

## 1 Introduction

Santos Limited (**Santos**) and Magellan Petroleum Corporation (**Magellan**) are pleased to provide the Australian Energy Regulator (**AER**) with this submission on the proposed revisions to the access arrangement for the Amadeus Gas Pipeline (**AGP**) submitted by NT Gas to the AER on 16 January 2011.

## 2 Background

Santos and Magellan hold interests in three assets in the Amadeus Basin of central Australia, namely the Mereenie oil and gas field, the Palm Valley gas field and the Dingo gas field. The Mereenie and Palm Valley fields commenced production in the early 1980s and are still in production with significant remaining reserves and contingent resources. Remaining Proved plus Probable (2P) Reserves for the Mereenie and Palm Valley gas fields are approximately 150PJ of gas.

The interests are held as follows:

	<b>Mereenie</b>	<b>Palm Valley</b>	<b>Dingo</b>
<b>Santos</b>	65% (operator)	48%	65.7% (operator)
<b>Magellan</b>	35%	52% (operator)	34.3%

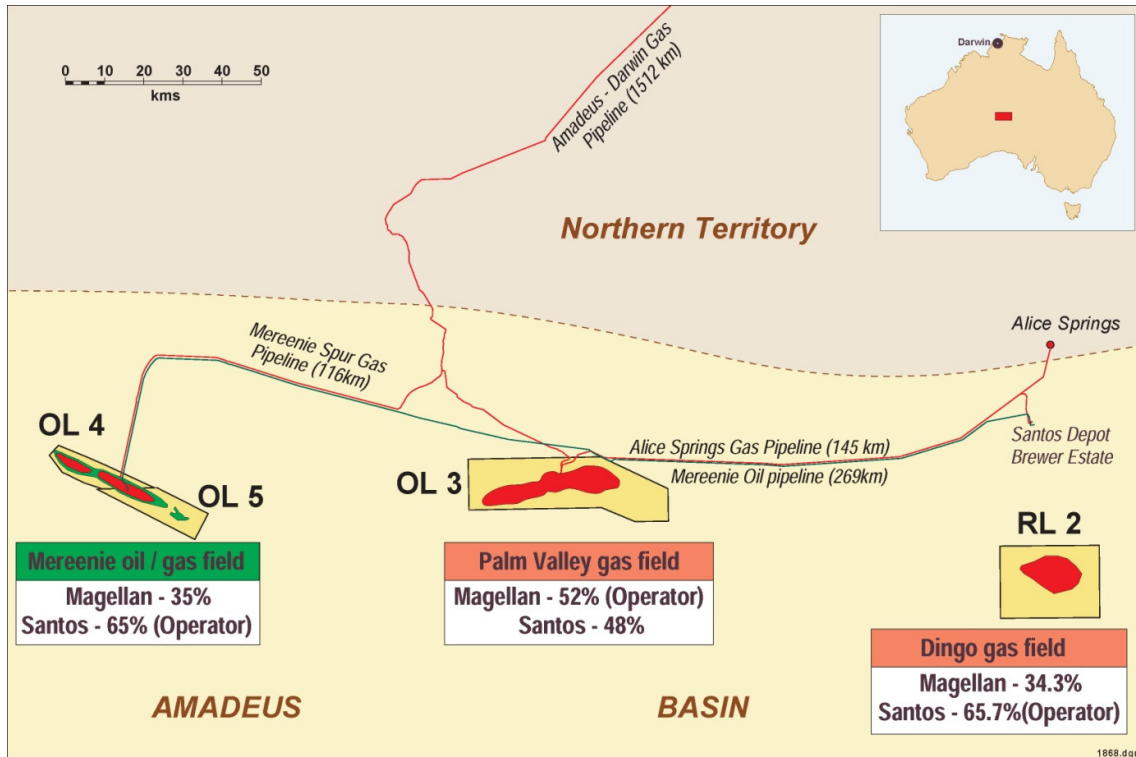
The Mereenie field is located about 270 km west of Alice Springs and is one of Australia's largest onshore oil fields. A total of 62 wells have been drilled at Mereenie, and gas is gathered in the field through approximately 80 kilometres of pipelines and flowlines. Gas sales to date total 216 PJ (185 Bcf). The field has also produced 16.5 million barrels of oil. The Mereenie field is not currently producing gas for sale but is capable of producing around 35 TJ per day (around 12.5 PJ per annum). The processing plant has a capacity of 55 TJ per day. Additional drilling would be required to meet this full capacity.

The nearby Palm Valley gas field is approximately 150 kilometres east of Mereenie and provides gas to Alice Springs via the 145 kilometre Palm Valley-Alice Springs gas pipeline which is connected to AGP at Palm Valley. The Palm Valley field is currently supplying gas at a rate of around 7- 9 TJ per day (around 2.0 PJ per annum). The gas is sold under a 25-year contract which ends in January 2012. Gas sales to date total approximately 174 PJ (152 Bcf).

The Dingo gas field is an undeveloped resource located approximately 60 kilometres south of Alice Springs. A total of four wells have been drilled on the field which has a contingent resource of approximately 20 PJ of gas. The field is currently capable of flowing at a rate of around 2.5 TJ of gas per day.

Both the Mereenie and Palm Valley facilities incorporate field boost compression in order to meet the AGP inlet pressure, and the gas from each field meets the current AGP gas specification. Both the Mereenie and Palm Valley fields will supply gas to customers through use of the AGP. The two fields provided the Northern Territory's total gas demand from 1983 to 2009, when the Blacktip field commenced supply for the majority of that demand under a 25 year contract.

Santos and Magellan are actively marketing gas into the Northern Territory gas market from the Mereenie and Palm Valley gas fields. As the fields have significant conventional and unconventional gas resources, both Santos and Magellan are considering marketing opportunities for supply to customers up to 2030.



### 3 Content of submission

Santos' and Magellan's interest in the revised access arrangement for the AGP is to ensure the access arrangement facilitates future gas transportation from the Palm Valley and Mereenie gas fields to gas markets in the Northern Territory on terms that facilitate competition between gas producers and traders in this market.

This submission addresses the following elements of the access arrangement:

- the proposed pipeline services and specification of the reference service;
- the terms and conditions for the reference service;
- the determination of the total revenue requirement;
- the demand for pipeline services;
- the allocation of total revenue to pipeline services and determination of the reference tariff;
- the reference tariff variation mechanism;
- the extensions and expansions policy for the pipeline; and

- the capital redundancy mechanism.

## 4 Pipeline services

The National Gas Rules (**Rules**) distinguish between reference services and other (non-reference) services. A reference service has terms and a tariff set out in the access arrangement and a user of the pipeline may insist upon obtaining a reference service on those terms and at that tariff. A pipeline service provider may indicate in an access arrangement a willingness to provide non-reference services, but the terms and tariffs for such services are to be determined by negotiation (subject to arbitration in the event of an access dispute).

NT Gas proposes a single reference service for the AGP, the firm service, with characteristics of:

- being contracted for on the basis of a contracted or reserved capacity for gas transmission between specified inlet and delivery points (specified as a maximum daily quantity and maximum hourly quantity);
- allowing for gas transmission (up to the level of the contracted capacity) that is not interruptible under normal pipeline operating conditions; and
- entailing a notional direction of gas transport in the pipeline in any direction, reflecting that inlet points occur both at the south end of the pipeline (Mereenie and Palm Valley) and north end (Ban Ban Springs and Wedell) and delivery points also occur at various locations along the pipeline.

NT Gas proposes non-reference services of:

- an “interruptible service”, which comprises a service that would be similar to the firm service except that it would be interruptible from time to time under normal pipeline operating conditions; and
- “negotiated services”, which cover any other form of service that may be negotiated between a user and NT Gas.

Santos and Magellan support the proposed reference and non-reference services proposed by NT Gas.

Santos and Magellan submit that the proposed firm service meets the requirements of the Rules for a reference service and supports the National Gas Objective, taking into account the following matters.

- The proposed firm service comprises a non-interruptible service, which is consistent with the demands for gas services by the vast majority of end-users of gas and hence by the most significant part of demand for transmission services by pipeline users.
- The proposed firm service makes provision for receipt of gas from any gas source connected to the pipeline and for delivery of gas to any delivery point, which is consistent with efficient use of the existing pipeline.
- The proposed firm service (and reference tariff) does not discriminate between users on the basis of the distance and notional direction of gas transportation.

This will promote competition between gas sources and gas traders which will promote the long-term interests of consumers of natural gas.

Santos and Magellan support the inclusion in the access arrangement of the proposed non-reference services.

Santos and Magellan submit that there may be a future demand for services in the nature of the interruptible service as proposed by NT Gas and that the availability of this service will promote efficient use of capacity in the pipeline and enable gas producers and gas traders to tailor gas services to the needs of gas consumers. However, as the character and demand for the interruptible service cannot readily be forecast at the current time and is likely to be small for at least the next access arrangement period, the service is appropriately treated as a non-reference service. Moreover, the treatment as a non-reference service will allow for the character and terms of this service to be flexibly determined by negotiation between users and NT Gas as demand for this service emerges.

## **5 Terms and conditions for the reference service**

The Rules do not specify particular requirements for the terms and conditions to apply for each reference service. However, the terms and conditions must be consistent with:

- the National Gas Objective; and
- the Rules and Procedures in force (Rule 100).

The AER has full discretion to withhold its approval of the terms and conditions if, in its opinion, a preferable alternative exists that complies with the Law, including applicable criteria (if any) prescribed by the Law (Rule 40(3)).

Santos and Magellan note that the existing AGP terms and conditions have been completely re-drafted in NT Gas' proposed terms and conditions. In its supporting submission, NT Gas indicates that the revisions to the terms and conditions have been made for the purpose of adopting consistent arrangements with other gas transportation agreements in place for NT Gas and APA Group. Overall, the proposed revisions to the terms and conditions appear to us to be heavily biased in favour of the service provider and, in particular, designed to re-allocate risk from the service provider to the user. For these reasons, we do not agree with NT Gas' submission that users and prospective users are likely to benefit from the revisions to the terms and conditions as a result of consistency in contracting arrangements across APA Group's assets.

Further, the following terms and conditions are not consistent with the National Gas Objective and require amendment to be consistent with the Law.

### **5.1 Prudential requirements (clause 1)**

Clause 1 provides that NT Gas may require the user to provide acceptable financial security; and, in certain circumstances, refuse to provide, or suspend the provision of, services without liability to the user.

Clause 1 should be amended as follows.

- The right to call for security should be clearly defined. That is, at the commencement of the agreement or if the user misses a set number of payment deadlines.

- The maximum amount of any security should be defined.
- NT Gas should be required to act reasonably in requiring security.
- The right to suspend should be clearly defined. That is, the events listed in clause 1 should be the *only* circumstances where suspension is allowed without liability (other than force majeure).

## 5.2 Scheduling (clauses 6 – 10)

Clause 7 outlines the scheduling priorities where there is insufficient capacity to transport all the quantities of gas nominated by all users on a day. Clause 7(d) provides that quantities nominated pursuant to interruptible agreements will be allocated first on the basis of the highest tariff being paid, second on a first come, first-served basis, and third on a pro rata basis. The firm service and the 'as available' service are scheduled on a pro rata basis first.

While the scheduling arrangements for interruptible agreements are not terms and conditions of the reference service, since these are included they should be subject to the AER's assessment against the requirements of the Rules. Santos and Magellan submit that the scheduling arrangements for the interruptible service are not consistent with efficient use of the pipeline as the nature of the service (in particular the reliability of the service) would vary between users, which would limit the predictability and attractiveness of the service to users and limit the efficient use of the service and of the capacity of the pipeline that is able to be used for this service. A more equitable manner of scheduling priority of the interruptible service that would be more conducive to development of this service and efficient use of pipeline capacity would be for non-discriminatory allocation of available capacity. This would be consistent with the characteristics of interruptible services that are offered, or that have previously been offered, by other gas transmission pipelines including the Access Arrangement for the Moomba to Adelaide Pipeline System (which applied up until revocation of coverage in 2007) that provided for an interruptible service as a reference service ("IT Service"), with an allocation of available capacity between users on a pro rata basis.

Clause 7 of the proposed revised access arrangement for the AGP should be amended so that the scheduling priority for interruptible service involves allocation of available capacity for the interruptible service on a pro rata basis.

## 5.3 Curtailment (clauses 11 – 14)

Clauses 11 to 14 set out NT Gas' right to curtail services. The right to curtail is much wider than the previous terms and conditions and the only criteria is insufficient capacity regardless of the reason for the insufficiency. Further, clause 12 permits NT Gas to curtail the service without liability if the insufficiency of pipeline capacity is not caused by NT Gas' wilful default or gross negligence. It is not reasonable to provide a right to curtail without liability where the pipeline has insufficient capacity due to NT Gas' negligence.

These clauses should be amended to provide that, as is the case in the previous terms and conditions:

- the right to curtail a service is limited to planned work, for safety reasons, to comply with the law, in an emergency or event of force majeure;
- NT Gas is required to provide reasonable notice of any curtailment; and

- NT Gas is subject to an obligation to minimise, as far as reasonably practicable, any curtailment.

#### **5.4 Imbalances (clauses 15 – 19)**

Clause 17 provides that if NT Gas believes that its ability to transport quantities of gas scheduled may be impaired by an unauthorised imbalance and the user does not take all steps reasonably practicable to correct such imbalance as soon as possible, NT Gas may correct such imbalance by reducing the user's receipts and/or deliveries of quantities of gas as necessary, or by buying or selling sufficient quantities of the user's gas, or a combination of both.

Consistent with the purpose of the clause, and the National Gas Objective, the user's obligation to correct the imbalance should only be to the extent that the imbalance will impair the ability of NT Gas to transport the quantities of gas scheduled under the user's agreement or any other agreement.

Further, the user should be permitted to elect whether NT Gas will reduce the user's gas by reducing the user's receipts or buying or selling the user's gas.

Clause 18 provides that the user will indemnify NT Gas for 130% of all costs and expenses it incurs in purchasing gas to make a correction to an imbalance. This clause also authorises NT Gas to retain 30% of the proceeds of sale of the user's gas to make a correction to an imbalance.

Clause 18 is not reasonable as it constitutes a penalty for the user having an imbalance. If the AER is minded to allow an indemnity (and it should only do so where clause 17 is amended as submitted above) then the indemnity should be limited to 100% of the reasonable costs incurred by NT Gas.

#### **5.5 Adjustment to Rates and Charges / Additional Payments (clauses 20 – 23)**

Clause 20 provides a broad right for NT Gas to recover a "New Impost" that increases its costs of providing the services under the user's agreement by more than a "trivial" amount. The definition of "New Impost"/"Impost" is very wide and would include taxes, charges etc that increase NT Gas' indirect costs.

Clause 21 provides an extremely broad mechanism for NT Gas to pass through a carbon-related charge.

Santos and Magellan are concerned that clauses 20 and 21 are drafted too widely and permit NT Gas to act inefficiently in its pass through of costs.

We submit that:

- the clauses are inconsistent with Rule 97(1)(c) of the Rules that allows for reference tariff variation by a cost pass-through only in respect of costs that arise in respect of a defined event and any cost pass through should be made subject to scrutiny and approval by the AER as provided for under Rule 97(4) (see comment on Reference tariff variation mechanism at section 9 below).
- NT Gas should only be entitled to pass through those taxes, charges etc which increase the direct costs of providing the service the subject of the agreement;

- NT Gas should be required to minimise any such costs (acting reasonably).

Without these requirements, there is no incentive for NT Gas to act efficiently.

Clause 20 should also be amended to include a mechanism which provides for any decreases in cost to be rebated to a user.

Clause 21 should be amended so that the user is only liable to reimburse direct carbon costs incurred by NT Gas in providing the pipeline services pursuant to the agreement and not for indirect costs or costs of NT Gas' related bodies corporate. To allow NT Gas to pass through all such costs removes any incentive for it to act efficiently in arranging its business and providing the pipeline services.

## **5.6 Operation of Pipeline (clauses 30 – 35)**

Clause 35 should be limited to such data as is *reasonably* required by NT Gas to provide the pipeline services under the agreement.

## **5.7 Metering and Records (clauses 36 – 40)**

Clause 40 provides that the "Metering and Measurement Requirements" govern the measurement of gas for the purposes of the agreement, unless otherwise negotiated by the parties. The "Metering and Measurement Requirements" are defined as "*specifications published by Service Provider from time to time in relation to metering and measurement in relation to the Pipeline which are made available to the User*".

The metering arrangements should be specified in the terms and conditions rather than being left to NT Gas' discretion.

## **5.8 Gas Quality (clauses 41 – 46)**

Clause 41 provides that the gas delivered at the receipt point must be in accordance with the quality required by the "Gas Specification" or any other quality as the law in the relevant jurisdiction requires. NT Gas may, by notice to the user, vary the above specifications if it is authorised or required to do so by law or any authority. "Gas Specification" is defined as "*the gas specification published by the service provider from time to time in respect of the Pipeline, which must comply with all applicable laws. Until otherwise advised by Service Provider, the gas specifications are available at <http://apa.com.au/our-business/gas-transmission-and-distribution.aspx>.*"

Given the potential barrier to entry that the gas specification can provide, the gas specifications should be specified in the terms and conditions rather than leaving them to NT Gas' discretion.

Clause 42 provides for NT Gas to pass through increased costs as a result of a change in the gas specification. This clause should be amended to provide that:

- only direct unavoidable costs can be passed through; and
- if a change to the gas quality specifications decreases NT Gas' costs, those costs should be rebated to all users in the same way that increases to costs are.

## **5.9 Receipt Pressures (clauses 47 – 49)**

Clause 47 provides that the user must supply gas to NT Gas at pressures nominated by NT Gas but not greater than a set maximum pressure determined for each receipt point.

Clause 48 states that the user must indemnify NT Gas for all loss and damage suffered or incurred by it as a result of a breach of this obligation.

The terms and conditions do not provide for a methodology for determining the maximum pressure and there is no transparency in the process of NT Gas setting the gas pressure for each receipt point. This is similar to the existing terms and conditions. However, there is currently no requirement for the user to indemnify NT Gas against loss or damage as a result of the user failing to comply with the pressure obligations. The indemnity is also not subject to the limitation of liability to direct damages only (clause 79).

These clauses should be amended as follows.

- The maximum pressure should be determined in consultation with the user or alternatively by NT Gas acting reasonably.
- The indemnity in clause 48 should be reduced to the extent that the loss or damage was caused or contributed to by NT Gas' negligence.

#### **5.10 Allocation of Receipts and Deliveries (clauses 57 – 60)**

Clauses 57 and 58 set out methodologies for allocation of receipts and deliveries at the relevant points. Clause 59 states that if all users for a receipt point or delivery point agree on an alternative allocation methodology to the above methodologies, then NT Gas may apply such alternative methodology.

Clause 59 should be amended to require NT Gas to apply any methodology agreed by the users rather than to leave it in NT Gas' discretion.

#### **5.11 Additional Receipt Points and Delivery Points (clauses 61 – 66)**

Clause 65(e) lists matters which the user must pay NT Gas for in respect of the construction of an additional receipt or delivery point.

Sub-clause 65(e)(ii) should be amended to clarify that the user is only liable to compensate NT Gas for obtaining a reasonable rate of return on capital expended to make the additional receipt or delivery point, where the costs are being recovered over time.

#### **5.12 Billing and payment (clauses 73 – 76)**

The terms and conditions should specify the interest charge that is payable under clause 74.

#### **5.13 Information Interface (clauses 77 – 78)**

Clause 78 provides that only the user's employees authorised by NT Gas may use the information interface pursuant to the right of access set out in clause 77. The user is liable for any loss incurred by NT Gas resulting from use of the information interface by such of the user's employees.

Clause 78 should be amended (as set out below) to provide that:

- the user is subject to liability for direct damages only; and



- the user is only liable where a user's employees misuse the information interface or act negligently. The user's any liability should be reduced in the event, and to the extent, of any negligence by NT Gas.

#### **5.14 Limitation of liability and indemnity (clauses 79 – 81)**

Clause 79 provides a general limitation to liability for consequential loss. It sets out a series of matters where this limitation would not apply, which only apply to the user. This is not fair, is unreasonable and is an inappropriate allocation of risk as between the parties.

Clause 79 should be amended so that both the user and NT Gas have the benefit of the limitation in the following cases.

- The delivery of off specification gas. If the user is liable for consequential loss for delivering off specification gas then NT Gas should be equally liable where it delivers off specification gas to the delivery point (unless otherwise agreed with the user).
- The obligation to deliver gas at the required pressure (for the same reasons as the treatment of off specification gas).
- The payment of rates, charges and other payments under the agreement (for example where NT Gas is liable to pay to the user refunds of over-payments which include interest).

The following exceptions to the limitation of liability should also be deleted.

- The use of the information interface (if this is retained it should only apply where the user has wilfully misused the information interface - see discussion on clause 78 above).
- The indemnity in clause 81 (clause 81 is not reasonable for the reasons set out below).

Clause 80 provides that the aggregate liability of NT Gas and its related bodies corporate is capped at an amount which is determined "on a case by case basis". This is inconsistent with the purpose of regulated terms and conditions and the cap, if any, should be specified in the terms and conditions.

Where damages are capped to direct damages only then the inclusion of a further liability cap is not reasonable. If the AER is minded to allow a cap it should be an amount which provides sufficient incentive for NT Gas to perform the agreement. For example, a minimum of 200% of contract value.

Clause 81 provides NT Gas with a broad indemnity from the user in relation to the matters specified. The matters referred to in clause 81(a) are acts or omissions which are the responsibility of NT Gas and not the user. It is not reasonable for the user to indemnify NT Gas and its related bodies corporate for these matters.

The indemnity in clause 81(b) is very broad and, combined with the exclusion of the limitation of liability to direct damages only (see above) potentially exposes the user to very broad damages claims. If the indemnity is retained then it should apply to both the user and NT Gas. Further, the indemnity should only cover actual losses and not extend to losses which a third party "claims to suffer".

## 5.15 Force majeure (clauses 82 – 87)

Clause 82 provides a general test for force majeure. The clause then sets out a list of events which would be considered as being a force majeure event (provided the foregoing test was satisfied) including paragraph (g):

*in respect of the Pipeline, and any lateral pipelines owned or operated by the Service Provider and related machinery, equipment or facilities (including Interconnection Facilities), accidents, breakdown, loss or damage or the necessity to undertake alterations, repairs or maintenance (other than routine maintenance for which notice has not been given).*

The event listed in paragraph (g) should be two sided. If a force majeure event is breakdown of NT Gas' equipment (provided it meets the general test of force majeure) then it should also cover the user's equipment (subject to the same requirement).

Clause 83 provides a list of events which would not be considered force majeure "regardless of how they are caused". The events include "the inability of the User or a person supplying gas at or upstream of the Receipt Points to provide gas for transportation under the Transportation Agreement or the inability of the User or a person consuming gas at or downstream of the Delivery Points to take gas".

Excluding these events from the definition of force majeure means the clause will provide little benefit for a user and is contrary to the purpose of a force majeure clause. There is no justification for removing these events from the definition of force majeure and they should be subject to the general force majeure tests.

Clause 85 provides that a force majeure event does not, among other things, relieve the user of its obligation to pay a minimum bill, capacity charge or tolling charge unless during a month NT Gas fails to deliver quantities of gas scheduled under the firm service as a result of a force majeure event affecting NT Gas. This removes a large part of the benefit of the force majeure clause for the user. If the user is unable to accept gas as a result of an event beyond its control then the user should not be liable to pay the charges under the agreement.

## 5.16 Confidentiality (clauses 93 – 95)

Clause 93 specifies how a party receiving confidential information may use the information which includes, for internal purposes related to the governance of the party or its related bodies corporate. Given the sensitivity of gas volumes, and the fact that NT Gas has various related entities acting in different roles, these obligations of confidentiality should be clear.

Clause 93 should be amended to clarify the meaning of "internal purposes related to the governance of the Party or its Related Bodies Corporate".

Clause 95 should also be amended specify when a disclosing party will be required to notify the other party and/or obtain a confidentiality agreement from a third party.

## 6 Determination of the total revenue requirement

Under the scheme of regulation established by the Law and the Rules, reference tariffs are determined by a process of:

- determining a total revenue requirement for the pipeline service provider as the sum of a return on a regulatory asset value, depreciation of the regulatory asset value, a forecast of operating costs and a forecast of taxation costs; and
- allocating to the total revenue a forecast demand for services to determine a unit tariff for the reference services.

In the access arrangement information and submission published by the AER, NT Gas has provided limited information relating to forecasts of expenditure. Further, no financial model showing the calculation of total revenue and the reference tariff has been made available. In the absence of this information, Santos and Magellan are not able to make a thorough, informed submission on the determination of total revenue. As such, Santos and Magellan will rely on the AER to make an assessment of the total revenue determination and may address this matter in a submission after the AER issues its draft decision.

The only exception to this is the rate of return proposed by NT Gas.

The rate of return proposed by NT Gas is greater than the rate of return that would be determined consistently with recent regulatory determinations of the AER. There are no characteristics of the AGP and the market for gas transmission that would result in the AGP facing a higher level of risk than other gas transmission pipelines in Australia, or, having a different profile of investors. On this basis, the nominal post tax rate of return proposed by NT Gas is too high by an amount of approximately 1.4 percentage points due to overstatement of the cost of debt, market risk premium and equity beta, and understatement of the value of imputation credits (gamma).

A comparison of the rate of return proposed by NT Gas and that which would be consistent with regulatory precedent is shown in the following table.

<b>Parameter</b>	<b>NT Gas Proposal</b>	<b>Recommended values to be applied by the AER, consistent with regulatory precedent</b>
Risk free rate	5.48%	5.48%
Gearing	60.0%	60.0%
Debt margin	5.46%	4.25%
Debt raising costs	0.11%	0.11%
MRP	6.50%	6.00%
Gamma	0.20	0.50
Equity beta	1.00	0.80
Cost of equity	11.98%	10.28%
Cost of debt	11.05%	9.84%
<b>Post tax nominal WACC</b>	<b>11.42%</b>	<b>10.01%</b>

## **7 Actual and forecast demand for pipeline services**

In the access arrangement information and the accompanying submission made to the AER, NT Gas has provided information on actual and forecast demand for pipeline services only in terms of total gas transportation. No actual and forecast information is provided for the actual amount of contracted capacity for the firm service, nor the capacity of the pipeline to provide interruptible services.

NT Gas should provide and substantiate a forecast of contracted capacity for the firm service for reasons that:

- the reference service is a service contracted for as a quantity of contracted capacity, and a forecast of contracted capacity provides users and prospective users of the AGP with important information on the availability for capacity for provision of the reference service; and
- the reference tariff for the reference service is calculated on the basis of total revenue and the forecast of contracted capacity, hence scrutiny of the forecast of contracted capacity is necessary for an assessment of the reference tariff.

## **8 Cost allocation and determination of reference tariffs**

NT Gas proposes that all of total revenue is allocated to the firm service (to be recovered by the reference tariff for that service). The reference tariff for the firm service is proposed to comprise only a charge for contracted capacity, with no charge on actual gas throughput. The reference tariff comprises only a charge per unit of contracted capacity and is not distance related.

This cost allocation and reference tariff structure are consistent with the revenue and pricing principles and National Gas Objective of Part 3 of the Law, taking into account the following matters.

- There is no significant forecast of demand for services other than the reference service. While demand for the interruptible service or other non-reference services may emerge, this demand is too uncertain for the recovery of part of total revenue to be attributable to this service.
- With the predominant sources of gas being the Bonaparte pipeline and Wickham Point Pipeline, Santos and Magellan expect use of the Warrego compressor station to be minimal and, hence, for variable costs of gas throughput to be negligible. As such, there is no basis in economic efficiency for a throughput-related tariff component.
- With gas sources and delivery points at various locations along the AGP and with no significant variable costs of gas transmission, there is no economic rationale for a distance-based reference tariff.

## **9 Reference tariff variation mechanism**

NT Gas proposes that the reference tariff be escalated for inflation over the access arrangement period. Santos and Magellan support this tariff variation mechanism, which is consistent with conventional regulatory practice.

However, NT Gas also propose a reference tariff variation mechanism that allows the reference tariff to be increased by a pass through of increases in costs that are

uncontrollable or unforeseen and have a material impact of greater than one per cent of forecast annual revenue. This mechanism is inconsistent with Rule 97(1)(c) of the Rules that allows for reference tariff variation by a cost pass-through only in respect of costs that arise in respect of a defined event. The provision for pass-through of costs should be limited to cost increases that arise in respect of events of a type defined in the access arrangement, and that any cost pass through should be made subject to scrutiny and approval by the AER as provided for under Rule 97(4).

## **10 Treatment pipeline extensions and expansions**

NT Gas proposes an extensions and expansions policy that contemplates an expansion in capacity not being treated as part of the covered pipeline.

The non-coverage of expansion in capacity of a covered transmission pipeline has recently occurred for the Goldfields Gas Pipeline in Western Australia under an access arrangement approved by the WA Economic Regulation Authority. In this case, the non-coverage of the incremental expansion in capacity, and some of the assets that allowed the expansion in capacity, gives rise to a potential for discriminatory pricing between existing and new pipeline users due to a differential allocation of costs between existing and incremental capacity to provide services.

Santos and Magellan request that the AER review this element of the extension and expansion policy for the AGP and the implications for consistency with the revenue and pricing principles and National Gas Objective.

## **11 Capital redundancy mechanism**

NT Gas proposes a capital redundancy mechanism in the access arrangement that comprises a general provision for costs of asset redundancy (as a reduction to the regulated asset base) to be “shared” between NT Gas and pipeline users. The mechanism and extent of this sharing are not specified. The capital redundancy mechanism also provides for redundant assets that are brought back into service be re-added to the capital base at the value brought to bear at the time of redundancy, increased by the rate of return. No provision is made for any cost of redundancy borne by users to be netted off from the value at which assets are re-added to the capital base.

More detail should be provided on how the capital redundancy mechanism will operate, and it should be ensured that the mechanism does not allow NT Gas, when bringing redundant assets back into service, to benefit where costs of asset redundancy have been borne by users.