AMCOR/PAPERLINX

RESPONSE TO

THE AUSTRALIAN COMPETITION

AND

CONSUMERS COMMISSION

ON

THE DRAFT DECISION ON GASNET

September 2002

Table of Contents

Executive Summary

AMCOR and PaperlinX are disappointed with the current access review process and with the draft decision. The ACCC's light-handed regulatory approach has accentuated the information asymmetry problems, which we consider have been cleverly exploited. The apparent reluctance of the ACCC to hold a public conference which would allow stakeholders to contest major aspects of the Commission's draft decision is also disappointing. As this submission shows, there are key areas of the draft decision where the ACCC has not provided justification or explanation for its conclusions.

AMCOR and PaperlinX will be providing further comments on the additional data including opex, which the Commission is putting on its website as a result of the draft decision.

For the moment AMCOR and PaperlinX makes the following recommendations:-

- AMCOR and PaperlinX consider that the ACCC must abandon its pro-infrastructure regulatory approach and adopts a process that produces outcomes that balance the interests of the users as well as the Service Provider.
- AMCOR and PaperlinX consider that GasNet's proposal to adjust the Initial Capital Base (amounting to some $40 million) must be rejected in terms of the provisions of the Gas Code and the Victorian Tariff Order.
- AMCOR and PaperlinX consider that the ACCC must assess the roll-in of the South West Pipeline on either the efficiency test or the system wide benefit test, but not on an aggregate of the two.
- AMCOR and PaperlinX consider that the ACCC's draft decision on the 'roll-in' of the South West Pipeline is unsatisfactory in the absence of transparent and relevant information and justification.
- AMCOR and PaperlinX consider that the draft decision is opaque in relation to the suggested South West Pipeline tariff and advise this is unsatisfactory regulatory practice.
- AMCOR and PaperlinX consider that the acceptance of the system wide K factor adjustment will result in additional contributions from PTS to SWP
- AMCOR and PaperlinX consider that the ACCC must reject GasNet's proposal to remove the peak withdrawal tariff, as it is not cost reflective.
- AMCOR and PaperlinX consider that the ACCC must require GasNet provide cost/benefit analyses for over-runs on approved capex, and must require GasNet provides benchmark outcomes for future capex
- The ACCC must remove the GST spike effects in order to avoid penalising consumers who are required to pay another 10% GST in their utility bills.
- Amcor and PaperlinX consider that the ACCC has awarded a WACC at the higher end of acceptable range, and strongly recommends that the ACCC review the WACC calculation in light of the two new reports now available.

1. Introduction

AMCOR and PaperlinX welcome the opportunity to present our views on the ACCC's draft decision on GasNet Australia's access arrangement revisions for the Principal Transmission System.

AMCOR and PaperlinX have major concerns with the ACCC's draft decision, which we consider breach key provisions of the National Gas Code, and have significant adverse cost impacts on users and prospective users of GasNet system. By avoiding rigorous assessment of key aspects of GasNet's claims on the grounds of 'complexity' and 'difficulty', the ACCC has not only failed to take into account users' and prospective users' interests (s.2.24 of the Gas Code) but is creating a dangerous precedent for future regulatory reviews by providing an incentive for access arrangement applications to be increased in 'complexity' in order to achieve an improved result for the service provider.

We also wish to register our concerns with the current access review process. Information asymmetry problems have been a key concern, with progressive public release of 'classified' material. More information is yet to be made available, as indicated in the draft decision, with stakeholders' ability to comment effectively constrained by timing considerations. Furthermore, there is an implication that a public conference will not be held because of timing constraints. Against the background of stakeholders concerns with the opaque nature of key aspects of the ACCC's draft decision, this submission expresses disappointment with the ACCC's access review process, as well as with the draft decision.

This submission covers the following issues, which are detailed in subsequent sections:-

- The ACCC's Pro-Infrastructure Draft Decision
- The Initial Capital Base: Revaluations
- Structure of GasNet's Assets: South West Pipeline
- "Flattening" Injection and Withdrawal Tariffs
- Capex
- GST Spike
- WACC
- Conclusion and Recommendations

2. The ACCC's Pro-Infrastructure Draft Decision

AMCOR and PaperlinX in their previous submission to the ACCC argued that the ACCC must reject GasNet's pro-infrastructure assertions. However, notwithstanding the claims by the ACCC that it has sought to balance the competing claims of the service provider and users, the ACCC's draft decision has taken a biased approach against users' interests particularly in key areas on the South West Pipeline 'roll-in', past capital expenditure, future operational and maintenance expenditure, benefit sharing mechanism, and (to a lesser extent) the WACC. In total, decisions in these areas will significantly add to the cost of GasNet's services, with the decision alone on the South West Pipeline adding some $80 million (or about 25%) to the regulatory asset base.

The ACCC has approached this access review with a 'light-handed' regulatory approach and this has exacerbated the information asymmetry problems for itself, as well as for users and potential users. The ACCC has nowhere provided empirical evidence that such an approach is efficient, nor has it shown that monopoly rents have been reduced or that inefficient or over-investments have been prevented. It is incumbent upon the ACCC that it justifies and substantiates its regulatory approach. We consider, however, that the ACCC has erred in the major areas identified above.

AMCOR and PaperlinX consider that the ACCC must abandon its pro-infrastructure regulatory approach and adopts a process that produces outcomes that balance the interests of both Service Provider and users.

3. The Initial Capital Base: Revaluations

AMCOR and PaperlinX have previously submitted that the National Gas Code does not allow for any adjustments (in terms of those sought by GasNet) to the Initial Capital Base at the start of the Second Access Arrangement Period. In addition, the Victorian Tariff Order prevents a re-visiting of the Initial Capital Base for the Second Access Arrangement Period. The Victorian Regulator General (now Chairman of the Essential Services Commission) has adopted this approach in relation to the gas distribution access reviews.

AMCOR and PaperlinX consider that GasNet's proposal to adjust the Initial Capital Base (amounting to some $40 million) must be rejected in terms of the provisions of the Gas Code and the Victoria Tariff Order, and supports the ACCC draft decision on this issue.

4. Structure of GasNet's Assets: South West Pipeline

The ACCC's draft decision provides for the 'roll-in' of the South West Pipeline into the Principal Transmission System on the basis that the part recovery of revenue from the South West Pipeline tariff, with the balance from the system wide benefit, is permitted under the feasibility of new facilities tests of the Gas Code.

AMCOR and PaperlinX, however, consider that s.8.18(b) of the Code requires that the investment, in addition to being the lowest cost option, must satisfy <u>one</u> of the other tests viz. sufficient revenue, <u>or</u> system wide benefit, <u>or</u> system safety. Therefore, the draft decision has erred in that it incorrectly assumes that an aggregation of benefits is permitted. The use of the word <u>"or"</u> before each of the options (i), (ii) and (iii) in s.8.18(b) clearly denotes mutual exclusion between the options, and we suggest too that the clear requirement of "one" of the options to be complied with, does not permit aggregation.

AMCOR and PaperlinX consider that the ACCC must assess the roll-in of the South West Pipeline on either the efficiency test or the system wide benefit test, but not on an aggregate of the two.

S.8.18(b)(ii) of the National Code permits either or both users and service provider to provide argument to satisfy the ACCC that the proposed investment provides a system wide benefit test. In the absence of any user applying for the "roll-in" of the South West Pipeline under that test (in fact users have consistently opposed the roll-in attempts of SWP by GasNet), the Commission could have only considered the information provided by GasNet. However, as for as we are aware, GasNet has not provided quantification of a system wide benefit, so it is somewhat intriguing that the ACCC has agreed in its draft decision, that the (un-quantified) benefit is sufficient to cover the expected under-run of the revenue flow from the tariff on the South West Pipeline. But the ACCC has not provided any justification either, other than resorting to a justification under a "regulatory judgment" argument, which does not satisfy users who have to pay for the "roll-in". This is not good regulatory practice.

AMCOR and PaperlinX consider that the ACCC's draft decision on the 'roll-in' of the South West Pipeline is unsatisfactory in the absence of transparent and relevant information and justification.

As well as not providing any quantified system benefit, the ACCC's draft decision does not provide any quantification of the revenue benefit from its suggested South West Pipeline tariff. With the extensive changes and WACC reduction, any calculation made by either GasNet or the ACCC cannot be sustained. Again, this is not a satisfactory regulatory practice, as users (who have to pay for the costs) must be able to be assured that the tariff is fair, reasonable and efficient.

AMCOR and PaperlinX consider that the draft decision is opaque in relation to the suggested South West Pipeline tariff and this is an unsatisfactory regulatory practice.

Acceptance of the K factor carry over permits GasNet the opportunity to cross-subsidise the SWP in the event of an under run of volume on that part of the GasNet system. Amcor and PaperlinX have real concerns that the ACCC has blindly accepted GasNet commentary that by insulating SWP from the rest of the PTS with regard to K factor adjustment, will result in excessive costs and complexity. The companies are of the view that SWP should probably be considered a separate pipeline, and the ACCC has conceded to GasNet statements without serious examination of the true costs involve as against the Gas Code requirement for cost reflectivity. The companies consider that by not insulating SWP from the PTS with regard to K factor, may result in additional but uncontrolled contributions from PTS users.

AMCOR and PaperlinX consider that the acceptance of the system wide K factor adjustment will result in additional contributions from PTS to SWP.

5. "Flattening" Injection and Withdrawal Tariffs

In their earlier submission, Amcor and Paperlinx noted that GasNet had not provided any legitimate reason for its request to reduce market signals to consumers, and that the proposed "flattening" of the tariff structure is not cost reflective. Moreover, GasNet had not provided the relevant data to demonstrate the extent by which it proposed to "flatten" the tariffs. The ACCC has erred by accepting the GasNet assertion that there is no need to send pricing signals through using a peak tariff, as the system is not constrained. In fact the primary reason for requiring peak tariffs is to comply with the cost reflectivity requirement of the National gas Code. An "any time" tariff does not comply with cost reflectivity requirements of the Gas Code.

AMCOR and PaperlinX consider that the ACCC must reject GasNet's proposal to remove the peak withdrawal tariff, as it is not cost reflective.

6. Capex

The ACCC has not required GasNet to justify the increases in past capex above the amounts approved in the 1998 decision. Whilst the activities were approved for a nominated amount GasNet the actual amounts spent exceeded significantly the nominated amounts. The ACCC must verify that the new amounts still comply with the cost/benefit target anticipated at the time of approval.

The ACCC has, again, erred in its draft decision in not requiring GasNet to provide quantifiable outcomes for all its capex proposals. This decision means that the ACCC could well be encouraging inefficient investments, and sets a dangerous precedent for future regulatory reviews.

AMCOR and PaperlinX consider that the ACCC must require GasNet provide cost/benefit analyses for over-runs on approved capex, and must require GasNet provides benchmark outcomes for future capex.

7. GST Spike

AMCOR and PaperlinX consider that the ACCC's draft decision not to consider the GST spike impact on the RAB, needs further explanation rather than being ignored. By adding the GST spike to the RAB (which is then passed through to users via higher tariffs because of the RAB times WACC calculation) the approach penalises consumers who also have to pay the full 10% GST which is added to utility bills. In other words consumers are left with a double jeopardy effect. This is not good regulatory practice and the ACCC has legal responsibility to ensure that there is clearly no consideration that the GST is being improperly applied by suppliers.

The ACCC must remove the GST spike effects in order to avoid penalising consumers who are required to pay the stated 10% GST in their utility bills.

8. WACC

The ACCC's draft decision on the WACC is a marked improvement on that claimed by GasNet. However, we believe that the WACC draft decision is still too high, give the relatively risk free nature of the GasNet business (and the advantages gained by the application of the K-factor mechanism).

We would draw attention to a recent report by Pareto Associates on what should be seen as an appropriate WACC. This report shows that an appropriate WACC should be much lower than that proposed by the ACCC. This report (Victorian Gas Distribution Access Arrangement 2003-2007, Customer Energy Coalition. Comment on Essential Service Commission Draft Decision, August 2002) is available on the website of the Victorian ESC.

Also of interest on the ESC website is a paper from Mercer Consulting which addresses the issue of "equity risk premium". It is worth recording that Mercer has so far not been involved in the debate on what constitutes an acceptable MRP and therefore brings a new and independent view.

The Mercer report suggests that the companies listed on the ASX exhibit an "ERP" of half that being permitted by the ACCC as GasNet's "market risk premium". We consider that the GasNet risk profile must be less than that of industries in a competitive environment and so the ACCC should reduce the MRP to reflect risk levels applying in a competitive environment.

Amcor and PaperlinX consider that the ACCC has awarded a WACC at the higher end of the acceptable range, and they strongly recommend that the ACCC review the WACC calculation in light of the two new reports now available.

9. Conclusion and Recommendations

AMCOR and PaperlinX are disappointed with the current access review process and with the draft decision. The ACCC's light-handed regulatory approach has accentuated the information asymmetry problems, which we consider have been cleverly exploited. The apparent reluctance to hold a public conference which would allow stakeholders to contest major aspects of the Commission's draft decision is also disappointing. As this submission shows, there are key areas of the draft decision where the ACCC has not provided sufficient justification or explanation for its conclusions.

AMCOR and PaperlinX will be providing further comments on the additional data including on opex, which the Commission is putting on it website as a result of its draft decision.

For the moment AMCOR and PaperlinX makes the following recommendations:-

- AMCOR and PaperlinX consider that the ACCC must abandon its pro-infrastructure regulatory approach and adopts a process that produces outcomes that balance the interests of the users as well as the Service Provider.
- AMCOR and PaperlinX consider that GasNet's proposal to adjust the Initial Capital Base (amounting to some $40 million) must be rejected in terms of the provisions of the Gas Code and the Victorian Tariff Order.
- AMCOR and PaperlinX consider that the ACCC must assess the roll-in of the South West Pipeline on either the efficiency test or the system wide benefit test, but not on an aggregate of the two.
- AMCOR and PaperlinX consider that the ACCC's draft decision on the 'roll-in' of the South West Pipeline is unsatisfactory in the absence of transparent and relevant information and justification.
- AMCOR and PaperlinX consider that the draft decision is opaque in relation to the suggested South West Pipeline tariff and advise this is unsatisfactory regulatory practice.
- AMCOR and PaperlinX consider that the acceptance of the system wide K factor adjustment will result in additional contributions from PTS to SWP
- AMCOR and PaperlinX consider that the ACCC must reject GasNet's proposal to remove the peak withdrawal tariff, as it is not cost reflective.
- AMCOR and PaperlinX consider that the ACCC must require GasNet provide cost/benefit analyses for over-runs on approved capex, and must require GasNet provides benchmark outcomes for future capex
- The ACCC must remove the GST spike effects in order to avoid penalising consumers who are required to pay another 10% GST in their utility bills.
- Amcor and PaperlinX consider that the ACCC has awarded a WACC at the higher end of acceptable range, and strongly recommends that the ACCC review the WACC calculation in light of the two new reports now available.