



BHP Billiton Petroleum Pty Ltd  
600 Bourke Street  
Melbourne Victoria 3000 Australia  
GPO Box 86A  
Melbourne Victoria 3001 Australia  
Tel +61 3 9609 3333 Fax +61 3 9609 3015  
bhpbilliton.com

13 September 2002

Ms Kanwaljit Kaur  
General Manager  
Regulatory Affairs - Gas  
Australian Competition and Consumer Affairs  
PO Box 1199  
DICKSON ACT 2602

Dear Ms Kaur

**Victorian Natural Gas Transmission Access Arrangement**

Please find attached BHP Billiton's response to the ACCC's draft decision on GasNet's Access Arrangements application.

BHP Billiton is very concerned that there is a lack of substantiation to a number of assertions made by the ACCC in its draft decision. In particular, we refer to the need to provide a clear and transparent justification for level of SWP capital expenditure that is accepted into the Capital Base under a system wide benefits test. We also do not accept that a justification of "complexity" is enough to address the issue of ring-fencing the SWP K-factor to provide cost reflectivity. In particular we see this as setting a precedent for future justification by asset owners when attempting to roll overcapitalized and inefficient assets into their Capital Base.

BHP Billiton has previously formally requested the ACCC to convene a public forum to discuss these and other issues raised. We look forward to a response on that proposal.

If there are any questions regarding this submission, please do not hesitate to contact me on (03) 9652 6800.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "D Murphy".

**David Murphy**  
Marketing Manager

**BHP BILLITON SUBMISSION**  
**ON**  
**ACCC DRAFT DECISION**  
**GASNET ACCESS ARRANGEMENTS APPLICATION**

**13 September 2002**

## Executive Summary

BHP Billiton considers that the draft decision has erred in many respects and is in breach of key provisions of the Natural Gas Code, especially with respect to cost reflectivity and the need to balance the interests of service providers and users.

Key areas of the draft decision are opaque, and it appears that rigorous analysis has not been applied. There are far too many assumptions proposed by GasNet which have been accepted by the draft decision, notwithstanding comments from other stakeholders.

Light-handed regulation as applied by the ACCC in this access review is a recipe for inefficient outcomes, the continuation of monopoly rents and inefficient/over investments. It has also exacerbated the information asymmetry problems for the Commission and users.

This current access review process has been disappointing. Moreover, several aspects of the draft decision will create a dangerous precedent for future regulatory reviews.

Accordingly, BHP Billiton recommends the following:-

- ↪ BHP Billiton is disappointed with the current access review process on several grounds. It considers that the Commission has erred in not making available information which would allow users and prospective users to replicate GasNet's tariff calculations.
- ↪ BHP Billiton believes that the intellectual basis driving this access review needs to be balanced by empirical evidence and transparent and rigorous analysis, in order to ensure that users' and prospective users' interests are not disadvantaged.
- ↪ The ACCC has erred in many key areas of its draft decision by not providing any substantiation for its decision to ignore stakeholder proposals that provide for transparent and cost reflective tariffs.
- ↪ The ACCC must review its draft decision on the value of system wide benefit attributable to SWP. The amount allowed under the draft decision cannot be transparently and clearly justified.
- ↪ The draft decision has erred in permitting the K-factor cross subsidy to the SWP from the PTS. 'Complexity' is a unsatisfactory reason for ignoring the cost-reflectivity provisions of the Code. BHP Billiton does not accept the 'complexity' argument, especially when other regulators of distribution systems have applied cost-reflective principles of the Code in their regulatory decisions.
- ↪ BHP Billiton is concerned with the opaque nature of the draft decision on the SWP tariff. It is also concerned that the forward process envisaged by the ACCC precludes stakeholders other than GasNet any opportunity to ascertain that the tariff is cost reflective.
- ↪ The ACCC must review its draft decision to permit roll-in of the SWP with more rigour as the SWP is in reality a new and separate pipeline.

- ↪ The ACCC's draft decision not to agree to GasNet's proposal to roll "omitted items" amounting to some \$40 million into the new Initial Capital Base is strongly supported.
- ↪ The ACCC must ensure that all capital expenditures are justified and demonstrated to be cost-effective under the "prudence" and "cost-efficiency" tests of the Gas Code.
- ↪ The ACCC must remove the initial GST spike in calendar year 2000 from the regulatory asset base.
- ↪ The ACCC must review all aspects of its draft decision which are "biased in favour of the service provider" against the Code provisions, which, inter alia, seek to balance the interests of service providers and users. Its review of the WACC should be undertaken in the light of the Pareto reports, which argue for a much lower WACC than the ACCC's draft decision.
- ↪ The ACCC's draft decision on the avoidance of price shocks is supported but these could be further minimized by review of the changes proposed in this submission.
- ↪ The ACCC must require GasNet to provide quantifiable outcomes for all capital expenditure proposals.
- ↪ BHP Billiton strongly recommends that the ACCC should require GasNet to substantiate its assessment of this cost (and gain VENCORP agreement to the number as independent verification), and then add this amount into the revenue allowed GasNet so that a true comparison of operating costs can be demonstrated.
- ↪ The ACCC must adopt an 'assessment by comparison' approach to GasNet's proposals for operating expenditure

## 1. Introduction

BHP Billiton welcomes the opportunity to provide its views on the ACCC's draft decision on GasNet Australia's access arrangement revisions for the Principal Transmission System (PTS).

BHP Billiton is disappointed with key aspects of the Commission's draft decision, which have additional cost implications for users of the GasNet system, and tilts the playing field by proposing to allow GasNet to cross-subsidize particular assets. In addition, the ACCC is proposing to adopt a 'conservative' approach that permits GasNet a higher WACC than is deemed reasonable, despite GasNet's adoption of the K-factor mechanism which passes significant risks to users of the system.

This access review has proceeded unsatisfactorily in terms of information disclosures and the problems experienced with information asymmetry. We would suggest that the Commission has erred by not requiring that sufficient information be provided to enable users and prospective users to replicate (within a reasonable margin) GasNet's tariff calculations to assess that tariffs are fair, reasonable, efficient and cost reflective. Accordingly, we maintain that the ACCC has not complied with the objectives of the Code.

In this regard, we would note that in the Supreme Court of Western Australia – Court of Appeal decision of 23 August 2002 (Re Dr Ken Michael AM; Ex Parte Epic Energy (WA) Nominees Pty Ltd and ANOR [2002] WASCA 231) a number of declarations were made, including the following which is relevant to our view regarding the current process:-

"The factors in s.2.24(a) to (g) of the Code are relevant to, and are to be given weight as fundamental elements in, the Regulator's assessment of the proposed Access Arrangement, including the issue whether the Regulator is satisfied that the proposed Access Arrangement contains the elements and satisfies the principles set out in s.3.1 to s.3.20."

GasNet has "queried" the need for the information to be provided, but we are not aware that it has referred to any detrimental effects GasNet would be exposed to (as a natural monopoly business) if this information were to be provided. S.2.24 states:-

"The Relevant Regulator may approve a proposed Access Arrangement only if it is satisfied the proposed Access Arrangement contains the elements and satisfies the principles set out in sections 3.1 to 3.20. The Relevant Regulator must not refuse to approve a proposed Access Arrangement solely for the reason that the proposed Access Arrangement does not address a matter that section 3.1 to 3.20 do not require an Access Arrangement to address. In

assessing a proposed Access Arrangement, the Relevant Regulator **must** (emphasis added) take the following into account:-

- a. the Service Provider's legitimate business interests and investment in the Covered Pipeline;
- b. firm and binding contractual obligations of the Service Provider or other persons (or both) already using the Covered Pipeline;
- c. the operational and technical requirements necessary for the safe and reliable operation of the Covered Pipeline;
- d. the economically efficient operation of the Covered Pipeline;
- e. the public interest, including the public interest in having competition in markets (whether or not in Australia);
- f. **the interests of Users and Prospective Users** (emphasis added);
- g. any other matters that the Relevant Regulator considers are relevant."

It is noted that s.3.2(b) states:-

"To the extent practicable and reasonable, a User or Prospective User must be able to obtain a Service which includes only those elements that the User or Prospective User wishes to be included in the Service."

In other words, we consider that users and prospective users must be able to replicate their tariffs to establish that they are fair, reasonable, efficient, and cost reflective. It is simply not satisfactory for users or prospective users to rely only on the Commission's judgements.

***BHP Billiton is disappointed with the current access review process on several grounds. It considers that the Commission has erred in not making available information which would allow users and prospective users to replicate GasNet's tariff calculations.***

## **2. The environment assumed by ACCC in reaching its Draft Decision**

Throughout the ACCC's draft decision there appears to be an assumption that incentive regulation will ultimately provide consumers with the outcomes anticipated by the Gas Code. The ACCC's assumption that positive incentives for GasNet to reduce its costs to efficient levels, will always be to the ultimate benefit of consumers has not been proven. Unlike other regulators (eg. in the U.K.<sup>1</sup>) the ACCC has not sought to test this very broad and altruistic assumption and appears to have adopted the high level concepts espoused in

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<sup>1</sup> All U.K. regulators use analysis and benchmark comparisons of past performance to inform judgments on future efficiencies, including applying different incentives for companies.

the Productivity Commission's draft report on regulated infrastructure businesses will apply to any regulated business eager to increase its short term profitability<sup>2</sup>. As the history of industry protection in Australia clearly demonstrates, it is strong competition which drives positive outcomes for consumers, rather than providing financial incentives such as tariff production or industry assistance to drive industry towards best practice outcomes.

It is for this reason that there is a great emphasis on comparative performance in the Gas Code, as "competition by comparison" is the only driver which will ensure both short and long term economically efficient outcomes for the regulated provider and for the consumer. Thus, the ACCC has been urged in earlier submissions by stakeholders to rigorously test both past and future costs of GasNet against its peers but it has chosen to ignore this (reasonable) but fundamental request.

The ACCC has sought to justify this approach as "light-handed regulation" but nowhere is this term sufficiently defined to give it a measurable yardstick. Nor has the Commission pointed to any empirical evidence that such an approach has been successful in reducing monopoly rents and benefiting consumers. We will, however, commend to the ACCC, research undertaken by Carpenter and Lapuerta<sup>3</sup> into gas and electricity regulation in the UK, who observed that:-

"Although attractive in theory, the implementation of light-handed regulation in the United Kingdom has faced several problems. First, light-handed regulation has not worked as anticipated to avoid the need for lengthy regulatory proceedings. Second, light-handed regulation has unintentionally created inefficient incentives for regulated companies. Third, light-handed regulation has not successfully constrained the monopoly power of incumbents."<sup>4</sup>

The conclusions reached by the authors are that:-

"Light-handed regulation initially promised to avoid the problems associated with traditional United States regulation. Proponents in the United Kingdom anticipated administrative simplicity and efficient incentives for privatized utilities. The reality has been more complex. Regulators have had to confront issues related to the measurement of assets, depreciation, rates of return, and cost projections. Had these issues been anticipated prior to privatization, more satisfactory solutions could have been found. Furthermore, **light-handed regulation has exacerbated the information disadvantage of regulators, which has been exploited successfully by regulated companies**. Finally, light-handed regulation has failed to avoid inefficient incentives. Although

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<sup>2</sup> It must be remembered that publicly traded businesses are now assessed for performance by their shareholders in very short time frames – as short as 6-12 months in many cases. Certainly a 5 year window for performance is seen at the extreme outer range of tolerance by the investment community.

<sup>3</sup> A critique of Light-handed regulation by Paul Carpenter and Carlos Lapuerta, *Northwestern Journal of International Law and Business*, February 1999

<sup>4</sup> *ibid*, page 2

UK regulators were justified in their attempt to avoid the pitfalls of the US-style regulation, it is evident from their experience with light-handed regulation that **examination of certain factors cannot be avoided when determining the appropriate rates offered by regulated companies.**<sup>5</sup> (emphases added)

In its draft decision on the Victorian gas distribution businesses, the Victorian Essential Services Commission explicitly stated that it:-

“... has adopted a number of conservative assumptions it considers to systematically favour the distributors”

over the users in five aspects of the review<sup>6</sup>. Whilst the ACCC claims to have sought to balance the competing demands of users and asset owners, it is in the more difficult (and technical) aspects of the review where the ACCC has shown bias. Specifically, BHP Billiton points to the draft decisions on the following: the SWP; past capital expenditures; future operating expenditures; benefit sharing; and, to a lesser extent, on the WACC. BHP Billiton’s concerns with these issues are developed more fully later in this submission.

It could be that the ACCC prefers to assume that Australian regulators are more capable than their overseas counterparts to administer “light-handed regulation” and so avoid its inherent pitfalls, by proceeding with a regulatory process where discovery of information has been a blatant and recurring problem,<sup>7</sup> and bland assumptions made that long term incentives will encourage cash hungry regulated businesses to deliver long term benefits for service users over short term profits and cash acquisition. Resorting only to general theory is an insufficient basis for producing good regulatory outcomes.

***BHP Billiton believes that the intellectual basis driving this access review needs to be balanced by empirical evidence and transparent and rigorous analysis, in order to ensure that users’ and prospective users’ interests are not disadvantaged.***

### **3. The lack of transparency of the current process**

In a number of areas throughout the draft decision, the ACCC makes a number of assertions in arriving at a decision. What is, however, absent from the draft decision is the clear quantification and substantiation of those assertions. This is unacceptable regulatory practice, and, we would contend, is in breach of the National Gas Code.

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<sup>5</sup> *ibid*, page 22

<sup>6</sup> Review of Gas Arrangements, draft decision July 2002, [Victorian] Essential Services Commission, page 136

<sup>7</sup> BHP Billiton refers the ACCC to other draft and final decisions by Australian regulators, all of whom have raised the issues of lack of information disclosure and information asymmetry.



An example concerns the assertion by the ACCC that the inclusion of the SWP into the PTS results in a system wide benefit of nearly \$4M per year<sup>8</sup>. There is no written substantiation provided that there is in fact a system wide benefit and what, if any, is the value of that benefit.

Another example concerns the ACCC's acceptance of GasNet's assertion that increasing the numbers of tariffs as proposed by a number of stakeholders (to ensure a more equitable allocation of costs) will result in excessive costs to GasNet. GasNet has not quantified what the additional costs per additional tariff will be, and therefore we fail to see how the ACCC is able to discern whether the request from stakeholders (for cost reflective tariffs) is reasonable. In this regard, it needs to be pointed out that AGL Gas Networks in Sydney has provided every one of some 450 industrial customers with a unique tariff, as it is required by IPART in its 2000 determination to ensure cost reflectivity is related to peak usage of the system by each customer.

Thus, we believe that the ACCC is in breach of requirements for regulatory transparency of tariff if it arbitrarily asserts, with no written and transparent substantiation, that the costs to require GasNet to provide features sought by stakeholders (which are available in other regulatory jurisdictions) are not warranted. The ACCC needs to carry out costings to quantify the basis for their assertions. Mere assertions are no substitute for best practice regulation.

***The ACCC has erred in many key areas of its draft decision by not providing any substantiation for its decision to ignore stakeholder proposals that provide for transparent and cost reflective tariffs.***

## 4. South West Pipeline

### SWP roll-in

Section 8.18(b)(ii) of the Gas Code allows either or both of the service provider and users to provide sufficient argument to satisfy the regulator that any proposed investment provides a system wide benefit. No user has applied for the SWP to be rolled-in under the system wide benefit test. Therefore, the ACCC must only have considered the information provided by GasNet in its application. As GasNet has provided no quantification of the system wide benefit in its application, we are at a loss to understand how the ACCC has reached the conclusion that the benefit is sufficient to cover the expected under-run of the revenue flow from the tariff on SWP. Review of the ACCC Final Decision on SWP on 29 June 2001, provides no additional information to support a quantification of the conclusion in the draft decision.

However, transparent regulation should require the regulator to transparently substantiate the decision to allow \$40 million of capital from the SWP into the

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<sup>8</sup> This calculation assumes ~\$40M increase in RAB above the ACCC assessed revenue recovery of ~\$45M from tariffs on SWP. Allowing a CPI of 2.5%, this results in a premium for all users of the PTS of ~\$3.6M pa

ARB under system wide benefit. It is not sufficient for the regulator to advise that it has reached a conclusion. They must demonstrate how the conclusion was reached. Failure to explain the “how” element of the review, negates the draft decision.

In particular, the draft decision failed to assess whether the same system wide benefit could have been provided in alternative ways, and at what cost. It also failed to take into consideration that the currently proven gas from Otway has been almost entirely contracted for South Australian use, and therefore the supposed benefit of access to new gas is definitely compromised. In view of the lack of quantification of the supposed benefits, BHP Billiton is firmly of the view that the ACCC has over-estimated the system wide benefit of SWP and is loading unnecessary costs onto all consumers.

***The ACCC must review its draft decision on the value of system wide benefit attributable to SWP. The amount allowed under the draft decision cannot be transparently and clearly justified.***

### **ACCC permits K-factor cross subsidy to SWP from PTS**

GasNet has made a decision to build the SWP. This decision was not a requirement of stakeholders, although there was significant pressure on GasNet by the Victorian Government for the building of it. On completion, GasNet has identified that there is unlikely to be sufficient revenue from it for the revenue stream to match the costs associated. As a result GasNet wants another party (all users of the PTS) to fund the shortfall in revenue, and to gain this benefit, has sought to convince the ACCC that there are other (inherent) benefits of SWP to PTS users.

Stakeholders have already commented that the SWP should be self-sustaining, but the ACCC appears to be acceding to GasNet protestations that PTS users do get a benefit. If this is the case, PTS users have every right to require that any benefit be quantified and that the opportunity to gain further benefits is eliminated from the assessment. By allowing the K-factor adjustment to be spread over all tariffs of the PTS, under-run on SWP can be added to the PTS tariffs, further increasing the benefit payable for the privilege of the SWP roll-in. The ACCC must ensure that GasNet cannot obtain further cash benefit for SWP than that already agreed to.

GasNet (and the ACCC) opine that there will be increased costs to GasNet if SWP is ring-fenced. If GasNet considers that the costs to ring-fence SWP are too great, then GasNet has the option to declare the SWP to be the separate pipeline it really is.

The ACCC avers that achieving cost reflectivity in the K-factor allocation is too complex. To use complexity as a factor to avoid requiring GasNet to prepare cost reflective tariffs (as required by the Gas Code) is unacceptable. It is incumbent on the ACCC to quantify the cost of this complexity and then allow the stakeholders the opportunity on commenting whether such cost is

acceptable compared to the cost of subsidizing an overcapitalized and inefficient asset.

It should be noted that other regulators (such as IPART and the Victorian ESC) are required to regulate gas distribution systems which provide a higher level of complexity than the PTS, and yet these regulators are able to follow the Gas Code requirements for cost reflectivity. As an example, AGLGN in its Sydney gas access arrangement provides over 450 separate tariffs, each calculated to reflect the usage of the network by individual industrial customers, including allocation of ring main usage and branch pipe usage. The statement on complexity quickly starts to lose credibility when comparisons are made with other more complex systems.

Our concern is that if the ACCC simply accepts that complexity is permitted by them to over-ride the basic tenet of cost reflectivity (user pays), then this sets a serious precedent for future regulatory practice. It will encourage service providers in future to ensure their applications are made deliberately complex to maximize their ability to game the tariffs to overcome poor investments and maximize revenue, ultimately to the disadvantage of consumers. This is a very serious issue and the ACCC is urged to consider the implications carefully.

***The draft decision has erred in permitting the K-factor cross subsidy to the SWP from the PTS. 'Complexity' is a unsatisfactory reason for ignoring the cost-reflectivity provisions of the Code. BHP Billiton does not accept the 'complexity' argument, especially when other regulators of distribution systems have applied cost-reflective principles of the Code in their regulatory decisions.***

### **SWP revenue and cost**

In its draft decision the ACCC has not quantified the revenue benefit from suggested SWP tariff. At the meeting on 9 September, the ACCC stated that the proposal for the SWP tariff to be the Longford-Pakenham tariff +10% must be considered as being "still up in the air as everything in the AA is subject to so many changes". The ACCC officers advised that when the other issues were settled, then it would be possible to settle on a SWP tariff and this would be advised as part of the Final Decision. This is unacceptable regulatory practice.

BHP Billiton has commented that this does not allow stakeholder review of the proposal to assess whether it complies with cost reflective principles of the Code. Currently, GasNet has suggested that the SWP tariff should be developed on a marginal cost approach<sup>9</sup>, which implies that there is a lack of cost reflectivity.

What is required is for the ACCC to advise GasNet (and stakeholders) that the SWP tariff is to comprise revenue from the agreed WACC on a defined capital

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<sup>9</sup> GasNet application schedule 5.7.4

amount, and a share of total operating expenditure based on a cost allocation methodology such as pipeline length x diameter. The failure to do this does not permit any future stakeholder input into the process. Due to the continuing dialogue between the ACCC and GasNet, the latter retains the ability to put its views to the ACCC beyond this point, but the process instituted by the ACCC does not allow other stakeholders this same prerogative.

***BHP Billiton is concerned with the opaque nature of the draft decision on the SWP tariff. It is also concerned that the forward process envisaged by the ACCC precludes stakeholders other than GasNet any opportunity to ascertain that the tariff is cost reflective.***

### **SWP is really a new and separate pipeline**

Despite the rhetoric, there is no doubt that SWP is a new pipeline to a new gas field, and not a true expansion of the PTS. The PTS provides a transmission pipeline system to much of Victoria, and in proportion, the addition of SWP (just one pipeline) increases the value of the PTS by some 25%. In reality, such a massive increase can hardly be justified as an augmentation. Notwithstanding this view, BHP Billiton accepts that the Gas Code does not differentiate between new pipelines to new gas fields, and the organic growth of a gas distribution system that was the prime consideration during the preparation of the Code.

However, because of the size of the expansion being requested by GasNet to be rolled-in, it is beholden on the ACCC to review the application with all of the rigor required by the Gas Code to ensure that GasNet is not using its unique position to pass onto its consumer base at large, the negative results of any of its poor investments.

It must be noted that by approving SWP to be rolled-in, the draft decision creates a precedent for service providers to use the organic growth principle to prevent competition for development of new pipelines between existing systems and new gas fields. For example, GasNet was proposing to build a new gas pipeline from Otway to Adelaide. On the arguments accepted by the ACCC for rolling-in of the SWP and allocation of the revenue under-recovery to all users under an uncosted system wide benefits test, this “expansion” could equally apply for roll-in as it would achieve exactly the same benefits the SWP is alleged to provide to the PTS ie. improved security and access to a new source of gas (from Moomba). Whilst apparently far fetched and absurd, the same arguments can be applied to this proposed “expansion”. Because of this, GasNet may have been able to undercut SEAGas pipeline tariffs for a similar service (gas from Otway to Adelaide) by having part of the revenue recovery mechanism allocated to PTS users under a so-called system wide benefit.

***The ACCC must review its draft decision to permit roll-in of the SWP with more rigour as the SWP is in reality a new and separate pipeline.***

## 5. The Initial Capital Base

### Omitted Items

BHP Billiton strongly considers that the so-called “omitted items” claimed by GasNet, should not be legally permitted to be rolled forward into the new ICB. We have provided extensive commentary on this issue and do not propose to further embellish on this issue.

***The ACCC’s draft decision not to agree to GasNet’s proposal to roll “omitted items” amounting to some \$40 million into the new Initial Capital Base is strongly supported.***

### Past capital expenditure

The Gas Code is explicit in requiring that all capital expenditure incurred in the previous access arrangement period must be justified and demonstrated to be cost effective under the “prudency” and “cost efficiency” tests. The ACCC has not, however, required GasNet to provide any **quantified** substantiation of past capital expenditure to demonstrate compliance with this requirement of the Gas Code. We draw attention to the observation made by BHP Billiton in its submission of 21 June 2002, that a number of the capital expenditure amounts proposed to be included were larger than the amounts approved for inclusion at the time of the last access arrangement. In particular, the compressor automation projects (and others) appeared to have over-run the allowances permitted.

We believe that the ACCC should address this very real concern. It is proposing to permit GasNet to set amounts for future capital expenditure in a new access arrangement, but if GasNet ultimately spends a greater amount than that initially approved, then the over-run is automatically accepted without any cost/benefit analysis. To allow this practice is simply to provide incentives for over-investment, and is detrimental to users’ interests.

The ACCC notes that it requires comments regarding the proposal to roll in the Murray Valley pipeline. As GasNet has provided this additional information late in the review period we will respond to this issue at the same time as when we comment on the future operating expenditure and other related issues.

***The ACCC must ensure that all capital expenditures are justified and demonstrated to be cost-effective under the “prudency” and “cost-efficiency” tests of the Gas Code.***

## Initial GST spike in Calendar Year 2000

The ACCC makes passing reference to the GST spike<sup>10</sup> (which were raised by many users in earlier submissions) and then does not consider the issue further. This is a major omission in the draft decision.

If the initial GST spike in calendar year 2000 is not removed, this means that the GST effects will be partially included (via the RAB x WACC calculation) in the allowable revenue. Consumers are then required to pay for the GST windfall through higher tariffs over the period ahead. By ignoring the impact of the initial “GST spike” in the CPI figures in calendar year 2000, the Commission has effectively permitted GasNet to levy an unintended benefit arising from the GST introduction.

***The ACCC must remove the initial GST spike in calendar year 2000 from the regulatory asset base.***

## 6. WACC calculation

In its earlier submissions, BHP Billiton provided a view as to what we considered to be an appropriate WACC for GasNet. To support our view, we provided a report from Pareto Associates to demonstrate that using a purely mathematical approach to calculating the WACC could lead to inappropriate outcomes.

The Pareto report analysed the outcomes for WACC that had been generated by equivalent regulators in the UK. Whilst we concur that the results of the ACCC's calculations for WACC under the CAPM shows a reduction from the levels asked for by GasNet in its access arrangement, we believe that the WACC calculated by the ACCC in its draft decision is still too high.

Since our submission Pareto Associates have carried out a further review of WACC and provided this to the Victorian Essential Services Commission<sup>11</sup>, adding further substantiation for an appropriate WACC to be lower than that calculated by the ACCC in its draft decision.

In particular, we would highlight that despite the protestations of GasNet, there would appear to be little correlation between the high level of WACC sought by GasNet and the level of investment required by the company as part of this Access Arrangement. As we noted in our earlier submissions, we believe that the ACCC should be seeking to identify the level of WACC at

<sup>10</sup> ACCC Draft Decision, GasNet Australia access arrangement revisions for the PTS, 14 August 2002, page 36

<sup>11</sup> Victorian Gas Distribution Access Arrangement 2003-07, Customer Energy Coalition Comment on Essential Services Commission Draft Decision, Prepared by Pareto Associates Pty Ltd, August 2002

which investment starts to be constrained. We are firmly of the view that this point is still well below that level included in the ACCC's draft decision.

Further we note that the ACCC has systematically made assumptions which it noted deliberately favored GasNet (e.g. "... even though it may provide a benchmark which is biased in favour of the service provider."<sup>12</sup> ). There is no reference in the draft decision where the ACCC has made an assumption or statement where it notes that the decision is made in favour of stakeholders!

This is a clear and considered evaluation of the ACCC approach that where the issue is difficult, then the decision apparently is made to bias the decision away from stakeholders, towards GasNet, giving it another "free kick".

There is nowhere in the Gas Code which states that the regulator must consistently bias its decisions in favour of one party or another. The ACCC must review all of its assessments made in favour of GasNet and revise them to reflect a neutral position based on rigorous analysis. If this is undertaken, we are of the view that the WACC approved by ACCC will reflect a result closer to the level suggested in the two Pareto reports.

***The ACCC must review all aspects of its draft decision which are "biased in favour of the service provider" against the Code provisions, which, inter alia, seek to balance the interests of service providers and users. Its review of the WACC should be undertaken in the light of the Pareto reports, which argue for a much lower WACC than the ACCC's draft decision.***

## **7. The tariff path proposed by the ACCC**

BHP Billiton notes the requirement of the ACCC for GasNet to provide a tariff path which avoids the massive 40% increase at the beginning of the 2003 year<sup>13</sup>. We also note the ACCC requirement for GasNet to provide a tariff path which provides minimal price shock commencing in the year 2003<sup>14</sup>. BHP Billiton strongly endorses this proposal and would add that with the changes recommended in this submission, there is every likelihood that the average tariff may well fall, rather than the 4% increase noted by the ACCC.

***The ACCC's draft decision on the avoidance of price shocks is supported but these could be further minimised by review of the changes proposed in this submission.***

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<sup>12</sup> ACCC Draft Decision, GasNet Australia access arrangement revisions for the PTS, 14 August 2002, page 63

<sup>13</sup> ibid, figure 8.1

<sup>14</sup> ibid figure 8.2

## 8. Future Capital Expenditures

BHP Billiton notes that the ACCC has required GasNet to remove a number of items from its list of future capital projects (capex), and we support the ACCC decisions along with the underlying reasons behind them.

However, as we noted earlier in this submission all capital expenditures must be accompanied by stated and quantifiable outcomes. Competitive industry institutes this approach as a basic premise for the approval of capital investment. Of major concern is the continuing position of the ACCC not to require such an approach for all capital expenditures to be similarly verified as necessary and then proven as cost effective, before it is permitted to be rolled into the RAB. This decision by the ACCC is, we believe, in direct contravention of the requirements of the Gas Code.

***The ACCC must require GasNet to provide quantifiable outcomes for all capex proposals.***

## 9. Aggregation of VENCORP and GasNet operating costs

The ACCC notes the BHP Billiton contention that GasNet and VENCORP costs should be aggregated<sup>15</sup>. It notes that there is difficulty in comparing systems where there is a different trading basis. However it then accepts **without any interrogation** the GasNet statement that the only benefit GasNet sees VENCORP provides over equivalent pipeline operators using the contract carriage model is valued at \$660,000 per annum over GasNet costs.

If the ACCC accepts this then it must accept that VENCORP is managing a market carriage system model at a cost to consumers of some \$15M pa, or a penalty of over 7 cents for every GJ of gas used in the State. Whilst BHP Billiton has been and remains critical of the costs of VENCORP for any benefit accruing to users, it does not accept that the value of VENCORP activities to the Victorian gas market is only \$660,000 pa.

***BHP Billiton strongly recommends that the ACCC should require GasNet to substantiate its assessment of this cost (and gain VENCORP agreement to the number as independent verification), and then add this amount into the revenue allowed GasNet so that a true comparison of operating costs can be demonstrated.***

## 10. ACCC assessments of benchmarks provided by GasNet and stakeholders

The ACCC has stated it is of the view “that GasNet’s KPI’s are inconclusive” and that “clear signals were not available to GasNet”<sup>16</sup>. These statements highlight the ACCC’s lack of preparedness to address a core aspect of the

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<sup>15</sup> *ibid*, page 184

<sup>16</sup> *ibid*, page 187



Gas Code requiring a clear *assessment by comparison* of GasNet proposals for its operating expenditure.

What the ACCC denies in this process, is the input provided by stakeholders. Submissions made to the ACCC issues paper by stakeholders provide clear calculations showing that the GasNet proposals are too high. Despite all this work, the ACCC has decided that due to the absence of just one additional benchmark (\$/TJ/km), they are unable to reach any conclusion as to the reasonableness of the GasNet proposal based on benchmarks, and so the ACCC therefore appears to recommend acceptance the GasNet figures unbenchmarked. This is contrary to the Code provisions.

***The ACCC must adopt an 'assessment' by comparison approach to GasNet's proposals for operating expenditure.***