

# Response to the AER's Draft Decision on the Wagga Wagga Natural Gas Distribution Network Access Arrangement Proposal

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January 2010

## General Overview

The Australian Energy Regulator (AER) released its draft decision on Country Energy Gas Pty Limited (*Country Energy Gas*) Access Arrangement proposal for the Wagga Wagga natural gas distribution network in November 2009 (the draft decision). The draft decision listed a number of amendments required to be made by *Country Energy Gas* before the *Access Arrangement* proposal could be accepted by the AER.

*Country Energy Gas* welcomes the opportunity to respond to the draft decision through a revised *Access Arrangement* proposal. The revised *Access Arrangement* proposal consists of this response, a revised *Access Arrangement*, a revised set of *Terms and Conditions* and revised *Access Arrangement Information*.

*Country Energy Gas* has reviewed the AER's proposed amendments and incorporated a significant number of these into its revised *Access Arrangement* proposal. This response sets out each amendment proposed by the AER, whether *Country Energy Gas* agrees to adopt the amendment in full, a reference to where any amendments made can be found within the revised *Access Arrangement* proposal, and where proposed amendments have not been adopted in full, a discussion of the reasoning for this.

## Response to Suggested Amendments

<b>AER Amendment 2.1</b>	<b>Section 14 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 2.2</b>	<b>Section 14 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 2.3</b>	<b>Sections 4.3.1, 4.3.2, 10.2.2 Access Arrangement</b>
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The proposed amendments have been incorporated in full.

<b>AER Amendment 2.4</b>	<b>Section 10.2.1 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 2.5</b>	<b>Sections 4.1, 4.3, 14 Access Arrangement</b>
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The proposed amendments have been incorporated in full.

<b>AER Amendment 2.6</b>	<b>Sections 3.1.3, 8.2.2 Access Arrangement Information</b>
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The proposed amendment to section 3.2 has been incorporated in full. The proposed amendment to section 8.2.2 has been aligned to proposed amendment 11.2 below.

<b>AER Amendment 2.7</b>	<b>Appendix 2 Access Arrangement</b>
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The structure and format of Appendix D of the draft decision has been incorporated into Appendix 2 of the *Access Arrangement*. However, the information presented in Appendix D has changed as a consequence of several other amendments from the draft decision not being adopted by *Country Energy Gas*, as described in the revised *Access Arrangement* proposal.

<b>AER Amendment 2.8</b>	<b>Sections 4.4, 4.5, 4.6 Access Arrangement</b>
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The proposed amendments have been incorporated in full.

<b>AER Amendment 2.9</b>	<b>Sections 3.2, 3.3 Access Arrangement Information</b>
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The proposed amendments have been incorporated in full.

<b>AER Amendment 3.1</b>	<b>Table 3 Access Arrangement Information</b>
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The AER's requested amendment for gas network management costs has been included in Table 3, along with actual 2008-09 capital expenditure. Forecast capital expenditure for 2009-10 has also been revised to reflect the latest inflation information and additional connections associated with amended demand forecasts.

<b>AER Amendment 3.2</b>	<b>Table 11 Access Arrangement Information</b>
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Table 11 has been updated with the latest inflation data.

<b>AER Amendment 3.3</b>	<b>Table 13 Access Arrangement Information</b>
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Table 13 has been updated with the latest information available for 2009-10 based on the methodology used in the draft decision.

<b>AER Amendment 3.4</b>	<b>Table 12 Access Arrangement Information</b>
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Table 12 has been recalculated based on the latest data included in amendments 3.1 to 3.3 described above.

<b>AER Amendment 3.5</b>	<b>Tables 14, 15, 16, 17 Access Arrangement Information</b>
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In the draft decision, the AER accepted the majority of *Country Energy Gas*' forecast capital expenditure. The exceptions to this related to forecast inflation and forecast cost escalators. While *Country Energy Gas* has implemented the forecast inflation from the draft decision, the AER's required amendments relating to cost escalators, apart from polyethylene pipe, have not been implemented for the reasons described below.

*Country Energy Gas*' understanding of the draft decision is that the AER considers the methodology used in the *Access Arrangement* proposal for forecasting increases in labour costs is appropriate. *Country Energy Gas* used a report from KPMG Econtech that was prepared for the AER in March 2009 and used in the NSW electricity distribution final determination. At the time of submitting the *Access Arrangement* proposal, this report was considered to be the best information available in the circumstances and therefore *Country Energy Gas* contends the *Access Arrangement* proposal complied with *National Gas Rule* (NGR) 74(2).

*Country Energy Gas* considers that, given the AER agrees the approach adopted in the *Access Arrangement* proposal was reasonable and appropriate, it would be unreasonable for it to substitute a different or, what it considers, a more desirable methodology.

In reaching its view, the AER has also stated that capital expenditure does not represent that which "would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services". This is the criteria set out in NGR 79(1)(a). *Country Energy Gas* notes that the AER's discretion with respect to this Rule is limited.

The extent of the limitation is set out in NGR 40(2) which states that the AER may not withhold its approval to an element of an *Access Arrangement* proposal where it is satisfied that it complies with applicable requirements and is consistent with applicable criteria. The assessment with respect to cost escalators, inflation and the criteria governing capital expenditure is intrinsically linked. The overarching obligation in assessment of new capital expenditure is that criteria set out in NGR 79. Forecasts are a constituent of the overall capital expenditure decision.

Therefore, where *Country Energy Gas* meets a benchmark of efficiency against a prudent *Service Provider*, in accordance with accepted good industry practice, to achieve the lowest sustainable cost, then its proposal complies with the applicable requirements and is consistent with the overarching criteria contained in NGR 79(1).

*Country Energy Gas*, as a prudent *Service Provider*, relied upon forecasts and figures used by the AER and other *Service Providers* in the industry in its *Access Arrangement* proposal. This is in accordance with accepted industry practice and therefore in accordance with NGR 79(1). To ensure consistency of approach across jurisdictions, *Country Energy Gas* is of the view that good industry practice was adhered to in following precedent set by the AER and prudent *Service Providers*.

The lowest sustainable cost requirement in NGR 79(1)(a) should be interpreted as not only achieving the lowest sustainable cost for *Country Energy Gas Customers*, but also the lowest sustainable cost at which *Country Energy Gas* can efficiently and sustainably operate its *pipeline* to ensure efficient operation and use of natural gas services. Underestimation of labour costs going forward will inhibit *Country Energy Gas*' ability to adequately resource its *pipeline* and manage its labour cost expenses.

*Country Energy Gas* is of the view that the AER has purported to use its discretion without limitation with respect to the application of new forecasts that will form part of *Country Energy Gas*' compliance with NGR 79(1). Where forecasts affect the capital expenditure to be approved by the AER, the discretion that exists for the AER to propose alternative forecasts in NGR 74 must be restricted by the limited discretion in NGR 79. As demonstrated above, *Country Energy Gas* has proposed capital expenditure that meets the overarching criteria of NGR 79(1), and in accordance with the national gas objective.

*Country Energy Gas* has engaged KPMG Econtech to provide an update of the March 2009 report in order that the AER has the latest and best information available in the circumstances with which to make its final decision. *Country Energy Gas* would be happy to work with the AER to ensure the latest information from KPMG Econtech is available for use in the final decision, whether that be in a submission on 12 February 2010 which would be based on the September 2009 quarter, or later in February using the absolute latest data available from the December 2009 quarter. There is unlikely to be an opportunity to use the March 2010 quarter given the final decision is due in April 2010. *Country Energy Gas* does not believe it is fair or reasonable for the AER to use a more desirable methodology or provider simply because it has the luxury of having the last opportunity under the access arrangement timetable to update data. If data needs updating, it should be based on the accepted, appropriate methodology submitted by *Country Energy Gas* as part of its revised *Access Arrangement* proposal.

*Country Energy Gas* has not incorporated the draft decision on forecast labour cost escalators as it is of the view that the original March 2009 escalators complied with NGR 74(2). For the purposes of the revised *Access Arrangement* proposal, *Country Energy Gas* has used the March 2009 KPMG Econtech report as timing constraints meant it was not possible to have final forecast labour cost escalators ready in time for necessary approvals. However, updated forecasts will be ready by the due date for submissions on 12 February 2010 and *Country Energy Gas* will supply them to the AER at that point. Given the methodology has been used, refined and considered appropriate by the AER in recent electricity decisions, this approach is thought to be reasonable for the purposes of the NGR and this revised *Access Arrangement* proposal.

*Country Energy Gas* has not incorporated the draft decision of excluding the crude oil cost escalator from forecast capital expenditure in its revised *Access Arrangement* proposal. Fuel and lubricants are a significant component of the plant used in capital expenditure projects. The crude oil escalator is the best predictor of future movements in fuel and lubricants, a position accepted by the AER in its recent NSW electricity distribution final determination. Contrary to statements made in the draft decision by the

AER, the crude oil escalator was applied to plant only and was never related to materials such as electricity transformers.

The only other change made was to update forecast new connection capital expenditure for the additional connections required as a result of the revised demand forecasts agreed to as part of proposed amendment 9.1 from the draft decision.

<b>AER Amendment 3.6</b>	<b>Table 19 Access Arrangement Information</b>
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Table 19 has been recalculated based on the latest data included in amendments 3.1 to 3.5 described above.

<b>AER Amendment 3.7</b>	<b>Table 20 Access Arrangement Information</b>
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Table 20 has been recalculated based on the latest data included in amendments 3.1 to 3.6 described above.

<b>AER Amendment 3.8</b>	<b>Section 11 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 3.9</b>	<b>Reference not applicable</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 5.1</b>	<b>Chapter 6 Access Arrangement Information</b>
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*Country Energy Gas* has implemented the proposed amendments in the draft decision relating to the weighted average cost of capital (WACC). The exceptions to this are the market based parameters and gamma (while not a direct component of the nominal vanilla WACC, it is linked to the market risk premium used in the WACC equation).

### Nominal Risk Free Rate

The nominal risk free rate has been determined and updated by *Country Energy Gas* on a moving average basis from the annualised yield on Commonwealth Government bonds with a maturity of 10 years using the indicative mid rates published by the Reserve Bank of Australia. *Country Energy Gas* has adopted a nominal risk free rate of 5.47 per cent observed over the 15 day averaging period ending on 10 December 2009.

### Debt Risk Premium

*Country Energy Gas* has calculated the debt risk premium with reference to the same averaging period that was adopted in determining the nominal risk free rate. The draft decision uses the CBASpectrum BBB+ fair value estimate for the debt risk premium. This differs to its use of Bloomberg solely for the recent NSW electricity distribution final determination<sup>1</sup>, and an average of CBASpectrum and Bloomberg in the Victorian advanced metering review<sup>2</sup>.

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<sup>1</sup> Australian Energy Regulator, *Final Decision: NSW distribution determination*, April 2009.

<sup>2</sup> Australian Energy Regulator, *Final Determination: Victorian advanced metering infrastructure review 2009-11 AMI budget and charges applications*, October 2009.

For the purposes of the revised *Access Arrangement* proposal and in the interests of consistency and certainty, *Country Energy Gas* has used an average of Bloomberg and CBASpectrum data observations in calculating a debt risk premium of 4.40 per cent, based on extending the Bloomberg AAA fair yield curve out to 10 years. *Country Energy Gas* notes that the average of the three debt risk premiums adopted most recently by the AER using three different methodologies is almost exactly the same as the average that would have been arrived at by using the CBASpectrum and Bloomberg average solely across all three decisions. Given the proprietary nature of both the Bloomberg and CBASpectrum services, *Country Energy Gas* believes this is a fair and reasonable approach that the AER should look to adopt in all future decisions.

It is not clear to *Country Energy Gas* from the draft decision how the AER would extend the Bloomberg BBB fair value curve from 7 years out to 10 years if it were to find that Bloomberg, or an average of Bloomberg and CBASpectrum, were the best estimates in the prevailing market conditions at the time of the final decision. *Country Energy Gas* believes that the AER should make clear and transparent the methodology it will use to extend the Bloomberg curve prior to making its final decision.

### **Averaging Period for Final Decision**

*Country Energy Gas* notes the confidential averaging period proposed by the AER in Appendix A of the draft decision. While in principle *Country Energy Gas* does not have an issue with the use of this period, it is imperative that the AER explore the use of other averaging periods in the event that there is a flight to liquidity/safety affecting CGS yields during the nominated averaging period, as occurred during the 2008 global financial crisis. *Country Energy Gas* requests that the AER remain flexible in its approach to determining the applicable averaging period where economic conditions during the proposed confidential averaging period would mean the WACC was not an unbiased estimate.

For further information and analysis on estimating the debt risk premium and events affecting CGS yields during the nominated averaging period *Country Energy Gas* has attached a report from the Competition Economists Group (CEG) as Appendix 1 to this response.

### **Gamma**

*Country Energy Gas* notes the lack of consensus among financial experts on gamma during the AER's WACC review and is not convinced that there is enough persuasive evidence to move from the previously adopted value of 0.3. This view was supported in submissions made by the Joint Industry Association (JIA)<sup>34</sup> and NSW Treasury<sup>5</sup> to the AER's electricity WACC review.

More recently, the Independent Pricing and Regulatory Tribunal of NSW (IPART) released a discussion paper on WACC<sup>6</sup> confirming that the greater amount of evidence supports a gamma value towards the lower end of the range between 1 and 0. In its discussion paper, IPART concluded that there was insufficient evidence to warrant a move away

<sup>3</sup> Joint Industry Association, *Network industry submission—AER Issues Paper—Review of the WACC parameters for electricity transmission and distribution*, September 2008.

<sup>4</sup> Joint Industry Association, *Network industry submission—AER Proposed Determination—Review of the WACC parameters for electricity transmission and distribution*, February 2009.

<sup>5</sup> NSW Treasury, *Weighted Average Cost of Capital: Response to the Australian Energy Regulator Review of Electricity Transmission and Distribution WACC Parameters*, January 2009.

<sup>6</sup> Independent Pricing and Regulatory Tribunal, *Discussion Paper: IPART's cost of capital after the AER's WACC review*, November 2009.

from the current gamma value range. IPART also stated that it is 'not convinced that there is conclusive evidence underpinning the values adopted by the AER for the payout ratio and theta'. These values adopted by the AER were used in part to justify the adoption of a gamma value of 0.65.

Therefore, *Country Energy Gas*' revised *Access Arrangement* proposal again adopts a gamma of 0.30 consistent with the gamma from the current *Access Arrangement*.

<b>AER Amendment 6.1</b>	<b>Post Tax Revenue Model</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 7.1</b>	<b>Table 23 Access Arrangement Information</b>
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In the draft decision, the AER did not accept *Country Energy Gas*':

- a) proposal to use 2009-10 as an efficient base year from which to forecast its operating expenditure requirements, and required a change to 2008-09 as the referable base year
- b) proposed cost escalation factors and substituted revised escalators and updated CPI calculations
- c) proposed application of an asset growth escalator to forecasts marketing expenditure
- d) proposed self insurance costs of \$632,750 and substituted an amount of \$3,865
- e) proposed debt raising costs of \$156,699 and substituted an amount of \$191,820
- f) proposed treatment of unaccounted for gas (UAG) and added an allowance of \$2.48 million to forecast operating expenditure for UAG.

*Country Energy Gas* has implemented all of the proposed amendments except for the revisions to cost escalators for the reasons described above in proposed amendment 3.5.

<b>AER Amendment 7.2</b>	<b>Section 5.3.3 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 7.3</b>	<b>Section 8.1.4 Access Arrangement Information</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 7.4</b>	<b>Section 5.2.1 (d) Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 8.1</b>	<b>Tables 28, 29 Access Arrangement Information</b>
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Tables 28 and 29 have been recalculated as a consequence of all of the amendments outlined above.

<b>AER Amendment 9.1</b>	<b>Table 8 Access Arrangement Information</b>
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*Country Energy Gas* has incorporated the proposed amendment to forecast new connections. However, the data presented in table 8 of the revised *Access Arrangement*



*Information* is slightly different to that in the draft decision due to updated actual 2008/09 consumption and *Customer* numbers being used as the base for the demand forecasts.

<b>AER Amendment 10.1</b>	<b>Reference not applicable</b>
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The proposed amendments have been incorporated in full.

<b>AER Amendment 11.1</b>	<b>Section 8.2.2.1 Access Arrangement Information</b>
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*Country Energy Gas* does not in general support side constraints as they can limit the ability to signal the true costs of service to *Customers* and create cross subsidies. However, in the interests of balancing cost reflectivity with price impacts on *Customers*, *Country Energy Gas* has incorporated the proposed amendment with slight modifications to align with the NSW electricity distribution final decision.

<b>AER Amendment 11.2</b>	<b>Section 12.1 Access Arrangement, Section 8.2.2 Access Arrangement Information</b>
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The proposed amendments have been incorporated with one minor change of bracketing *Additional Services* with *Monthly Metering Charges* in the *Access Arrangement Information* as a compromise with proposed amendment 2.6.

<b>AER Amendment 11.3</b>	<b>Section 14 Access Arrangement, Section 8.2.2.1 Access Arrangement Information</b>
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*Country Energy Gas* believes that consistency with the annual pricing proposal used for electricity is desirable where possible. For this reason, the proposed amendment has not been incorporated in the revised *Access Arrangement* proposal. *Country Energy Gas*' original *Access Arrangement* proposal replicated the tariff variation formula from the AER's final decision for NSW electricity distribution network service providers. *Country Energy Gas* does not believe that the AER has adequately explained the reasons for departing from the approach adopted in electricity distribution.

In order to clarify the formula proposed in the revised *Access Arrangement* proposal, *Country Energy Gas* has clarified the definition of the change in CPI in section 14 of the *Access Arrangement* and aligned it to the electricity definition.

<b>AER Amendment 11.4</b>	<b>Section 12.3 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 11.5</b>	<b>Section 12.6 (h) Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 11.6</b>	<b>Section 12.6 (g) (3) Access Arrangement</b>
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*Country Energy Gas* believes that consistency with the annual pricing proposal used for electricity is desirable where possible. For this reason, the proposed amendment relating to an independent audit or verification of actual *Quantities* has been incorporated. However, *Country Energy Gas* does not accept the proposed amendment relating to the periods and frequency of *Gas Quantity* data to be audited or verified.

*Country Energy Gas*' understanding of the draft decision is that the AER requires the most recent calendar year actual *Quantities* disaggregated into four separate quarters to be audited and used in the annual tariff variation process. The justification for using calendar year *Quantities* over financial year *Quantities* appears to be so that they are aligned with the CPI used in the tariff variation formula.

The use of calendar year quantities creates many problems, complexities and costs for no additional benefits. The tariff variation formula proposed in the draft decision is built around actual and forecast financial year price against financial year *Quantities*. *Country Energy Gas* is not sure how the AER envisages calendar year quantities can work within the tariff variation formula and weighted average price cap when they span two price points on either side of the commencement of the financial year. *Country Energy Gas* is not aware of such an approach being used in any other jurisdiction.

The requirement for audited quarterly *Quantities* is also breaking new ground for an annual tariff variation process. *Country Energy Gas* is not able to find the AER's reasoning for such a requirement in the draft decision. *Country Energy Gas* would incur significant extra costs in providing audited quarterly *Quantities* for no benefit at all in terms of annual tariff variations.

*Country Energy Gas* believes the AER needs to amend its approach to align it with its electricity annual pricing proposal process. *Country Energy Gas* cannot see any reason as to why the proposed amendment is an improvement on the current electricity process, which has itself been approved recently by the AER and is working well. The annual tariff variation formula is based on annual *Quantities* that align with reporting periods, being financial years, and *Country Energy Gas* does not believe a move to quarterly and calendar years can be justified as contributing to the achievement of the national gas objective under s28 of the National Gas Law (NGL).

<b>AER Amendment 11.7</b>	<b>Section 12.6 (f) (2) Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 11.8</b>	<b>Section 12.5 Access Arrangement, Section 8.2.3 Access Arrangement Information</b>
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*Country Energy Gas* has incorporated the substance of the proposed amendment through the inclusion of a general *Pass Through Event*. However, the definition of a general *Pass Through Event* has been aligned with that agreed between EnergyAustralia and the AER in the recent electricity distribution determination merits review process.

<b>AER Amendment 11.9</b>	<b>Section 12.5.1 Access Arrangement</b>
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*Country Energy Gas* has incorporated the substance of the amendment to 12.5.1. However, the definition has been aligned with that agreed between EnergyAustralia and the AER in the recent electricity distribution determination merits review process.

The proposed amendment to 12.5.1 (b) has been incorporated in full.

<b>AER Amendment 11.10</b>	<b>Section 12.5.3 (g) Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 11.11</b>	<b>Sections 12.5.2 (b), 12.5.3 (a), 12.5.3 (b), 12.5.3 (c), 12.5.3 (d), 12.5.3 (f), 12.5.5 Access Arrangement</b>
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The proposed amendments have been incorporated in full.

<b>AER Amendment 11.12</b>	<b>Sections 12.5.2 (c), 12.5.2 (d) Access Arrangement</b>
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*Country Energy Gas* has incorporated the proposed amendments as stand alone paragraphs, as they do not align with section 12.5.2 (b). The first sentence of 12.5.2 (c) has been slightly reworded in order to ensure clarity of what is required.

<b>AER Amendment 11.13</b>	<b>Section 12.5.3 (c) Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 11.14</b>	<b>Section 12.5.3 (e) Access Arrangement</b>
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*Country Energy Gas* has varied the proposed amendment to be consistent with the provision in the recent NSW electricity distribution determination that states notification must be made within 90 business days of the event, rather than the draft decision proposal of 3 months. This will assist with efficient and streamlined processes being implemented across the business.

<b>AER Amendment 11.15</b>	<b>Sections 12.6 (a), 12.6 (d) Access Arrangement</b>
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The proposed amendments have been incorporated in full.

<b>AER Amendment 11.16</b>	<b>Section 12.5 Access Arrangement</b>
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*Country Energy Gas* has incorporated the substance and intent of the proposed amendment into the revised *Access Arrangement* proposal. The wording has been slightly amended so as to remove the inference that only one *Pass Through Event* can be considered to vary *Reference Tariffs* over the course of an access arrangement period.

*Country Energy Gas* contends that should it be constrained through the *Access Arrangement* from being able to have one or more *Pass Through Events* considered, then it is effectively restrained from recovery of costs for unforeseen events which is contrary to the objects of the NGL. The NGL seeks to promote the efficient investment in, operation and use of natural gas with respect to price whilst maintaining quality, safety, reliability and security of supply. If *Country Energy Gas* is precluded from recovering the efficient costs of supplying natural gas, it is effectively restricted from meeting the national gas objective.

In addition, in accordance with the revenue and pricing principles in section 24 of the NGL, a *Service Provider* should be provided with a reasonable opportunity to recover at least the efficient costs incurred in providing *Reference Services*. Irrespective of whether the event is one or more events, the costs associated with such events continue to affect the ability of *Country Energy Gas* to deliver services and recover its efficient costs. The combined effect of “one or more” *Pass Through Events* on *Reference Tariffs* meeting the materiality threshold proposed in the revised *Access Arrangement* proposal will provide *Country Energy Gas* with the opportunity to recover the efficient costs of delivering its services.

<b>AER Amendment 12.1</b>	<b>Clause 1.1 Terms and Conditions</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.2</b>	<b>Clauses 3.22, 3.23 Terms and Conditions</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.3</b>	<b>Reference not applicable</b>
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The inclusion of the proposed amendment would be inconsistent with the object of clause 12.12. This clause refers to circumstances that are ‘beyond *Country Energy Gas*’ reasonable control’. In order to establish that *Country Energy Gas* was negligent, then the matters to which the negligence relates must be in the reasonable control of *Country Energy Gas*. Where *Country Energy Gas* has no control over the events, it can not be held to be negligent. Therefore, *Country Energy Gas* believes the proposed amendment is not required.

<b>AER Amendment 12.4</b>	<b>Clause 6.14 Terms and Conditions</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.5</b>	<b>Clause 6.23 Terms and Conditions</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.6</b>	<b>Section 14 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.7</b>	<b>Clause 8.20 Terms and Conditions</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.8</b>	<b>Reference not applicable</b>
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*Country Energy Gas* has not amended this section as the definition in section 14 of the *Access Arrangement* is suitable and is in line with other *Country Energy* force majeure obligations.

<b>AER Amendment 12.9</b>	<b>Section 14 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.10</b>	<b>Clauses 10.6, 10.7 Terms and Conditions</b>
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The proposed amendments have been incorporated in full.

<b>AER Amendment 12.11</b>	<b>Reference not applicable</b>
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The AER proposes in the *Terms and Conditions* the inclusion of clause 12.2A(a) which limits the operation of clause 12.2 where a *User* can establish that the limitation on

*Country Energy Gas*' liability is "not fair or reasonable in the circumstances". This is proposed to be in accordance with section 68A of the *Trade Practices Act 1974* (TPA).

The provisions set out in section 68A preserve the contractual terms for services when the supply is not of services of a kind normally acquired for domestic and household consumption. The acquisition of *Gas* by a *User* under this *Access Arrangement* therefore entitles *Country Energy Gas* to provide in its contract a limitation on its liability for a breach of a condition or warranty by virtue of it either re-supplying the relevant *Service* under the Agreement, or paying to have the relevant *Service* re-supplied in accordance with the requirements set out in clause 68A(b).

Section 68A(2) limits the application of section 68A(1) where the *User* can establish that the term of the contract is not "fair or reasonable" and that *Country Energy Gas* should not be entitled to rely on the term of the contract. Under section 68A(2) the onus is on the *User* to establish that the term is not "fair and reasonable". However, this is not a unilateral right held by the *User*. Rather, it is the measure by which a court will assess whether the statutory limitation on liability provided to *Country Energy Gas* under section 68A(1) will not apply. Such a burden of proof applies in any legal proceedings.

By proposing the inclusion of a "fair and reasonable" test in the *Terms and Conditions*, the AER is applying the test set out in section 68A of the TPA beyond the scope of the legislation by providing the *User* with a discretion that is otherwise retained and to be determined by the Court.

The inclusion of this discretion creates uncertainty for *Country Energy Gas* and the *User*. This uncertainty results in an unmanageable risk and an unreasonable burden being placed on *Country Energy Gas* as it is unable to adequately determine its areas of potential liability with any certainty.

The inclusion of such a provision is without precedent. *Country Energy Gas* is not aware of any industry and regulatory standards that impose that level of uncertainty in managing business and operational costs or any enquiries or complaints that would lead to the inclusion of the proposed amendment.

With respect to section 68A(b), *Country Energy Gas* is of the view that this statutory right applies in any event under the TPA, and its inclusion in the *Terms and Conditions* is confusing and superfluous.

The implied warranty under section 69 of the TPA is also a statutory right, and therefore available to all *Users* to rely upon in contracting with *Country Energy Gas*. Therefore, this does not need to be specified in *Country Energy Gas*' *Terms and Conditions*.

<b>AER Amendment 12.12</b>	<b>Reference not applicable</b>
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*Country Energy Gas* has removed this sentence as it is not appropriate to prescribe the manner in which a bank must guarantee credit.

<b>AER Amendment 12.13</b>	<b>Reference not applicable</b>
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*Country Energy Gas* has removed the definition of 'Required Bank Guarantee' due to issues in prescribing the manner in which a bank must guarantee credit. The pro forma has also been removed from the revised *Access Arrangement* proposal as each bank will have its own format for the issuance of a guarantee. In addition, each situation requiring a bank guarantee may differ over the course of the access arrangement period.

<b>AER Amendment 12.14</b>	<b>Clause 1.12 Terms and Conditions</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.15</b>	<b>Section 5.1 (g) Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.16</b>	<b>Clause 18.3 Terms and Conditions</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.17</b>	<b>Clause 18.4 Terms and Conditions</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.18</b>	<b>Clause 18.13 Terms and Conditions</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.19</b>	<b>Section 4.6.1 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.20</b>	<b>Section 5.1 (c) Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.21</b>	<b>Section 5.7.1 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.22</b>	<b>Reference not applicable</b>
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All references to capacity management policy have been removed.

<b>AER Amendment 12.23</b>	<b>Section 14 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.24</b>	<b>Various clauses Terms and Conditions</b>
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The proposed amendments have been incorporated in full, with the exception of the clause 5.17 reference to the *Network Code* has been removed.

<b>AER Amendment 12.25</b>	<b>Section 5.4.1 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.26</b>	<b>Section 10.2.4 (d) Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.27</b>	<b>Section 8 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.28</b>	<b>Section 8.3 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.29</b>	<b>Section 14 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.30</b>	<b>Section 7.1.1 Access Arrangement</b>
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The draft decision does not accept the main element of *Country Energy Gas*' proposed *Extensions and Expansions* policy in respect of *Extensions*. *Country Energy Gas* had proposed that all *Extensions* to the *Network* be included as part of the *Covered Pipeline*, unless *Country Energy Gas* specifically apply to have it excluded. This was consistent with the wording in the preceding *Access Arrangement*.

The proposed amendment requires that *Country Energy Gas* must apply to the AER for a determination about inclusion of a proposed high pressure pipeline *Extension* as part of the *Covered Pipeline*, and that the application must be made before the high pressure pipes come into service. That is, *Country Energy Gas* may not invest in the high pressure pipes in its *Network* until the AER has made a decision about whether the pipes should be included as part of the *Covered Pipeline*. The proposed amendment also requires *Country Energy Gas* to notify the AER annually of all *Extensions* of the low and medium pressure pipeline.

The reason stated for this proposed amendment is that high pressure pipes have characteristics similar to transmission pipelines, and because of that, coverage should not be the default. The rationale for not accepting *Country Energy Gas*' *Access Arrangement* proposal is that the pipeline could be extended for a number of reasons. This could include serving a large industrial user or supporting the medium and low pressure parts of the *Network*. The determination of whether coverage is appropriate would appear to be based on the purpose of the high pressure *Extension*.

The draft decision does not explain the similarity of high pressure pipes within a distribution network to transmission pipelines, which characteristics of a transmission pipeline affect the need for coverage, nor why these characteristics suggest coverage may not be appropriate.

The draft decision does not explain why any particular purpose would influence the need for non-coverage or why the extent of integration is relevant, whether it be for *Supply* to a large *Customer* or to support the *Network*. Specifically, the AER does not relate these matters to the coverage criteria contained in section 15 of the NGL.

*Country Energy Gas* has a number of concerns with the proposed amendment including:

- It is not within the AER's functions and powers,
- The rationale for the amendment is incorrect,
- It is contrary to the purpose of *Extensions* and *Expansions* requirements,
- It is not based on any analysis of the coverage criteria,
- It has not been needed for the two prior *Access Arrangement* periods and there has been no change to circumstances or evidence of a problem to be solved,
- The approach being adopted amounts to micromanagement and is inconsistent with incentive regulation, and
- It is inconsistent with the national gas objective.

**The proposed amendment is not within the functions and powers of the AER**

The proposed amendment requires that *Country Energy Gas* 'must apply to the Regulator' to determine if the high pressure *Extension* will form part of the *Covered Pipeline*. This means that *Country Energy Gas* must seek approval before it makes a decision to invest.

The AER's powers in respect of an *Access Arrangement* concern the terms of the *Access Arrangement* including approved costs and *Reference Tariffs*. *Country Energy Gas* contends that in the AER using the terms of an *Access Arrangement* to determine whether *Country Energy Gas* (or any other *Service Provider*) invests in the *Covered Pipeline* is not within its functions and powers set out in section 27 of the NGL.

As a prudent *Service Provider*, *Country Energy Gas* invests in and operates its pipeline in the long term interests of consumers of natural gas. A decision to invest in the development of the pipeline in the interests of consumers is in accordance with the national gas objective. *Country Energy Gas* is of the view that as a *Service Provider*, its decisions on the investment in its pipeline do not fall within the AER's functions and powers set out in section 27 of the NGL, or the exercise of a function or power in accordance with the national gas objective as set out in section 28(1) of the NGL.

**The rationale for the proposed amendment is incorrect**

The draft decision is based on the view that high pressure distribution pipes have characteristics similar to transmission pipelines. However, this is only true to the extent that high pressure pipes operate at higher pressure than medium pressure pipelines and are made from steel. That is where the similarity ends and beyond this, the statement is incorrect. In the economic sense, high pressure pipes are simply part of the *Network* and are clearly so, whether they supply large *Customers* or provide bulk supply for the remainder of the *Network*, and are no different to medium pressure pipes. They are assessed as conforming capital expenditure on exactly the same basis as all other gas distribution assets.

Transmission pipelines deliver gas in bulk across long distances to major centres of consumption, or directly to very large customers that have gas demand that would generally be considerably greater than country towns. In contrast, high pressure distribution pipes deliver gas as part of the network, including direct delivery to industrial customers and are an integral part of the distribution network. The draft decision has not provided any reasoning or explanation as to why high pressure pipes are similar to transmission pipelines and why they are not similar to medium pressure pipelines or why their assessment for conformance should be different from all other assets. The draft



decision's statement about the similarity of high pressure pipes to transmission pipelines is unsustainable. Therefore its rationale for changes to the *Extensions* and *Expansions* policy has no foundation.

**The proposed amendment is contrary to the purpose of an extensions/expansions policy**

The purpose of the inclusion of the *Extensions* and *Expansions* policy in an *Access Arrangement* carries forward the same purpose as the requirement for the inclusion of an *Extensions* and *Expansions* policy under the National Third Party Access Code for Natural Gas Pipelines (the Gas Code). Without inclusion of an *Extensions* and *Expansions* policy an *Access Arrangement* would only govern the originally *Covered Pipeline*, and not the *Extensions* and *Expansions* to it. The result would be that *Extensions* and *Expansions* to a pipeline would be automatically unregulated.

The drafters of the Gas Code wanted to ensure that *Extensions* to an existing pipeline (which were just as likely to meet the coverage test, because they were an *Extension* of a pipeline that met the coverage test) did not escape regulation. As a result, the Gas Code included a requirement that an *Access Arrangement* specifically deal with whether an *Extension* or *Expansion* would be automatically covered.

The rationale from the Gas Code was carried forward into the development of the NGL. Section 18 of the NGL provides that, subject to the *Access Arrangement*, an *Extension* or *Expansion* to a *Covered Pipeline* should automatically be taken to form part of that pipeline. The second reading speech in explaining section 18 states - "*Provides that extensions and expansions to Covered Pipelines are to be treated as part of the Covered Pipeline if the applicable Access Arrangement provides that they will be*". It therefore appears that the intention of the legislation is not to provide for each and every *Extension* or *Expansion* to be assessed by the Regulator, but where a pipeline is already covered, that any *Extensions* or *Expansions* should fall within the current determination.

As a result, a majority of *Access Arrangements* include an *Extensions* and *Expansions* policy where an *Extension* or *Expansion* of a *Covered Pipeline* automatically be covered, especially in the case of a distribution network. A policy such as this reasonably assumes that the *Extension* or *Expansion* has the same market power as the remainder of the pipeline. Section 18 of the NGL requires an assessment of coverage only if provided for in an *Access Arrangement*. It therefore appears beyond the intention of the regulation envisaged to seek to have an assessment of coverage made again for an *Extension* or *Expansion*.

The likelihood that a high pressure *Extension* to a large individual *Customer* (or for any other purpose) will not have a similar level of market power as the rest of the *Network* is very low. Imposing a requirement on *Country Energy Gas* to apply for a coverage decision every time it intends to extend its high pressure *Network* is unnecessary and is inconsistent with the intent of the NGR and the national gas objective. The proposed amendment will create costs and inconvenience for *Country Energy Gas*, *Customers* and the AER.

**The proposed amendment is not based on any analysis of the coverage criteria**

Critical to the question of whether an *Extension* or *Expansion* should be included as part of the *Covered Pipeline* is the question of whether it will or is likely to meet the coverage criteria set out in section 15 of the NGL. The draft decision makes no attempt to consider this question. The likelihood that the default assumption that an *Extension* will meet the coverage criteria, for example having sufficient market power, is highly likely to be true. It is logical that if it the network to which an *Extension* relates meets the coverage criteria then the *Extension* will also meet the criteria.

While the AER has not given any reasons other than the transmission type nature of high pressure pipes, if the AER is concerned that the inclusion of high pressure *Extensions* may have the effect of increasing prices then one has to look to NGR 79. NGR 79 does not allow inclusion of capital expenditure in the capital base for which the effect would be to increase tariffs, unless there is an offsetting economic benefit. The decision about inclusion of capital expenditure in the capital base is ultimately the AER's at the time of each *Access Arrangement* revision, subject to NGR 79.

**The proposed amendment has not been required for the two prior Access Arrangement periods and there has been no change to circumstances or evidence of a problem to be solved**

IPART has twice previously approved the *Extensions* and *Expansions* policy that is contained in *Country Energy Gas*' proposed *Access Arrangement* proposal. There have been no market events or complaints from *Users* that suggest that this *Extensions* and *Expansions* policy has any faults or created any problems. The draft decision provides no explanation of why IPART's evaluation should be overturned or of any anticipated change that would support the proposed amendment. *Country Energy Gas* submits that it is incumbent on the AER to demonstrate that there is need for a change to the *Extensions* and *Expansions* policy and the net benefits produced by the change.

**The approach being adopted amounts to regulatory micromanagement and is inconsistent with incentive regulation**

The requirement on *Country Energy Gas* to seek a coverage decision by the AER every time it extends its high pressure *Network* is an unprecedented level of intervention by a regulator. The micromanagement aspect of the proposed amendment is best illustrated in the draft decision where the AER states that it '*will be best placed to consider such matters*'. The AER does not give reasons for why it considers itself more expert or in a better position to assess high pressure pipeline *Extensions* than *Country Energy Gas*.

For all of the reasons identified above, the proposed amendment is unnecessary and contrary to the principles of incentive regulation. The economic regulatory framework comprises the *Service Provider* having a period of intense engagement with the regulator during *Access Arrangement* revisions, and then little or no interaction with the regulator between reviews. This process allows the *Service Provider* to focus on the business of operating the network with high standards of service and improving the efficiency of service delivery.

Applications for regulatory decisions and provision of information are unnecessary distractions from the business of supplying distribution services. Requirements such as these should be avoided as intrusion, intervention and distraction without commensurate economic benefit is contrary to the national gas objective. The AER has not demonstrated any benefits of the proposed amendment.

**The proposed amendment is inconsistent with the national gas objective**

For all of the reasons identified above, *Country Energy Gas* believes that the proposed amendment in relation to high pressure pipes does not meet the requirements of the national gas objective. Requiring *Country Energy Gas* to obtain a coverage decision for every high pressure *Extension* would cause additional administrative costs to be incurred by both the AER and *Country Energy Gas* and borne by *Customers* for which there is no resulting economic benefit.

Similar to the proposed amendment in relation to high pressure pipelines, the proposed amendment requiring annual information for medium and low pressure *Extension* is not within the economic functions and powers of the AER. The function of the AER as set out

in the NGL and the requirements of *Country Energy Gas* under the NGR do not extend to allow the AER to use an *Access Arrangement* as a tool for gathering information outside an *Access Arrangement* review. *Country Energy Gas* is of the view that if such information can be justified, then it should be gathered using the appropriate powers under the NGL through the use of a *Regulatory Information Notice* or *Regulatory Information Order*.

The proposed amendment imposes costs on *Country Energy Gas* for which there is no economic benefit. The information sought will be available to the AER at each *Access Arrangement* revision and the AER has not demonstrated that there is any economic benefit in providing the information annually between revisions. Accordingly, even if the AER does have the power to make the proposed amendment, *Country Energy Gas* believes that this reporting requirement would not contribute to the national gas objective.

<b>AER Amendment 12.31</b>	<b>Section 7.1.2 Access Arrangement</b>
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For the same reasons discussed in proposed amendment 12.30 above in relation to annual information requirements for medium and low pressure *Extensions*, *Country Energy Gas* believes the proposed amendment for reporting on all *Expansions* is not within the economic functions and powers of the AER. The function of the AER as set out in the NGL and the requirements of *Country Energy Gas* under the NGR do not extend to allow the AER to use an *Access Arrangement* as a tool for gathering information outside an *Access Arrangement* review. *Country Energy Gas* is of the view that if such information can be justified, then it should be gathered using the appropriate powers under the NGL through the use of a *Regulatory Information Notice* or *Regulatory Information Order*.

The proposed amendment imposes costs on *Country Energy Gas* for which there is no economic benefit. The information sought will be available to the AER at each *Access Arrangement* revision and the AER has not demonstrated that there is any economic benefit in providing the information annually between revisions. Accordingly, even if the AER does have the power to make the proposed amendment, *Country Energy Gas* believes that this reporting requirement would not contribute to the national gas objective.

<b>AER Amendment 12.32</b>	<b>Section 7.2 (c) Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.33</b>	<b>Section 7.2 (d) Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.34</b>	<b>Sections 7.3.2, 7.3.3 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.35</b>	<b>Section 8.4.2 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.36</b>	<b>Section 8.5.1 Access Arrangement</b>
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The proposed amendment has been incorporated in full.

<b>AER Amendment 12.37</b>	<b>Reference not applicable</b>
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*Country Energy Gas* has reviewed its position, the status of other gas *Access Arrangements* and the draft decision in relation to trigger events. *Country Energy Gas* is of the view that the trigger events put forward by the AER under this proposed amendment are unnecessary. Both of the proposed trigger events can be catered for under an application to vary the *Access Arrangement* in accordance with NGR 65, similar to the approach the AER has taken with adverse self insurance events in the draft decision.

The occurrence of one of the proposed trigger events would impose unnecessary costs on the *Network*, which is small in scale compared to most gas distribution networks. Therefore, a small and potentially inconsequential connection of one contract *Customer* to the *Network* could trigger a full revised *Access Arrangement* proposal. This would be at significant cost to *Country Energy Gas*, with such cost unlikely to be recovered by the potential revenues to be earned from that *Customer*. *Country Energy Gas* is of the view that the cost associated with the preparation and submission of a revised *Access Arrangement* proposal to the AER is not the efficient use of its resources and will not contribute to the achievement of the national gas objective under s28 of the NGL.

In summary, *Country Energy Gas* has deleted clause 10.3.1 from its *Access Arrangement* proposal and has not included the proposed amendment from the draft decision. Proposed amendment 12.38 below therefore becomes section 9.3.1 in the revised *Access Arrangement* proposal.

<b>AER Amendment 12.38</b>	<b>Section 9.3.1 Access Arrangement</b>
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The majority of the proposed amendment has been incorporated. *Country Energy Gas* believes that an amendment to the NGL or NGR should be more than “an amendment” as this would cover all amendments, including non-material changes that may not affect *Country Energy Gas*’ obligations under the *Access Arrangement*. *Country Energy Gas* has accordingly amended 9.3.1.2(a) to include the words ‘materially affects the operation of this *Access Arrangement*’.

# Appendix 1 – CEG Testing the accuracy of Bloomberg vs CBASpectrum Fair Value Estimates