro	0.19	0.21	0.24	0.29	0.30	0.31	0.23	0.24	0.25
Culcairn to North Hume	0.46	0.50	0.58	0.43	0.44	0.45	0.34	0.35	0.36

Tariff V Customers

	Current Tariffs (\$/GJ)			GasNet Proposed Tariffs (\$/GJ)			ACCC Proposed Tariffs (\$/GJ)		
	Load Factor			Load Factor			Load Factor		
	100%	80%	60%	100%	80%	60%	100%	80%	60%
Longford to Metro	0.22	0.24	0.27	0.34	0.36	0.38	0.27	0.29	0.31
Longford to North Hume	0.81	0.94	1.06	1.25	1.26	1.29	1.00	1.01	1.03
Longford to Culcairn	0.58	0.67	0.81	0.78	0.80	0.82	0.62	0.64	0.66
Iona (Port Campbell) to Metro	0.30	0.35	0.41	0.39	0.42	0.46	0.30	0.31	0.34
Iona (Port Campbell) to Culcairn	0.66	0.77	0.95	0.83	0.86	0.90	0.63	0.64	0.66
Iona (Port Campbell) to Longford	0.23	0.27	0.32	0.33	0.35	0.40	0.23	0.24	0.26
Culcairn to Metro	0.21	0.23	0.26	0.31	0.32	0.33	0.25	0.25	0.26
Culcairn to North Hume	0.54	0.60	0.66	0.48	0.49	0.50	0.39	0.39	0.40

- For the bulk of the Victorian gas customers - in the Metro zone - the estimated shipping costs are \$0.27/GJ from Longford, \$0.30/GJ from Iona and \$0.24/GJ from Culcairn. Shippers at Culcairn have the potential to be competitive with shippers from Longford and Iona provided they can deliver gas to Culcairn at a cost competitive with the ex-plant cost of Otway or Bass Strait gas.
- Shippers into the North Hume zone receive very different treatment depending on their injection point. We estimate that injections at Culcairn for withdrawal in the North Hume zone incur effective transmission costs of \$0.35/GJ compared with \$0.77/GJ from Longford. All other things being equal, this should enable shippers at Culcairn to market to customers in northern Victoria or to seek gas swaps with a similar effect.
- Deliveries to Culcairn in NSW via the Interconnect bear approximately the same GasNet transportation costs from Longford (\$0.65/GJ at 80% load factor, Tariff D, annual average), and Iona (\$0.64/GJ).

4.3 Relative Shipping Costs from Otway Basin and Bass St to Metro

As shown in Table 1, we estimate that following the Draft Decision, the difference between GasNet's annual average tariffs ex the Otway Basin and ex Gippsland is in the order of \$0.03/GJ at an 80% load factor. The ACCC's decision represents a reduction in that difference compared with GasNet's original application by around \$0.03/GJ, as a result of the factors mentioned in the decision.

Santos supports these decisions by the Commission, although we argue in Section 5 that full roll-in of SWP costs is justifiable.

5. South West Pipeline

Development of WUGS was seen as critical by the then Victorian Government to meeting peak and backup conditions in the Victorian gas market. WUGS was promoted and developed, and the SWP installed to meet those strategic aims. Not unreasonably from a technical viewpoint, the capacity of SWP was set to match the capacity of WUGS. To have installed less capacity (and thereby reduce capital costs) would have been contrary to those aims.

The SWP investment was and is for the benefit of the total system. It has delayed (at the very least) the need to expand the Longford-Melbourne pipeline system. Moreover, it provides an alternative source of gas in the event of another failure at Longford like that in 1998, which had catastrophic consequences for the Victorian economy.

5.1 Comparison with Interconnect

In its "Annual Planning Review 2002-2006" (pages 27-28), Vencorp noted that the capacity to inject from the Interconnect, with the Springhurst compressor in operation, is 50 TJ/d; if delivered for a full year with no downtime, the Interconnect could supply 18.3 PJ. By comparison, injection capacity at Iona is 250+ TJ/d giving a comparative full year delivery of 91.0 PJ. Without any production from the Otway Basin, WUGS can deliver a maximum of its storage capacity, or about 10.7 PJ.

The Commission has noted (page 48 of Draft Decision) that "the system wide benefits available from the Southwest Pipeline are broadly commensurate with those provided by the Interconnect Assets (which were assessed as being adequate to justify \$40.4 million of costs in 2000)."

Santos agrees that the reserves quantity delivered over a year by the two pipelines is broadly similar and they would give similar energy supply in the event of a major failure of supply from Gippsland. However, the SWP can deliver five times the peak rate of the Interconnect at less than double its capital cost. In the much more likely scenario of normal peak day demand or a short-term failure of supply from Gippsland, the SWP clearly delivers more benefit.

On this basis, Santos believes that the full cost of the SWP should be rolled in under the system-wide benefits test and that tariffs ex Iona should be the same as gas injected at Longford.

5.2 Comparison with Expansion of Longford-Melbourne System

The Commission notes (page 45 of Draft Decision) that, if the capacity of the Longford-Melbourne system had to be increased by the equivalent of the SWP's capacity, capital expenditure would be in the order of two thirds of the cost of the SWP or about \$57m on the basis of estimates by GasNet's predecessor. On that capacity basis alone, the system wide benefit is 75% of the costs expended by GasNet (after allowing for the Victorian Government contribution). While an expansion of Longford-Melbourne capacity would match the peak capacity provided by the SWP, it would not provide any benefits of improved backup of supply.

5.3 Summary

To summarise, Santos argues that the Commission has understated the amount which should be recovered under the system-wide benefits test. The full cost of the SWP should be rolled in, based on costs saved in Longford-Melbourne and improved security of supply. The Commission has itself set a precedent in its Interconnect decision for rolling in all of the cost.

6. Allocation of Costs to Peak vs Any Time Tariffs

GasNet has proposed a reduction in the proportion of its costs recovered by peak charges, eliminating the peak withdrawal charge and recovering the peak injection charge over 10 days compared with the previous 5 days. Table 2 demonstrates the effect of GasNet's proposals on the peak/off-peak composition of the average Longford to Metro tariff.

Table 2. Peak and Anytime Components of Longford/Metro Tariffs

Transmission Charges - Longford to Metro Tariff V Customer 60%LF		
Current Tariffs	\$/GJ	%
Peak Injection Charge	0.05	19%
Peak Delivery Charge	0.11	39%
Anytime Delivery Charge	0.11	41%
Incremental Peak Delivery Charge	0.00	0%
Incremental Anytime Delivery Charge	0.00	0%
Total Cost	0.27	100%
GasNet Proposed Tariffs	\$/GJ	%
Injection Tariffs	0.11	28%
Transmission Delivery Tariffs	0.28	72%
Transmission Refill Tariffs	0.00	0%
Cross System Withdrawal Tariff	0.00	0%
Total Cost	0.38	100%
ACCC Proposed Tariffs	\$/GJ	%
Injection Tariffs	0.08	28%
Transmission Delivery Tariffs	0.22	72%
Transmission Refill Tariffs	0.00	0%
Cross System Withdrawal Tariff	0.00	0%
Total Cost	0.31	100%

6.1 Commission's Position

The Commission has recognised that "the major issue raised by the change in cost allocation and tariff structure is that of appropriate price signals." It indicated that it was unconvinced by submissions calling for removal of all peak pricing or for retention of the current structure, and did not oppose GasNet's proposal for a partial reduction in peaking charges.

We believe that GasNet's and the Commission's position is not in the long term interests of the market, and support continuation of the existing allocation of costs to peaking, but with broadening of the 5 peak days to 10 to emphasise real attempts to reduce peaks rather than reward users who have an ability to reduce demand on easily forecast peak days.

The absence of an active demand side response at this early stage of the restructuring of GasNet's charges does not indicate that the Commission should facilitate a reduction in the peak charging signal. Rather, it reflects the fact that existing users are currently sold a bundle of peaking/reliability/commodity services at a bundled average price and do not perceive that there is a peak charging signal, as detailed below.

6.2 Consumer Issues

In buying “gas”, the consumer is in fact buying a bundle of services:

- supply of energy in a form suitable for his facilities
- matching of supply to varying load pattern, subject to system or contractual constraints
- reliability of supply so that own usage and production can be planned
- supply over extended period rather than short term, thus allowing rational investment and production planning, and reduced risk on energy supply
- energy supply that is at a low enough price to enable its profitable use.

Some of these aims are contradictory: matching of supply to highly variable load pattern should be reflected in a higher price. Sometimes one consumer with a flat load profile is paying the same price as a consumer with highly variable load and so subsidising the latter.

If there was a gas pricing regime to the end user which truly reflected the services used by that consumer and the costs to supply those services, and so encouraged rational choices by the consumer about what they bought, then there would be an argument for insisting that each part of the system bear its own costs. Such a market system would encourage decisions by producers and pipeliners about what product they would supply, and what facilities they would install: receiving a high price for peak gas would encourage them and enable them to install peak capacity.

However, such a perfect market does not exist. Consumers do not see the cost of peak gas supply. For simplicity, retailers roll the peaking cost into their average. Currently, retailers do not pay an increased price to the producers for peak gas. Storage facility owners do not receive appropriate recompense for their investment.

6.3 Comparison with Electricity Market

The Commission's willingness to consider reducing the peak charging signal at the end of the first Access Arrangement is in marked contrast to the position in the electricity market, where there are continuing efforts to strengthen the signals for demand side management and to reduce any barriers to implementing it. Santos argues that the existing gas contracts, which bundle peak and base gas together under an average price, should desirably be replaced over time by unbundled contracts, with base and peak load producers and transporters being rewarded differently as is the case in the electricity market for base and peak load generators.

7. Differential Tariffs from Different Injection Points

On similar grounds, we believe the Commission should be concerned to ensure that the effects of the proposed tariff restructure by GasNet encourage supply side competition and appropriate pricing signals to users. We support the proposal by GasNet and the Commission that tariffs should encourage supply from sources that minimise the costs to the system: this is proposed to be achieved by introducing matched withdrawal discounts. It will have the effect in Northern Victoria of a lower transport cost from Culcairn as compared with supply from Iona or Longford.

We look forward to the Commission's response and would be happy to provide further explanation of our views at your convenience.

Yours sincerely

John Anderson
Manager, Commercial

