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**Victorian Energy Networks Corporation**

28 March, 2002

Mr Michael Walsh  
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Regulatory Affairs – Gas  
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Dear Mr Walsh

**Revision of VENCORP'S Access Arrangement**

Attached is VENCORP'S proposed revised access arrangement for the Victorian Principal Transmission System, submitted by the *revisions submission date*, as required by section 2.28 of the National Third Party Access Code for Natural Gas Pipelines (the Access Code).

In submitting these revisions, VENCORP is pleased to propose:

- Maintaining the current terms and conditions for third party access, thereby avoiding the creation of major uncertainty and potential risk re-allocation as a consequence of the revision of its access arrangements;
- Maintenance of the current range of services being offered by VENCORP, and in some cases expansion of the level of services being provided, at no extra cost to Users;
- An immediate reduction in its commodity tariffs of 4.0%, to be instituted six months prior to the commencement of the access arrangement period, under the existing annual process for budget approval;
- A tariff structure designed to stabilise and avoid any increase in these tariffs for the full 5 years of this next access arrangement period. These tariffs have not been increased for the last 2 years. This proposal should lock in real price reductions of over 10% for the next access arrangement period for VENCORP'S services;
- An access arrangement based on the currently operational Market and System Operations Rules (MSO Rules), avoiding the need for consideration of substantive changes to the MSO Rules as part of the process for approval of the revisions to the access arrangement, and the consequential complexity this would impose on the process;
- A reduction of over 10% in the tariff for distribution metering services, starting in the first year of the access arrangement period.

The submission comprises:

- an Access Arrangement;
- Market and System Operation Rules (MSO Rules);
- a Gas Transportation Deed; and
- Access Arrangement Information.

In addition, VENCORP is pleased to provide the following information to clarify a number of issues associated with the drafting of the revised access arrangement, and to assist in understanding the interaction between VENCORP's access arrangement as system operator, and that of GasNet as system owner.

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#### ***(a) Proposed changes to MSO Rules***

VENCORP is not proposing substantive changes to the MSO Rules as part of these revisions to its access arrangement. VENCORP and industry have put in considerable effort to ensure that this administrative complexity can be averted as far as is practicable.

However, some minor changes are necessarily required to parts of the MSO Rules as part of the revision of its access arrangement. These minor changes are needed to give effect to the changes in the tariff design which VENCORP is proposing as part of the revisions to the access arrangement.

The proposed registration and commodity tariff arrangements have been developed to comply with industry's request for greater stabilisation of transmission pricing. However, VENCORP's access arrangement tariffs are also prescribed in clause 2.6 of the MSO Rules. The tariff proposals outlined in the revised access arrangement would, if accepted by the Commission, necessitate corresponding amendments to the current clauses 2.6 and 2.7 in the MSO Rules. Suggested draft revisions to clauses 2.6 and 2.7 are provided in Attachment 1.

Recognising that many of the provisions of the Victorian Tariff Order expire on 31 December 2002, the revised access arrangements have imported all relevant definitional terms to avoid the need for reference to multiple external legislative instruments. Some very minor changes are correspondingly being proposed to the MSO Rules, to replace references to the Tariff Order with the definitions being proposed for the revised access arrangement. This will assist with clarity and provide consistency with the approach adopted in the revised access arrangement. Attachment 2 provides suggested drafting of these proposed changes.

The MSO Rules changes are consequential upon and dependent on the Commission's acceptance of the revisions to VENCORP's access arrangement. To avoid process confusion and uncertainty, VENCORP suggests that the changes to clauses 2.6, 2.7 and MSO Rules definitions be required by the Commission in the course of its deliberations on the access arrangement revisions.

***(b) Tariff timing issue***

As a consequence of these modifications, the revised access arrangement will, as far as practicable, operate as a stand-alone instrument to determine reference tariffs effective from the commencement of the next regulatory period, i.e. from 1 January 2003.

While the current tariff approval mechanisms (as set out in the Tariff Order, and clause 2.6 of the MSO Rules) purport to apply for the 12-month period commencing 1 July 2002, VENCORP's current access arrangement expires on 31 December 2002. The revised Access Arrangement, once approved, will override any inconsistent provisions in the Tariff Order or MSO Rules.

Nevertheless, as these instruments bind VENCORP and the Commission at this time, and as they reflect robust consultative processes subject to the Commission's consideration and approval, VENCORP has submitted its revised access arrangement with proposed tariffs being set on the following basis:

- *System security and meter data management tariffs*
  - *1 July 2002 to 30 June 2003 – annual approval process under current AA*  
 VENCORP's forecast expenditure for the period from 1 July 2002 to 30 June 2003 will be determined in accordance with the current mechanism with corresponding tariffs to be set for the period 1 July to 31 December 2002. The resulting system security tariffs and metering data management tariffs will apply for the first six months of the next access arrangement period.
  - *1 July 2003 to 31 December 2007 – annual approval process under revised AA*  
 The revised Access Arrangement includes provision for subsequent tariffs for these services to be set annually using the same process as that currently required under the MSO Rules and Tariff Order.
- *Commodity and registration tariffs*  
 The revised access arrangement proposes a significant change to stabilise the tariff structure for commodity and registration tariffs. Under this proposal, VENCORP's commodity tariffs would be set as follows:
  - *1 July 2002 to 31 December 2002 – current annual approval process as set out in clause 2.6 of the MSO Rules*  
 The current annual approval process will apply to determine tariffs, and it is proposed that this establish forecasts for the period 1 January 2003 to 30 June 2003.
  - *1 January 2003 to 31 December 2007 – revised access arrangement*  
 VENCORP's forecast expenditure for the first 6 months of 2003 will be submitted as part of the current annual approval process. Forecasts for the remainder of the next access arrangement period are submitted in accordance with this revised Access Arrangement.  
  
 Tariffs will be set for the entire 5-year access arrangement period in accordance with the revised Access Arrangement.

***(c) Joint submissions***

Pursuant to section 10.2 of the Code, the services and obligations for third party access to the Principal Transmission System are allocated between VENCORP and GasNet by their

respective access arrangements. VENCORP's access arrangement details its services and tariffs as system operator, and refers to GasNet's access arrangement for details of GasNet tariffs and transmission services as owner of the system.

VENCORP has attempted to ensure that the combination of its and GasNet's Access Arrangement comply with the Code requirements<sup>1</sup>. The components of VENCORP's access arrangement have been made public through VENCORP's public pre-consultation and its response papers, and drafts of its access arrangement have been shared with the Commission during development. Although VENCORP has not viewed GasNet's revised Access Arrangements submission, based on discussions with GasNet, there may be areas of divergence between the VENCORP and GasNet access arrangements as lodged. Potential areas of difference could relate to:

- *Description of GasNet transmission services*

VENCORP has assumed that, as with GasNet's current access arrangement, GasNet will continue to describe in its access arrangement the transmission services and capacity provided to VENCORP, as a current User of these services. To the extent that GasNet does not do so, the access arrangements may be inconsistent in their current form. VENCORP's strong preference remains for GasNet to include the Service Envelope Agreement, or at least key obligations from that agreement, in GasNet's access arrangement. This position was strongly supported by market participants as Users during VENCORP's recent public pre-consultation on its access arrangements.

If the Commission does not require GasNet's access arrangement to include a description of its services, then VENCORP proposes that the Commission should add the Service Envelope Agreement to the VENCORP access arrangement, to caution Users of VENCORP's reliance on this Agreement, and of the significant limitations entailed. Clearly, this is a second best option, but is, nevertheless, essential.

- *Services policy*

VENCORP has assumed that, consistent with current access arrangements and clause 5.3.1 of the MSO Rules, GasNet does in fact provide transmission services and capacity to VENCORP as a User. Again, this may not be entirely consistent with the approach that has been adopted by GasNet in its access arrangement, dependent upon how GasNet structures its submission.

#### ***(d) Materiality***

Section 10 of the Code allows for the provision of multiple service providers and in such cases recognises allocation of compliance of the Code between the service providers. Therefore, the Reference Tariffs for the Principal Transmission System are in two parts. Tariffs for the VENCORP Reference Services are described in the VENCORP Access Arrangement, and those for GasNet's Reference Services are described in GasNet's Access Arrangement. The costs of the overall transportation service on the Principal Transmission System are, therefore, reflected by the combination of the VENCORP and GasNet tariffs.

The materiality of the VENCORP share of the total transmission costs is very relevant in relation to assessing whether VENCORP's proposed tariffs comply with sections 8.1 and 8.2 of the Code. For example, VENCORP costs on average amount to less than 15% of total GasNet and

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<sup>1</sup> Section 10.2 of the Code allows for allocation of compliance with the Code obligations where there is more than one Service Provider in connection with a Covered Pipeline.

VENCorp transmission costs (which equates to an estimated 1% to 2% of industry revenue). Further, while separately identifiable due to the split in responsibilities between VENCORP and GasNet, VENCORP's costs are not additional costs associated with operation of the pipeline because of that division of responsibilities. The operational and balancing functions performed by VENCORP are necessary functions for any open access pipeline.

VENCORP's tariffs are unlikely to materially influence the total cost of delivered gas for consumers, and, hence, are unlikely to have a significant impact on investment decisions made by the industry.

Important factors are:

- the relative size of the VENCORP tariffs as a proportion (approximately 15%) of the overall transportation costs, and the total cost of supply of gas for Users including, particularly, costs arising from upstream well head/refinery charges;
- the fact that separation of VENCORP costs from GasNet costs already provides very significant cost reflectivity in the transmission service tariffs to which Users are exposed, by clearly delineating return on investment and marketing costs (GasNet) from those for operation of the assets and provision of competitive arrangements for operational balancing (VENCORP); and
- both GasNet and VENCORP each then further differentiate their costs on a service-by-service basis, in VENCORP's case via six distinct tariffs in this revised Access Arrangement.

Given these considerations, VENCORP believes that there is little net benefit in attempting to further allocate VENCORP's costs in pursuit of additional cost reflectivity to that already provided.

#### ***(e) Gas Transportation Deeds***

As required by the Commission<sup>2</sup> for the current access arrangements, the revised access arrangement includes by attachment a pro-forma Gas Transportation Deed. This is the document between VENCORP and gas shippers by which VENCORP directs shippers, and shippers agree, to pay transmission tariffs directly to GasNet. The revised pro-forma deed reflects a number of changes from existing gas transportation deeds to align them with the revised access arrangements, and to recognise expiry of the regulatory instruments currently referred to in the deeds. The changes have been discussed and agreed with GasNet.

The Service Envelope Agreement stipulates that any existing gas transportation deeds cannot be amended without GasNet's consent, unless changes are required by the Regulator. In addition, by its 1998 decision, the Commission also required<sup>3</sup> that the pro-forma gas transportation deed only be changed by following the procedure in section 2 of the Victorian Access Code. For existing shippers with gas transportation deeds, VENCORP and GasNet propose to offer to amend existing deeds, or enter new deeds in line with the pro-forma document ultimately approved by the Commission.

#### ***(f) LNG costs and System Security tariff***

The system security service is the means by which VENCORP ensures the ultimate security and integrity of the transmission system. VENCORP currently achieves this with 3000 tonnes of LNG

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<sup>2</sup> ACCC: "Final Decision on access arrangements by TPA and VENCORP for the Principal Transmission System", 6 October 1998, ACCC; Amendment 4.7, p 123.

<sup>3</sup> *ibid*

in GasNet's Dandenong storage facility. This LNG would normally be reserved for managing a total shutdown of the system.

An extensive and fully consultative process has reviewed the LNG reserve arrangements and concluded that it is appropriate for VENCORP to maintain the 3000 tonne LNG reserve, subject to ongoing monitoring of this requirement as new gas supplies become available and/or gas usage profiles change significantly. There are several proposed new gas supplies expected within the next 5 years that may affect VENCORP's system security reserve requirements or provide alternative means of meeting them. A cost benefit analysis of the need for and use of LNG for meeting this requirement has been published on VENCORP's website<sup>4</sup>.

The current system security tariff is a pass-through of the charges from GasNet to VENCORP for provision of storage capacity. This charge is capped at \$1.4m per annum by provisions of the Tariff Order that expire on 31 December 2002. Thereafter, GasNet's charges to VENCORP for this service will be subject to the terms of the existing contract, which stipulates a higher price. This contract expires in May 2004, and thereafter the charge will be determined following commercial negotiations with GasNet.

At this time, the provision of storage capacity for the 3000 tonnes of LNG for the system security reserve is a GasNet monopoly service, and is an essential service to ensure the safety of the Principal Transmission System. In these circumstances, industry has expressed concerns regarding the revised contract price that may be negotiated for the period beyond May 2004.

#### ***(g) FRC Costs***

VENCORP has a transitional role for facilitating full retail competition (FRC), to be reviewed in 2004. This is not part of the Reference Services provided by VENCORP at the wholesale gas market level for access to the principal transmission system. Correspondingly, it is not appropriate that the costs associated with this transitional FRC role be included in VENCORP's reference tariffs relating to services at the wholesale gas market level for access to the principal transmission system. Whereas wholesale level services are regulated under VENCORP's Access Arrangement by the Commission under the Access Code, section 69 of the *Gas Industry Act 2001* provides for VENCORP's costs associated with its transitional role in FRC to be recovered through a separate regulated process, subject to approval by the Essential Services Commission.

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<sup>4</sup> Refer *Victorian Gas Systems Security Cost Benefit Risk Analysis Report* prepared by Charles River Associates, March 2002.

***(h) Definitions of the transmission system***

When the VENCORP and GasNet revised access arrangements commence, the assets that make up the Western Transmission System will become part of the covered pipeline referred to as the Principal Transmission System. Any definitional concerns about delineation between the Western Transmission System and the Principal Transmission System are fully resolved by this action.

VENCORP's revised Access Arrangement continues to utilise the definition of 'Principal Transmission System' (which incorporates those assets previously called the Western Transmission System). For the following reasons, VENCORP believes that the use of the term 'Principal Transmission System' provides clarity and helps to avoid confusion:

- The *Gas Industry Act 2001* is the authoritative instrument and defines the Gas Transmission System as those assets in Victoria operated by VENCORP under the MSO Rules.
- VENCORP's access arrangement relates to that part of the *Gas Transmission System* owned by GasNet, meaning the assets owned by GasNet which are operated by VENCORP under the MSO Rules, and which are the covered assets under the Access Code.
- Clearly, GasNet may have (and currently does have) assets other than the Principal Transmission System that are not operated by VENCORP under the MSO Rules. Potentially, VENCORP may operate pipelines other than GasNet's.

There is an ongoing and compelling need for a clear delineation of definitions relating to the Gas Transmission System arising from the *Gas Industry Act* and those assets covered by the access arrangements of VENCORP and GasNet. VENCORP considers the use of the definition *Principal Transmission System* to be the most appropriate means of achieving this clarity.

The Service Envelope Agreement utilises its own definition of Gas Transmission System, which is effectively equivalent to the definition of *Principal Transmission System*, as per VENCORP's access arrangement. Notably, this description is not the *Gas Transmission System* defined by the Gas Industry Act. The pro-forma Gas Transportation Deed adopts definitions similar to the Service Envelope Agreement, for the sake of contractual consistency. At the time of lodgement of this revised Access Arrangement, GasNet has not advised VENCORP of the relevant terminology GasNet plans to adopt in its access arrangement. However, regardless of the terminology adopted in the various contractual and legal instruments, provided care is taken, there should be no legal issue. The terminology will be legally effective and equivalent, albeit potentially confusing for Users.

VENCORP looks forward to working with the Commission during the Access Arrangement consultation process, to ensure that the final approved instruments deliver benefits to Users of the Principal Transmission System.

Please contact Terry Grimwade if you have any further queries on 03 8664 6610.

Yours sincerely



Matt Zema

**Chief Executive Officer**

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