25 September 2002

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

Dear Ms Kaur

Moomba Sydney Pipeline Revised Access Arrangement
Responses to Submissions

Thank you for the opportunity to comment on matters raised in submissions responding to EAPL's Revised Access Arrangement.

As identified in EAPL's letter of 20 September the Supreme Court's Decision is the most significant interpretation of the Gas Code to date and has changed the way regulators and industry must view the Code. This response does not alter EAPL's view that the Draft Decision on the MSP is fundamentally flawed and should be set aside.

The Epic Decision has major implications with respect to consideration of the Initial Capital Base. EAPL has already written to the Commission requesting it agree to seek to have the Draft Decision set aside and to restart the process. Given this and the need for all parties to be able to review their positions on a range issues, particularly those surrounding the Initial Capital Base, we have limited our comments in respect of matters which are likely to be affected by the interpretation of the Code as a result of the Epic Decision. In regard to issues surrounding the Initial Capital Base we have not commented in any way.

While the submissions have raised numerous issues, EAPL has elected to only address issues for which a response is likely to assist the Commission. Where an issue has not been addressed is this submission, this does not indicate EAPL's agreement in respect of that issue. EAPL's comments on relevant matters follow.

ExxonMobil

The responses to this submission are in the same order as presented by ExxonMobil:

1. Clause 6.13 provides for the recovery of costs associated with EAPL meeting new obligations associated with the introduction of full retail contestability (FRC) through an apportionment of the costs to each User. This limits the passing on of EAPL's FRC costs to any User to an appropriate proportion of the actual reasonable costs incurred by EAPL. As FRC costs will be associated with all Users, EAPL cannot reasonably be required to

only pass on costs directly associated with a particular User, but should be able to recover its costs by proportionate contributions from all Users.

2. Under Clause 19 of Attachment D, EAPL is responsible to deliver on-specification gas subject to all Users delivering on-specification gas into the MSP. As EAPL is not in a position to observe and physically control gas entering the pipeline at its Receipt Points, it cannot reasonably be required to accept risk and liability for non-specification gas entering its pipeline. Liabilities associated with receipt of non-specification gas is best shared among the Users requiring them to carry the risk in relation to any damages or loss experienced by them.

3. The assumption behind Clause 23 of Attachment D is that awareness of entry of non-specification gas into the pipeline system will generally result from awareness of it entering at a Receipt Point. Generally gas analysis is not undertaken at Delivery Points and so no reference is made to this possibility. It would be acceptable to EAPL that in addition to the obligation for both EAPL and a User to notify the other of gas entering the system at the Receipt Point, that there be an obligation on both EAPL and the User to notify the other when either becomes aware of non-specification gas leaving the pipeline at a Delivery Point.

4. Clause 24 of Attachment D suggests that an indemnity for non-specification gas only be provided to EAPL if receipt of non-specification gas is not authorised. It may be reasonable that EAPL cannot claim against that User for loss or damage that may arise from the non-specification gas if EAPL authorises the receipt of non-specification gas from a User at a Receipt Point. However, EAPL should not be obliged to indemnify that User against liability to others for damages as a result of the non-specification gas entering the pipeline system.

   ExxonMobil's suggestion that the User be indemnified in connection with receipt of authorised non-specification gas and for delivery of authorised non-specification gas at the Delivery Point is not reasonable, particularly as EAPL does not have physical and legal control of the Gas at the Receipt Point.

5. Under clause 26 of Attachment D, the risk for gas is implicitly held by EAPL as it has the obligation to deliver the quantities of gas it receives. The Service Provider is responsible for gas lost due to its negligence.

6. Clause 60 of Attachment D provides that capacity charge relief will commence 24 hours after the occurrence of the Force Majeure occurrence. This is the reasonable basis for relief and does not reflect the fact that in a majority of circumstances there will be a time delay between when a Force Majeure event occurs and when delivery of gas is affected.

7. There is no need for a test to ensure the appropriate technical and operational competence of an assignee in the event of assignment of a transportation agreement by EAPL to a person holding an interest in the pipeline. However, EAPL would not object to a statement that the assignee be capable of performing the obligations under the transportation agreement.

8. It is implicit that the limitation of liability in Clause 73 of Attachment D applies generally and no further clarification is necessary.

9. Clause 74 of Attachment D reflects the appropriate reciprocal obligations of EAPL and a User to carry all risk property damage insurance. Self-insurance is unacceptable and an uncertain means of protecting the interests of each of the parties.

TXU

Key Areas of Concern

Matters are numbered as in TXU's covering letter.

1. *TXU has raised a concern that it is unable to assess whether or not Prospective Users will be offered access to the MSP on terms and conditions commensurate with existing contracts.*

The Code requires a Service Provider to offer one or more services that are likely to be sought by a significant part of the market. There is no requirement in the Code that Prospective Users are offered access on terms commensurate with existing contracts. In any event is EAPL's view that the existing transportation agreements for Firm Service are substantially the same terms and conditions to those contained in the Revised Access Arrangement.

It should be noted that the major existing contract (the Gas Transportation Deed between EAPL and AGL Wholesale Gas) was approved by the Commission as part of the establishment of APT.

2. *TXU believes the simplistic approach in the queuing policy is unlikely to result in the most efficient outcome and meet the section 8 Code requirements.*

The queuing policy in the Revised Access Arrangement is substantially the same as in the approved Central West, Roma to Brisbane and Carpentaria Gas Pipelines Access Arrangements, which the Commission has concluded meets the section 8 Code requirements and is appropriate for the pipelines. There are benefits to Users in all APT pipelines being subject to similar, if not the same, queuing policy.

EAPL appreciates TXU's experiences in the South Australian and Victoria gas markets where there is little or no spare capacity may have affected its view of what is appropriate in the case of the MSP. However, the MSP has a significant level of spare capacity available and this policy, and as discussed above, this queuing policy has not hindered the expansion of the Roma to Brisbane and Carpentaria Gas Pipelines.

TXU has suggested that EAPL needs to develop a queuing policy for non-firm requests. As non-firm capacity is effectively interruptible, EAPL would evaluate whether spare interruptible capacity existed for the level of interruption that was acceptable to the

prospective user. Where spare interruptible capacity at a level of potential interruption that was acceptable exists a queue would not need to exist for such requests.

3. EAPL has proposed high over-run and imbalance charges relative to industry practice.

Overrun charges, whether authorised or unauthorised, are intended to ensure that users contract for the appropriate quantity of MDQ to fairly reflect their usage.

Shippers should not be able to gain a market advantage by under-contracting MDQ and utilising overruns to meet their required daily demand given the current spare capacity on the MSP. In addition, the use of overruns must not prevent EAPL from meeting its obligations to other contracted parties.

EAPL tariffs are determined on the basis of its estimate of firm capacity required to meet projected demand and the costs associated providing this capacity. Use of overruns to avoid contracting for capacity would otherwise result in EAPL under-recovering allowable revenue under the proposed tariff structure in the Revised Access Arrangement.

EAPL therefore believes that the proposed overrun charges provide an appropriate economic signal to Users to contract sufficient capacity to reflect their daily and annual contractual requirements. In any event, EAPL's proposed policy on overruns provides the Users with flexibility in incurring a limited overrun quantity and limited number of occurrences before overrun charges would apply.

EAPL believes that where TXU refers to imbalance or balancing charges in its submission, that they meant the Daily Variance Charges included in the Revised Access Arrangement.

In the case of imbalance charges these should reflect a balancing of both the Pipeline's and Users' interests with respect to variability in daily supply and demand and the pipeline's operational and technical integrity. As a result of recent User behaviour during peak periods, EAPL has submitted revisions to the balancing procedures proposed in the Revised Access Arrangement.

Other Matters

1. TXU expresses concerns about the priority of Negotiable Services and suggests that "section 9.2 restricts Negotiable Services to a lower priority than Firm Service".

EAPL's Reference Service is a Firm Service, which is the service that EAPL believes a significant part of the market will seek. It is important that Users choosing this service know that they will be afforded the priority normally associated with a Firm Service.

TXU appears to have misunderstood the terms of Section 9.2 which states that "Negotiable Services will have a priority agreed on a case by case basis but will not be higher than Firm Service". That is, a Negotiated Service may have the same priority as a Firm Service, but not

higher. In addition Section 5.5 of the Revised Access Arrangement clearly states that "EAPL will not act in a non-discriminatory manner in providing Services".

2. *That an Access Arrangement should not include provisions for pass through of FRC costs and requires oversight by the Commission.*

TXU's proposal that FRC costs be recovered separately from the Access Arrangement is not possible under the Code.

The forecast operating expenditure does not incorporate an estimate of the FRC costs. The current provision of the Revised Access Arrangement provides for EAPL to only recover the costs it actually incurs. It is appropriate that EAPL recover these costs which it incurs to facilitate a competitive market through a simple and reasonable mechanism such as that proposed by it.

4. *TXU has stated that a pass through mechanism for tax increases and licence fees are reasonable, but a broad definition such as includes for government charges, levies, imposts and fees is inconsistent with incentive regulation and that if allowed a mechanism to consult affected users and gain ACCC approval is needed.*

It is not correct to suggest that pass through of this set of items is not compatible with incentive regulation. Incentive regulation provides for the pass through of these costs for which there is no doubt about prudence. That is it would be imprudent for EAPL not to incur costs imposed by law.

In addition the list of items included in the Revised Access Arrangement to be passed through has precedent in many contracts and in a number of approved Access Arrangements including the Access Arrangement for the Central West Pipeline.

7. *TXU suggest that all expansions of the MSP should be covered.*

The arguments presented by TXU are inconsistent with the wording of s3.16, which clearly anticipate a future decision. The approach proposed by EAPL in the Revised Access Arrangement is consistent with other approved Access Arrangements, is within the Commission's power and should be accepted.

10. *TXU has stated that system use gas should be a cost of the service provider and asks ACCC to confirm that operating costs do not include system use gas, and require clarification of Access Arrangement as to its treatment.*

System use gas is not included in EAPL's Opex in the Revised Access Arrangement. It is a common practice in Australian pipelines that system use gas be provided by users.

11. *TXU suggests that Force Majeure should exclude strikes involving a party to the agreement, or where EAPL action or lack of action causes certain events.*

The definition proposed by EAPL reflects industry contracting practice, that where parties to the transportation agreement are involved strikes are included in the definition of force majeure. It is unreasonable that such events should be excluded. The early part of the clause states that any cause not reasonably within the control of the party, so the proposed amendments are not necessary.

Energy Markets Reform Forum

Initial Capital Base

EAPL will not comment on this aspect of the EMRF submission for the reasons stated above.

WACC

The section of the EMRF submission dealing with WACC relies almost entirely on a submission made to the Commission by BHP Billiton in connection with the Commission's review of the GasNet Access Arrangement, and includes a paper prepared for BHP Billiton by Pareto Partners. We request that submissions in response to BHP-Billiton in respect of GasNet concerning WACC that are relevant to the Commission's consideration of the WACC for the MSP also be taken into account.

The Pareto paper is critical of the submissions of regulated companies and their consultants on the grounds that they are motivated by self-interest. It also suggests that regulators' decisions on WACC have been unduly influenced by the submissions of regulated companies. The Pareto paper, in its own words, "provides an end-user commentary … " and bases much of its argument on the need to 'focus on the long-term interests of end-users". There is no question that those interests are important, but it must be recognised that the relationship between service providers and end-users is a symbiotic one. That is, the long term interests of end-users will be served best by the timely and efficient provision of adequate infrastructure services over the long term. Such long term interests will not be achieved if the levels of return are driven down in the manner suggested by Pareto on behalf of BHP-Billiton, and endorsed by the EMRF.

The need to look beyond the narrow concern of driving down prices for access to gas pipelines in the short term is recognised by Section 2.24 of the Code which is now understood has fundamental weight as a consequence of the recent Epic decision.

In the case of WACC, the question is what is the appropriate value of WACC for the circumstances of the access arrangement under review ie. in the circumstances of a particular pipeline operation in Australia. International comparisons may be of interest but cannot be determinative and may only be partially relevant. Pareto has expanded on work performed by NERA (NERA, March 2001) in which cost of capital decisions in the UK and USA are compared with those made in Australia. NECG has responded to NERA (and, by extension, to Pareto) "disput[ing] strongly any implication that NERA's analysis somehow supports the

view that determinations by Australian regulators are generous in international terms." NECG go on to stress that "it would be very dangerous for any Australian regulator to revise its approach to setting the allowed rate of return merely on the basis that other regulators in other countries apparently allow investors in other businesses a lower return." (NECG, 18 July 2001). Pareto make only "a (limited) response" to the NECG conclusions.

Pareto also refer to submissions by GasNet (in support of its proposed Access Arrangement) and suggest, in footnote 17, that regulators and policy makers are "susceptible" to the arguments put by regulated companies and their advisers, and that this is exemplified by the Position Paper produced by the Productivity Commission in its Review of the National Access Regime. The Productivity Commission subsequently produced its Final Report which was released recently by the Commonwealth Government. The Report confirms that:

> "The paramount concern is the potential for access regulation to deter investment in essential infrastructure. To lessen this risk, the Commission has proposed that new measures be incorporated into the national access regime to facilitate efficient investment." (PC Report, p xii)
>
> "The potential 'chilling' effect of access regulation on investment in essential infrastructure services is the main concern." (PC Report, p xix)
>
> "But most importantly, the national access regime does not do enough to guard against the possibility that investment in essential infrastructure will be deterred. So-called 'regulatory risk' under the regime is greater than it need be." (PC Report, p xxi)

In its Position Paper, the Productivity Commission accepted the view that efficiency losses resulting from over-pricing of infrastructure services are likely to be smaller than the adverse consequences, in terms of non-provision of services, that could arise as a result of under-pricing those services. This was also confirmed in the Commission's Final Report:

> "Nonetheless, the Commission accepts that there is a potential asymmetry in effects:

- Over-compensation may sometimes result in inefficiencies in the timing of new investment in essential infrastructure (with flow-ons to investment in related markets), and occasionally lead to inefficient investment to by-pass parts of a network. However, it will never preclude socially worthwhile investments from proceeding.

- On the other hand, if the truncation of balancing upside profits is expected to be substantial, major investments of considerable benefit to the community could be forgone, again with flow-on effects for investment in related markets.

> In the Commission's view, the latter is likely to be a worse outcome. Accordingly, it concurs with the argument that access regulators should be circumspect in their attempts to remove monopoly rents perceived to attach to successful infrastructure projects." (PC Report, p 83)

And:

> "In sum, the pricing principles must necessarily involve a balancing act between addressing monopoly pricing and allowing a degree of flexibility for revenue to be above costs. In pursuing this balance, the Commission considers that the principles should explicitly recognise the role of access regulation in curbing inefficient monopoly rents, but set a clear floor to ensure that incentives to invest are protected." (PC Report, p 332)

We submit that Pareto's suggestion in footnote 17 is mistaken and inappropriate given the Commission's foundations in legislation and the manner in which it conducts its reviews:

> "The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole." (PC Report, Frontice)

The value of WACC determined by CAPM is a strong function of a number of input variables including equity beta and market risk premium and it is widely acknowledged, including by Pareto, that there is no precise value for any of them – the actual value of WACC is uncertain. In the end, Regulators must apply appropriate judgement in determining the WACC to be recovered by a service provider. In the light of the strong position taken by NECG in its response to NERA (and, by extension, Pareto); the conclusions of the Productivity Commission; and the requirements of Clause 2.24 of the Code, we believe it would be an inappropriate and risky exercise of regulatory discretion to set the regulatory WACC at the lowest possible value, as espoused by the EMRF and Pareto.

Should you have any matters for clarification arising from this response to submissions please contact Chris Harvey of Agility on 02 9922 8601.

Yours sincerely

Robert McMaster
Commercial Manager