Draft Decision

APA GasNet

Access Arrangement Variation Proposal

April 2009

Contents

Shortened forms

ACCC	Australian Competition and Consumer Commission
AER	Australian Energy Regulator
APA Group	Australian Pipeline Trust
Code	National Third Party Access Code for Natural Gas Pipeline Systems
GasNet	APA GasNet Australia Pty Ltd
NGL	National Gas Law
NGR	National Gas Rules
PTS	Principal Transmission System
transitional code provisions	Sections 3, 8 and 10.8 of the Code
VENCorp	The Victorian Energy Networks Corporation
WACC	Weighted Average Cost of Capital
WUGS	Western Underground Gas Storage facility

Summary

On 18 December 2008, APA GasNet Australia Pty Ltd (GasNet) submitted under rule 65 of the National Gas Rules (NGR), a variation proposal to its Access Arrangement covering the Principal Transmission System (PTS) in Victoria approved by the Australian Competition and Consumer Commission (ACCC) on 25 June 2008.

The variation concerns the application of tariffs applying to the Western Underground Gas Storage (WUGS) facility and SEA Gas connection points.

On 16 January 2009, the Australian Energy Regulator (AER) determined GasNet's variation proposal to be a material access arrangement variation proposal in accordance with rule 66 of the NGR and is to be treated as a full access arrangement proposal under Division 8 of the NGR. Following this decision, the AER sought submissions from interested parties as required by the NGR. Two submissions were received, one each from AGL and TRUenergy.

As set out in this draft decision, the AER proposes to not accept GasNet's variation proposal. While the AER accepts there are concerns with the current tariff structure, it considers that these are outweighed by concerns with the manner in which GasNet have proposed to address these. The AER considers that the proposed application of a withdrawal tariff at WUGS could be improved if GasNet proposed a way of effectively unbundling the services provided via WUGS. However, the AER notes that concerns with the other elements of the proposal remain.

The AER is now seeking submissions from interested parties in relation to the matters identified in this draft decision, to be considered in its final decision. The NGR provides 6 months for the AER to complete this process, with the possibility of stop-the-clock provisions to account for time allowed for public submissions and revision periods, as per rule 11(1) of the NGR.

The NGR requires the AER to provide at least 20 business days for stakeholders to comment on the draft decision. Accordingly, interested parties are invited to make submissions to the AER by **4 June 2009.**

The AER prefers that all written submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information are asked to provide both confidential and non-confidential versions of their submission. All non-confidential submissions will be placed on the AER's website.

The AER will treat all information and documents provided to it as part of this process in accordance with the ACCC/AER's *Information Policy* dated October 2008, which is available on the AER's website.

Submissions can be sent electronically to aerinquiry@aer.gov.au. Alternatively, they can be sent to:

Mr Chris Pattas
General Manager
Network Regulation South
Australian Energy Regulator

GPO Box 520
Melbourne VIC 3001

Enquiries on this matter should be directed to the Network Regulation South Branch (Adelaide office) of the AER on (08) 8213 3458.

1 Introduction

1.1 Proposed variation

This variation proposal concerns the application of tariffs to the Western Underground Gas Storage (WUGS) facility and SEA Gas connection points, as a consequence of changes to the way in which compressor fuel gas is treated under the Victorian gas industry Market and System Operation Rules (MSOR)[1]. The submitted proposal comprises a number of specific components. These include:

1. Removing the WUGS Transmission Refill Tariff;
2. Applying the standard withdrawal tariff for the South West Zone ($0.1411/GJ) to all withdrawals at WUGS, irrespective of whether the gas is exported via the SEA Gas Pipeline to South Australia or injected into the Principal Transmission System (PTS);
3. Removing the Cross System Withdrawal Tariff for all withdrawals from the Port Campbell Injection Zone; and
4. Incorporating the tariff, gas volumes and revenue applicable to WUGS into the Price Control Formula.

A stated outcome of the variations is that tariffs for exporting gas to South Australia from WUGS and from the SEA Gas connection point would be equalised (at $0.1411/GJ). The merits of this outcome have also been considered by the AER.

1.2 Regulatory framework

The AER is responsible for the economic regulation of covered natural gas transmission and distribution pipelines in all states and territories (except Western Australia).[2]

On 1 July 2008, the economic regulatory regime applying to gas transmission and distribution businesses under the National Third Party Access Code for Natural Gas Pipeline Systems (the Code) was repealed and superseded by the new regime provided in the National Gas Law (NGL) and the National Gas Rules (NGR).[3]

However, the NGL also provides transitional arrangements for access arrangements approved under the Code but which remain in force after 1 July 2008. Under the NGL, these transitional arrangements apply to access arrangements which satisfy the definition of a ‘transitioned access arrangement’.[4] GasNet’s access arrangement approved by the ACCC on 25 June 2008 is a transitioned access arrangement.

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[1] Responsibility for the procurement of compressor fuel gas that is, gas required to operate the compressors to deliver gas within the pipeline, including storage facilities, has transferred from GasNet to VENCorp with effect from 1 January 2009.

[2] As of 1 July 2008.

[3] The Code was part of the Gas Pipelines Access Law, a schedule of the Gas Pipelines Access (South Australia) Act 1997. The Act has been superseded by the National Gas (South Australia) Act 2008 to which the NGL is a schedule.

[4] NGL, schedule 3, section 1.

Of these transitional arrangements, schedule 3, section 30(1) of the NGL provides that sections 3, 8 and 10.8 of the Code (the transitional Code provisions) continue to apply to a transitioned access arrangement until the AER approves a service provider's next set of revisions.[5] As GasNet's revision is not scheduled to commence until 2012, the transitional Code provisions continue to apply for the purpose of assessing GasNet's variation proposal. While assessment of GasNet's variation proposal will be against the relevant provisions in the Code, the process to be followed is that contained in the NGR.

Rule 65 of the NGR permits service providers to submit an access arrangement variation proposal to their access arrangement, stating the reasons for the variation and the basis on which the service provider considers it to be non-material. Rule 66 requires the AER to decide whether the proposal is non-material. Where a proposal is considered material it is to be dealt with by the AER as a full access arrangement proposal under division 8 of the NGR.

The AER has determined GasNet's variation proposal to be material, requiring it to be assessed as a full access arrangement proposal.

1.3 Assessment criteria

GasNet's proposed variation relates to the application of reference tariffs and will be assessed against the provisions of the reference tariff principles in section 8 of the Code.

Section 8 sets out the principles with which reference tariffs and a reference tariff policy (the principles underlying the calculation of reference tariffs) included in an access arrangement must comply.

Certain objectives are provided in section 8.1 of the Code. These guide the design of what GasNet's reference tariffs and reference tariff policy are to achieve. They include:

- 8.1(a) providing the service provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the reference service over the expected life of the assets used in delivering that service;
- 8.1(b) replicating the outcome of a competitive market;
- 8.1(c) ensuring the safe and reliable operation of the pipeline;
- 8.1(d) not distorting investment decisions in pipeline transportation systems or in upstream and downstream industries;
- 8.1(e) efficiency in the level and structure of the reference tariff; and
- 8.1(f) providing an incentive to the service provider to reduce costs and to develop the market for reference and other services.

[5] Sections 3, 8 and 10.8 concern the content of an access arrangement, reference tariff principles and definitions, respectively.

In addition to these general objectives, section 8 also provides a series of factors (section 8.2) that the AER must be satisfied with in determining whether to approve a reference tariff and reference tariff policy, and particular provisions relating to the objectives that incentive mechanisms should be designed to achieve (section 8.46).

If the AER in its assessment of a proposed variation identifies a conflict between individual objectives in section 8.1, the AER must exercise its discretion in reconciling the conflict. In doing so the AER will take into account the matters contained in section 2.24 of the Code. The AER acknowledges that section 2 is not specifically referred to in the transitional provisions, however, given the role of section 2 in the regulatory framework under the Code, the AER considers that not taking it into account in reconciling conflicts would be unsound.

The AER has, in assessing GasNet's proposal as set out in this draft decision, considered the proposal against all of the objectives in section 8 of the Code. The sections that the AER has considered relevant to GasNet's proposal include sections 8.1(a), 8.1(e) and 8.38.

1.4 The Principal Transmission System

GasNet is a wholly owned subsidiary of the APA Group and is the owner of the PTS. The Victorian Energy Networks Corporation (VENCorp) is the operator of the PTS.

The PTS, also known as the GasNet System, is the primary system for the transmission of natural gas at high pressure in Victoria. The PTS is not a traditional point-to-point pipeline as there are a number of injection and withdrawal points. Gas injected into the PTS is primarily delivered into Victoria's gas distribution network and serves approximately 1.4 million residential users, 45,000 industrial and commercial users as well as some electricity generators. In addition, a small amount of gas is exported out of Victoria and some gas is provided for storage.

For the purpose of tariff recovery the PTS is comprised of gas injection and withdrawal pipeline assets. Injection tariffs are charged for the costs attached to usage of injection pipeline assets. Withdrawal tariffs recover the costs attached to usage of the system for transmission of gas from injection pipelines to users, i.e., primarily those costs incurred in the usage of withdrawal pipelines.

As at 1 January 2008, the PTS:[6]

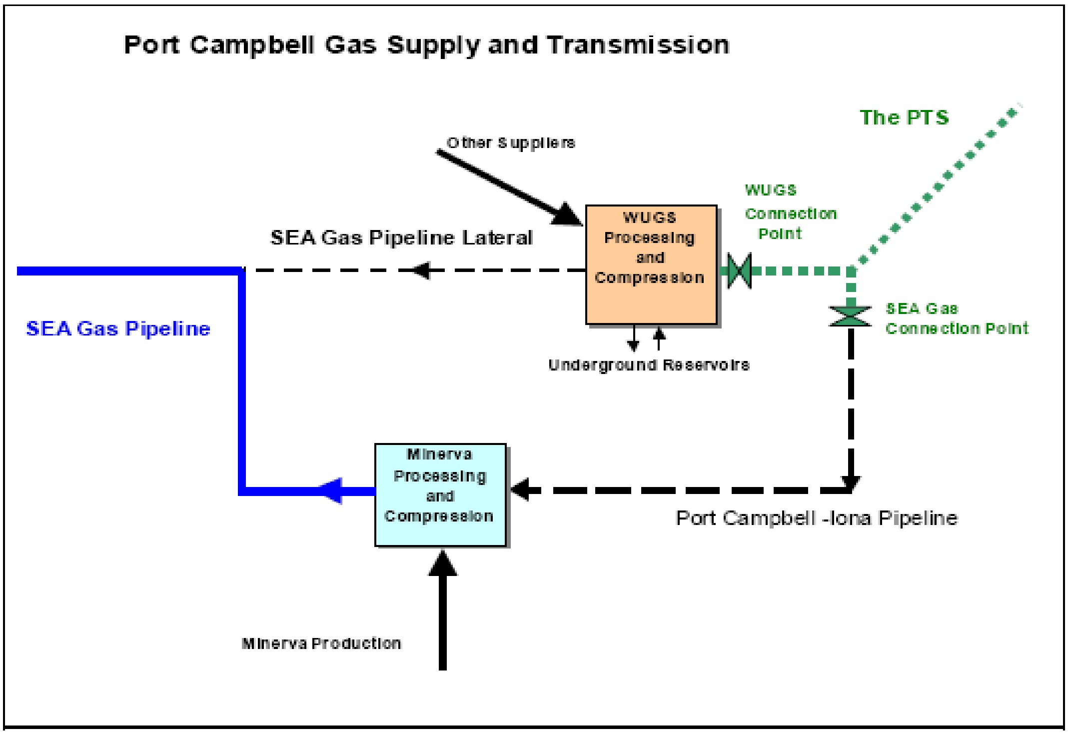
- Comprised approximately 1,933 km of pipelines;
- Had five main injection points, including Longford, Dandenong, Culcairn, Pakenham and Port Campbell. The latter being:
  - The injection point for WUGS and various production fields; and
  - The interconnection with the SEAGas Pipeline and Minerva processing plant.

[6] GasNet, *Revised GasNet Australia Access Arrangement*, 1 January 2008.

Figure 1 shows the connections between the PTS and the various facilities within Port Campbell. While some of GasNet's proposed variations have PTS-wide implications, they principally relate to tariffs applying to the PTS at the Port Campbell region within the South-West Zone. In particular, alterations to tariffs applying to two withdrawal points, WUGS and SEA Gas are proposed.

Notably, gas can flow from the PTS into WUGS for storage or exporting to South Australia, or back out into the PTS. Alternatively gas can flow from the PTS to South Australia from the SEA Gas connection point.

Figure 1: Port Campbell Gas Supply and Transmission



Source: GasNet Access Arrangement Variation Proposal, 12 December 2008, p.7.

2 Assessment

2.1 Proposed variation

While GasNet's proposal has been submitted as one whole variation, it comprises a number of distinct but related components. Firstly, GasNet has proposed to remove the WUGS transmission refill tariff ($0.05/GJ) and apply the standard withdrawal tariff for the South West Zone ($0.1411/GJ) to all withdrawals at WUGS, irrespective of whether gas is then exported via the SEA Gas Pipeline to South Australia or re-injected into the PTS. GasNet's proposal submits that the $0.05/GJ tariff under-recovers for the cost of withdrawing gas via WUGS. Shippers using WUGS to export from the PTS to South Australia are able to do so without incurring the standard withdrawal tariff for the South West Zone currently applying to withdrawals from the SEA Gas connection point. GasNet submitted that the change is necessary to ensure that users of WUGS pay their fair share of transmission costs.

Secondly, GasNet has proposed to incorporate the $0.1411/GJ tariff, the gas volumes and revenue applicable to WUGS into the Price Control Formula. GasNet highlighted that any over or under-recovery relating to withdrawal tariffs at WUGS would be consolidated with other amounts over-recovered or under-recovered by GasNet during the same period and incorporated into the tariffs set for the following year. GasNet has also proposed to apply these additions by making adjustments to the initial revenue and initial forecast volumes to account for the costs and volumes associated with refill services.[7]

Thirdly, GasNet propose to remove the Cross System Withdrawal Tariff currently applying to gas withdrawals from the SEA Gas connection point (currently $0.1772/GJ). GasNet's proposal to remove this tariff appears unclear as no particular reason was provided. The AER notes however, that when considered together with the other proposed amendments, this would have the effect of equalising tariffs between WUGS and SEA Gas.

A stated intention of GasNet's overall proposal is to equalise tariffs between the WUGS facility and SEA Gas connection point. Shippers using SEA Gas or WUGS to export to South Australia (or re-inject back into the PTS) would both be charged a $0.1411/GJ withdrawal tariff by GasNet. GasNet submitted that this would create an efficient pricing structure, correcting for different treatment of customers accessing similar services and thus distortions in the competitive use of the PTS.

GasNet's current proposal is similar to that which it proposed in 2004, with the exception of the removal of the cross system withdrawal tariff which was not proposed at that time.[8] The proposal to include refill into the price control formula was also proposed in 2008.[9]

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7 GasNet, *Email response to AER request for clarifications*, 24 February 2009.

8 ACCC, *Final Decisions – GasNet Australia access arrangement revisions for the GasNet System*, 15 December 2004, pp.17-29.

9 ACCC, Final Decision – Revised access arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System, 30 April 2008, p.97.

2.2 Current access arrangement provisions

Alterations to the WUGS tariff

Currently, shippers have two possible connection points to export gas to South Australia, WUGS and SEA Gas. If WUGS is used, GasNet charges a tariff of $0.05/GJ. This tariff reflects the marginal cost of providing refill services, including the operating and maintenance costs of running compressors.[10] Shippers also use WUGS for gas storage and for re-injection later into the PTS, to which GasNet also charges a tariff of $0.05/GJ. In this case, GasNet will later recover a withdrawal tariff at the relevant withdrawal point within the PTS. Storage was envisaged as the principal purpose of the WUGS facility, providing additional security of supply to the overall system.

Alternatively, if shippers use the SEA Gas connection point to export gas to South Australia, GasNet charges a $0.1411/GJ withdrawal tariff, plus an additional $0.1772/GJ cross system withdrawal tariff if the gas is transported across the PTS. The $0.1411/GJ withdrawal tariff is the standard withdrawal tariff for the South-West Zone.

To transport gas to the SEA Gas and WUGS connection points (whether for export or re-injection), shippers use GasNet's transmission pipelines. Those using the SEA Gas connection point pay directly for this transmission usage as they are charged a withdrawal tariff that recovers these costs. However, those using WUGS for export do not incur a withdrawal tariff and thus do not pay directly for this transmission usage. The transmission costs and the sunk capital costs are currently recovered by GasNet as these are accounted for at the start of the access arrangement period, but they are not recovered directly from users of these services at WUGS as no tariff currently exists upon which to allocate these costs.

GasNet have confirmed that they are unable to identify the destination of gas after it passes the connection point for entry into WUGS.[11] However the AER notes that as part of its previous proposal to alter the WUGS tariffs, GasNet had proposed a scheme which separated charges for the two uses of WUGS via a rebate mechanism.[12]

Additions to Price Control Formula

GasNet's revenues are subject to a revenue control model and a price control formula which are designed to ensure efficient recovery of costs associated with providing reference services, together with productivity improvement incentives. Under this model, initial target revenues and forecast volumes have been set at the start of the access arrangement period (2008-12) and used to determine average reference tariffs. Upon conclusion of each regulatory year, actual achieved volumes are adjusted by

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[10] Previously, under the 2008 tariff structure, GasNet charged a $0.20/GJ transmission refill tariff. This tariff recovered the marginal cost of refill services, which is principally the cost of additional compressor fuel gas required to deliver gas to the storage facility. However, as of 1 January 2009, responsibility for the procurement of compressor fuel gas has transferred from GasNet to VENCorp. The $0.05/GJ tariff recovers the only other direct costs incurred by GasNet, which include the marginal operational costs (such as maintenance).

[11] GasNet, *Email response to AER request for clarifications*, 24 February 2009.

[12] ACCC, *Final Decisions – GasNet Australia Access Arrangement Revisions for the GasNet System*, 15 December 2004. pp.17-18.

factors such as weather conditions and subject to a side constraint of a $\pm 5.5\%$ bound on the initial forecast volume to reach an adjusted target volume. An adjusted target revenue is then determined by multiplying the adjusted target volume by the average tariff after undertaking pass through and k factor adjustments (i.e., carry-over).[13]

Any over/under recovery by GasNet compared to the adjusted target revenue will have to be returned or recovered from customers via annual tariff adjustments. Key to this proposal is that whenever actual volumes exceed those forecast, GasNet is allowed to keep the associated revenue providing the volume does not exceed the 5.5% bound. When the bound is exceeded GasNet has to adjust average tariff levels to pass on the extra benefit associated with it.[14]

Under GasNet's current Access Arrangement, the transmission refill tariff and the volumes and revenues associated with refill are all excluded from the price control formula. Yearly refill tariff movements are in accordance with a CPI-X formula and volume outcomes against forecast do not cause changes in other tariffs. GasNet now proposes to include refill into the price control formula by making adjustments to the initial revenue and initial forecast volumes to account for the costs and volumes associated with refill services, and any over/under recovery arising from these services will lead to adjustments in average tariffs.

Refill volumes are small compared with the total demand on the PTS and therefore variables such as weather and the use of gas-fired electricity generation can have a strong influence. As part of the last revision to GasNet's Access Arrangement, the ACCC considered that there is inherent difficulty for GasNet in being able to forecast these volumes and decided to exclude these from the workings of the price control formula.[15] The AER notes that GasNet have reiterated that there is still difficulty in forecasting refill volumes.[16]

Equalising tariffs – WUGS & SEA Gas

Both the WUGS and SEA Gas connection points are located within Port Campbell and provide two options for shippers to export gas to South Australia. Currently GasNet charges exports via these facilities at different tariffs, as outlined in Table 1.

[13] ACCC, Final Decision – Revised Access Arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System, 30 April 2008, p.112.

[14] And vice-versa, whenever actual volumes are less than those forecast, GasNet faces revenue downside. If actual volumes are less than -5.5% of forecast volumes then GasNet will increase average tariff levels to account for any divergence from the -5.5% bound.

[15] ACCC, *Final Approval – Revised Access Arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System*, 25 June 2008, p.97.

[16] The issue of forecasting refill volumes is discussed in more detail in section 2.3 of this draft decision.

Table 1: Port Campbell export costs under the current Access Arrangement

Withdrawal Point	Year	Transmission Refill Tariff	Withdrawal Tariff	Cross System Withdrawal Tariff	Total tariff
Iona/WUGS	2008	$0.20/GJ	None	None	$0.20/GJ
	2009	$0.05/GJ	None	None	$0.05/GJ
SEA Gas	2008	None	$0.1368/GJ	$0.1715/GJ	$0.3083/GJ
	2009	None	$0.1411/GJ	$0.1772/GJ	$0.3183/GJ

Source: data sourced from GasNet Variation Proposal, 18 December 2008, pp.9-10.

GasNet recovers higher tariffs for use of the SEA Gas connection point than for WUGS, with the disparity between the two increasing from 2008 to 2009. This is a result of transferring of responsibility for the procurement of compressor fuel gas from GasNet to VENCorp as of 1 January 2009. As noted previously, fuel gas is the principal cost involved in providing refill services. The remaining tariff of $0.05/GJ recovers the only other costs incurred by GasNet for the service of using refill storage at WUGS for later re-injection into the PTS, which include the marginal operational costs (such as maintenance). WUGS can also be used for exporting gas to South Australia and in such cases GasNet also charges the $0.05/GJ tariff as no withdrawal tariff currently exists for this distinct service.

Removal of cross system withdrawal tariff

The cross system withdrawal tariff was approved by the ACCC as part of GasNet's second Access Arrangement following a proposal from GasNet.[17] The tariff is an additional levy for carriage of gas through the Metro Zone, for withdrawals off the injection pipeline which are linked to injections at an unrelated injection point, for example, for gas injected at Longford and exported to South Australia. This levy is calculated as the Metro Zone tariff discounted for the indirect cost allocations which are already recovered from the withdrawal zones.[18]

Of relevance to this proposal, the cross system withdrawal tariff currently applies to withdrawals from the SEA Gas connection point, but only if gas is shipped from outside of the South-West Zone. The tariff recognises the additional costs of carriage across the PTS for serving a zone which is not supplied from its nearest connection point. The AER considers this tariff is consistent with section 8.38 of the Code as this tariff recognises the additional costs of transportation.[19]

[17] This was the first scheduled revision of GasNet's Access Arrangement, covering the period 2003-07.

[18] The cross system withdrawal tariff does not apply in the northern zones as the costs of transmission through the metro zone are included in the northern zone withdrawal tariff.

[19] ACCC, *Final Decision – Revised Access Arrangements by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System*, 30 April 2008, p.117.

2.3 AER considerations

Alterations to the WUGS tariff

The AER considers that if a withdrawal tariff were applied to shippers exporting to South Australia via WUGS, the $0.1411/GJ level at which this tariff has been proposed would be efficient. The tariff is the standard withdrawal tariff for the South West Zone. It is already a feature of GasNet's current access arrangement, set at a level associated with the costs of withdrawing gas from this zone. Currently, it applies to the SEA Gas connection point which, like WUGS is located in the South West Withdrawal Zone.[20] The AER is aware that a fundamental principle of the PTS tariff design is that the same tariff applies for all withdrawals from any given zone. As both connection points are in the same zone, cover the same pipeline distances and the same services are provided by GasNet at either point, in so far as they are used for exporting gas to South Australia, the AER considers that this tariff level would be efficient and is consistent with the objective in section 8.1(e) of the reference tariff principles in the Code. This is consistent with previous commentary made by the ACCC.[21]

By contrast, the current tariff structure can lead to inefficient outcomes in so far as it permits gas to be exported to South Australia via WUGS without incurring a withdrawal tariff. In such a case, shippers exporting to South Australia avoid their share of the costs of the services they receive.[22] While these shippers incur the marginal refill cost, they do not incur a transmission withdrawal cost, thereby avoiding $0.0911/GJ in charges. GasNet still recovers these operating and capital costs associated with exporting to South Australia, but are unable to allocate these costs to the appropriate shippers as no withdrawal tariff is currently assigned to these shippers. GasNet recovers these costs through tariffs that are applied to other shippers. In effect, all shippers are subsidising the services utilised by those exporting to South Australia. The AER considers that the current tariff structure is inefficient and appears inconsistent with the objective in section 8.1(e) of the reference tariff principles in the Code.

However, the AER is concerned with GasNet's proposed solution to addressing the existing anomalies in the current tariff structure. This is because the AER considers that it is not reasonable for all shippers using WUGS to be charged the same tariff which incorporates the costs of exporting to South Australia, that is, $0.1411/GJ, even if a shipper does not export to South Australia. Under the proposal, shippers using WUGS for gas storage and later re-injection into the PTS would incur two withdrawal tariffs, the first being the proposed WUGS tariff of $0.1411/GJ, and the second being a withdrawal tariff at the relevant point at which gas is later withdrawn after re-injection into the PTS. The second tariff allows GasNet to recover their share of costs associated with the transmission service, however, the first withdrawal tariff would over-recover the costs of the WUGS storage (refill) service, intended to be recovered at a marginal cost ($0.05/GJ). Applying a marginal cost tariff was deemed to provide

[20] While these are in the Port Campbell injection zone, that zone is also the South West Withdrawal Zone. WUGS is not listed within the later as currently no withdrawal tariff applies there.

[21] ACCC, *Final Decisions – GasNet Australia access arrangement revisions for the GasNet System*, 15 December 2004, p.20.

[22] This was also acknowledged by the ACCC as part of its 2004 Final Decision on revisions to GasNet's Access Arrangement.

GasNet with sufficient opportunity to recover the costs of this service in accordance with objective 8.1(a) of the reference tariff principles.[23] The AER understands that the refill tariff was set at marginal cost because the service of delivering gas into storage for later re-injection is considered merely a stage in the transportation of gas between production and use.

The AER considers that while the current tariff structure does not appear efficient from a cost allocation perspective, GasNet's proposed solution to the current tariff structure also raises competing cost allocation concerns that impact on the promotion of an efficient tariff structure, contrary to objective 8.1(e). The AER considers that the proposal is less likely to promote efficiency compared to the current structure.

In particular, the AER's concerns with GasNet's proposal are as follows. Firstly, the proposal would allocate a tariff based on the costs of exporting to South Australia to an unrelated and distinct service, that of storage for later re-injection into the PTS. Secondly, while the current tariff structure apportions the costs of exporting to South Australia across all shippers, it does not lead to a situation in which these costs are over-recovered. This is not the case under GasNet's proposal, where the costs of services associated with exporting to South Australia via WUGS would be over-recovered. Thirdly, the AER considers that the proposed cost allocation creates a disincentive for shippers to use storage in the PTS.

In relation to the incentives surrounding the use of storage, the AER recognises that storage was considered to have wider benefits to the overall operation of the PTS that justified maintenance of marginal cost pricing. Storage can be used by shippers in periods of low demand for later augmentation of supply in periods of high demand, providing competition and system security benefits.[24] Applying a marginal cost tariff to this service currently provides an incentive to the efficient use of this facility.

Additions to Price Control Formula

With regard to GasNet's proposed additions to the price control formula the AER has considered the relationship between achieving volumes greater than those forecast, and GasNet's revenue and average tariff levels. The AER notes that the accuracy of the refill forecasts can have a substantial impact given that under-forecasting volumes provides extra revenue to GasNet (subject to the 5.5% bound). This issue has already been reviewed as part of the last revision to GasNet's access arrangement undertaken by the ACCC.[25] At that time the ACCC decided that refill volumes should be excluded from the price control formula as GasNet was unable to demonstrate that they could accurately forecast these volumes and their volatility from year to year.[26] As part of an amendment to the access arrangement revisions required by the ACCC, the tariff was kept outside of the price control formula and at a level equal to the forecast marginal cost of providing refill services.

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[23] ACCC, *Final Decision – Revised access arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System*, 30 April 2008, p.152.

[24] ACCC, *GasNet Australia Access Arrangement Revisions for the GasNet System*, 15 December 2004. pp.17-22.

[25] ACCC, *Final Approval – Revised Access Arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System*, 25 June 2008, p.21.

[26] ACCC, *Draft Decision – Revised Access Arrangement by GasNet Australia Pty Ltd for the Principal Transmission System*, 14 November 2007, pp.144-145.

The AER considers that there is still inherent difficulty for GasNet in forecasting refill volumes. For example, since the last access arrangement revision in 2008, GasNet's forecast of 0.5PJ/yr for refill volumes has proven to be significantly under forecast for the 2008 year, with achieved volumes being approximately 4.7PJ.[27] GasNet have now revised their annual forecast to less than half of the volume achieved in 2008. [28] The fact that this forecast is set at a constant yearly level for the remaining years of the access arrangement period is further evidence of the inherent difficulty involved. [29]

The AER has analysed revenue outcomes associated with the proposed amendments to the price control formula by modelling a number of scenarios using different volume outcomes. The AER acknowledges that if current forecasts are achieved, GasNet appears to be revenue neutral when compared with the current tariff structure. However, the AER is aware of the possibility of material revenue upside to GasNet, greater than the marginal cost currently recovered if refill volumes prove to be under-forecast.[30] While the likelihood of this occurring in this access arrangement period appears unclear, it would occur if GasNet was to experience volume shortfall elsewhere in the PTS. Under such a scenario, the AER estimates that the possible revenue up-side to GasNet could be an estimated annual average of $0.47 million for every PJ under-forecast. This would be significantly higher than the revenue GasNet would earn from 1 PJ of refill volume charged at a marginal cost outside of the price control formula, which equates to approximately $0.05 million/PJ.[31]

As such the AER is not satisfied that GasNet has made a case to depart from the current access arrangement. Under the current access arrangement, GasNet are still provided the opportunity to recover the costs of delivering storage services at WUGS consistent with objective 8.1(a).[32] However, the inclusion of the refill tariff into the price control further exacerbates the concerns associated with the promotion of an efficient tariff structure as highlighted above. GasNet are recovering the costs associated with exporting to South Australia via WUGS, albeit not being able to apportion them appropriately. In contrast, introducing an element of inherent forecasting difficulty, which evidence suggests has often led to a situation of under-forecast volumes could provide substantial revenue gains to GasNet. Under these circumstances, there would be an inefficient tariff structure, contrary to objective 8.1(e) of the reference tariff principles, as it would produce higher tariffs than are necessary to recover the efficient costs.

Equalising tariffs – WUGS & SEA Gas

The AER has also considered the merits of GasNet's overall goal of achieving tariff equality between WUGS and the SEA Gas connection points. In doing so, the AER's consideration has focussed on the nature of the services for which tariff equality is intended, and the manner in which equality is being proposed to be achieved.

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[27] APA, *Access Arrangement Information*, 1 January 2008, p.21., & GasNet, *Application for Annual Tariff Variation*, 17 November 2008, p.8.

[28] GasNet, *Email correspondence – GasNet to AER*, 24 February 2009.

[29] GasNet have confirmed to the AER that there is inherent difficulty in forecasting these volumes – GasNet, *Email correspondence – GasNet to AER*, 4 March 2009.

[30] Vice-versa, there is possible revenue downside to GasNet if they have over-forecast volumes.

[31] Both of these figures are expressed in 2006$.

[32] ACCC, *Final Decision – Revised access arrangement by GasNet Australia (Operations) Pty Ltd and GasNet (NSW) Pty Ltd for the Principal Transmission System*, 30 April 2008.

The AER considers that the equalisation of tariffs does not recognise the difference in services provided by means of the SEA Gas and WUGS connection points. As it stands, GasNet's proposal seeks to apply the $0.1411/GJ tariff, currently applying to users of the SEA Gas connection point to all users of WUGS. The AER notes that there are two distinct uses of WUGS, exporting to South Australia and storage for re-injection into the PTS. As discussed previously it is inappropriate to apply this withdrawal tariff to the latter.

However, the AER considers that if the $0.1411/GJ tariff was being proposed to be equalised between WUGS and the SEA Gas connection points for the service of exporting gas to South Australia, then it is likely that this approach would be more acceptable. In such a case, the merits would hinge on the question of what level of tariff would be consistent with the efficient costs of providing the relevant service. GasNet proposes to apply the standard withdrawal tariff for the South West Zone to WUGS. This tariff currently applies to the SEA Gas connection point and the AER understands that shippers seeking to export via either facility receive essentially the same service from GasNet as the withdrawal points are located close to each other.[33] As considered by the ACCC as part of earlier revisions to GasNet's Access Arrangement in 2004, the South West Zone tariff was calculated on the same cost reflective basis as most other tariffs in the access arrangement. Further, as previously noted, a fundamental principle of the PTS tariff design is that the same tariff applies for all withdrawals from a given zone.[34]

The AER considers that if the service in question was one of simply exporting gas to South Australia then applying the standard withdrawal tariff for the South West Zone of $0.1411/GJ would be consistent with objective 8.1(e) of the reference tariff principles as the tariff would be underpinned by the efficient costs of providing the service. However, GasNet's proposal attempts to equalise tariffs for different services provided at these facilities where the tariff does not distinguish between the service of using WUGS for export to South Australia or storage for later re-injection into the PTS.

Removal of cross system withdrawal tariff

Finally, the AER has considered the merits of removing the cross system withdrawal tariff. If the tariff were removed, shippers transporting gas to the SEA Gas connection point from outside of the South West Zone would no longer incur a tariff that reflects the costs of cross system transportation and would be charged the same as shippers transporting gas within the zone. Section 8.38 of the Code requires that to the maximum extent possible the portion of all the revenue that a reference tariff should be designed to recover should reflect the costs incurred that are directly attributable to the reference service. Removing this tariff would mean that shippers transporting across the system would not be charged their share of the costs relevant to the service they receive.

Furthermore, for GasNet to recover these cross system transportation costs, the costs would have to be recovered from all shippers, which reduces the cost reflective nature

[33] ACCC, Final Decisions – GasNet Australia access arrangement revisions for the GasNet System, 15 December 2004. pp.17-22.

[34] Ibid.

of the tariffs, contrary to objective 8.1(e) of the reference tariff principles. The AER acknowledges however, that the effect on shippers via average tariff increases is likely to be minor. Analysis undertaken by the AER estimates that with acceptance of the proposal, removal of this tariff would lead to annual increases in average tariffs of approximately 0.1% over the access arrangement period.[35]

GasNet have not provided reasons for why this tariff should be removed, other than the fact that it would equalise tariffs. The removal of this tariff appears unclear and the AER considers that this would not be compliant with the reference tariff principles, in particular, section 8.38 of the Code.

2.4 Submissions

The AER received two submissions with regard to GasNet's proposed variation, one each from AGL and TRUenergy.[36]

AGL Submission

AGL's submission supported the variation proposal. AGL indicated that the proposal would have the benefit of delivering efficient tariffs that are non-distortionary, while at the same time ensuring that lower prices are delivered. The AER does not agree with AGL's view. The AER acknowledges that GasNet's proposal would decrease the tariff at the SEA Gas connection point from its current figure of $0.3183/GJ to $0.1411/GJ. However, this is due to GasNet proposing to remove the cross system withdrawal tariff. The AER considers that for the reasons discussed in section 2.3, this would not lead to efficient tariffs, and would have distortionary effects because GasNet would need to recover these cross system transportation costs from all shippers.

Further, AGL indicated that parties who have entered into long-term contracts on the expectation of the previous tariff arrangements are not financially disadvantaged, but did not substantiate why they believed this to be the case.

TRUenergy submission

TRUenergy's submission opposes GasNet's proposal, indicating that it would create tariff uncertainty for shippers. TRUenergy have also submitted that the weighted average cost of capital (WACC) parameters applying to GasNet should be altered, therefore requesting that the AER undertake a broader assessment of GasNet's Access Arrangement. These points are considered below.

Regulatory certainty:

In its submission TRUenergy states that:

> "the proposed variation creates tariff uncertainty for all major gas shippers. A more stable tariff regime (without major tariff variations) during a five-year access arrangement period would be more consistent with best practice regulation".

[35] Based on the assumption that the cost is uniformly apportioned across all tariffs.
[36] The submissions dated 19 February 2009 are available on the AER website: [http://www.aer.gov.au]

Rule 65 of the NGR enables a service provider to submit to the AER a proposal for variation of the applicable access arrangement at anytime during the course of an access arrangement period. As such, shippers should be aware that changes are not limited to ‘trigger-events’ or other pass-through mechanisms set in an access arrangement and that changes to reference tariffs may occur at any point during an access arrangement period.

WACC:

In its submission TRUenergy states that:

> “the changes in the prevailing conditions in the market for funds since the rate of return was set have been so substantial that the reference tariff principles in section 8 no longer apply”.

Furthermore, TRUenergy state that the AER should request amendments that:

> “re-adjust the WACC and make the necessary changes to the building block revenues”.

The assessment of matters beyond those proposed in an access arrangement revision has been the subject of a number of revisions under the Code.[37] However, the AER is now guided by the NGR in how it should make decisions on access arrangement variation proposals. According to rule 59(2), an access arrangement draft decision:

… indicates whether the AER is prepared to approve the access arrangement proposal as submitted and, if not, the nature of the amendments that are required in order to make the proposal acceptable to the AER.

Similarly, according to rule 62(2), an access arrangement final decision is:

…a decision to approve, or to refuse to approve, an access arrangement proposal.

Rules 59(2) and 62(2) direct the AER to make a decision on the service provider’s access arrangement proposal by responding to that proposal. In making this decision, the AER is confined to analysing the matter being proposed, in this case by GasNet. Any re-adjustment of the WACC parameters is a separate and distinct matter from that pertaining to the tariff variation proposed by GasNet and is not a matter that GasNet have included in their proposal. As such the AER considers that TRUenergy’s request is not relevant to the variation proposal and is unable to form part of the AER’s draft decision.

Furthermore, the AER has clearly indicated in its Explanatory Statement that the outcome of the WACC review applies only to electricity determinations and has no direct or formal applicability to gas access arrangements.[38] TRUenergy has correctly highlighted that in this same document the AER has also stated that it may use the outcome of this review for consideration of WACC issues in future gas access

[37] ACCC, *Final Decision - Access Arrangement for the Principal Transmission System, Application for Revision by GPU GasNet Pty Ltd,* 28 April 2000., &, ACCC*, Final Decision - Access Arrangement for the Principal Transmission System, Application for Revision by GPU GasNet Pty Ltd., South west pipeline,* 29 June 2001.

[38] AER, “*Explanatory Statement – Electricity transmission and distribution network service providers, Review of the weighted average cost of capital (WACC) parameters”*, Australian Energy Regulator, December 2008. P.21

arrangement reviews. While this may be a future possibility, the AER has not undertaken a detailed study of the application of the WACC parameters to gas access arrangements in Australia. As well, the WACC review for electricity transmission and distribution network service providers is scheduled to be completed by the AER by 1 May 2009, after the release of this draft decision.

2.5 Overall assessment

The AER has considered each specific component of GasNet's proposal. The AER also agrees that a solution be sought to the current situation in which shippers are able to export gas to South Australia via WUGS without incurring a withdrawal tariff that is equal to that currently applying to the SEA Gas connection point.

However, the AER is of the opinion that the manner in which GasNet has sought to address the current situation raises a number of concerns which, when compared to the current access arrangement, are unlikely to achieve a set of reference tariffs that best promote the 8.1 objectives under the Code. By proposing to apply the $0.1411/GJ tariff currently applying to the SEA Gas connection point, to all users of WUGS, GasNet has in effect sought to equalise tariffs for services that are different in nature. Allocating a tariff associated with the costs of exporting to South Australia to shippers seeking gas storage at WUGS for later re-injection to the PTS would over-recover for the use of services that are being provided by the use of that facility. While the current tariff structure apportions costs of exporting to South Australia across all shippers, posing a cost allocation concern, it does not lead to a situation in which these costs are over-recovered by GasNet. Therefore, the AER considers that applying the $0.1411/GJ tariff to all users of WUGS is less likely to promote objective 8.1(e) of the reference tariff principles. Furthermore, the AER is also mindful of the wider benefits that storage provides to the overall operation of the PTS and considers that accepting this component of the proposal could provide a disincentive to the use of this facility.

The AER acknowledges that if the proposal had sought to equalise tariffs applying to the SEA Gas connection point and WUGS for exporting to South Australia, then it is likely that such a proposal would have merit. Under such a scenario, applying the standard withdrawal tariff for the South West Zone as proposed by GasNet would have been valid and consistent with objective 8.1(e).

Also, the AER considers that there is no significant reason to warrant a departure from the current access arrangement in which refill is excluded from the price control formula and kept at marginal cost. The current access arrangement provides GasNet with the opportunity to recover the costs of delivering services associated with refill at WUGS consistent with objective 8.1(a) and GasNet are also able to recover the costs associated with exporting to South Australia via WUGS consistent with objective 8.1(a). Introducing an element of inherent forecasting difficulty, which has often led to the under-forecasting of volumes could provide substantial revenue upside to GasNet, in-turn leading to inefficient tariffs inconsistent with objective 8.1(e) of the reference tariff principles.

Finally, the AER considers that the removal of the Cross System Withdrawal Tariff is at odds with the cost reflectivity objective of GasNet's Access Arrangement, which is consistent with section 8.38 of the reference tariff principles in the Code.

3 Draft decision

As set out in this draft decision the AER proposes not to accept GasNet's variation to its Access Arrangement. While some concerns with the current situation are highlighted, the AER considers that these are outweighed by concerns with the manner in which GasNet have proposed to address the current situation. In particular:

a. The AER does not support altering the WUGS tariff from $0.05/GJ to $0.1411/GJ and applying this tariff to all users of WUGS as this would be inconsistent with objective 8.1(e).

b. The AER considers there would be merits in the overall goal of achieving equality in tariffs between WUGS and SEA Gas, if tariff equality was being sought only for the use of these facilities for the similar service of exporting to South Australia. Under such a scenario, the AER considers it would be consistent with objective 8.1(e) to apply the standard withdrawal tariff for the South West Zone of $0.1411/GJ. However, WUGS provides additional services to the PTS which is a distinguishing factor in considering the equalisation of tariffs between the two connection points.

c. The AER does not support inclusion of the WUGS tariff and the volumes and revenues associated with refill services into the price control formula. Given the inherent difficulty in forecasting refill volumes, the AER is unaware of any significant reason to warrant departure from the current access arrangement under which refill is excluded and kept at marginal cost. The current access arrangement is considered to be consistent with objective 8.1(a) in that GasNet are able to recover the efficient costs associated with WUGS services.

d. The AER does not support the removal of the Cross System Withdrawal Tariff. The proposal to remove this tariff appears unclear given the cost reflectivity objective of this current feature of GasNet's Access Arrangement, which is consistent with section 8.38 of the principles.

The AER recognises GasNet's concerns with the current tariff structure in so far is it permits gas to be exported to South Australia via WUGS without incurring a withdrawal tariff, and supports a definitive resolution of this matter. The AER would consider more favourably a proposal which effectively unbundled the services provided via WUGS so that GasNet's proposed tariff of $0.1411/GJ could be applied to shippers using the SEA Gas connection point or WUGS, solely for the service of exporting Gas to South Australia and not storage for later PTS re-injection. However, the AER notes that concerns with the other elements of the proposal would remain.

Glossary

ACCC	Australian Competition and Consumer Commission
Access Arrangement	An arrangement setting out terms and conditions about access to pipeline services provided or to be provided by means of a pipeline
AER	Australian Energy Regulator
APA Group	Australian Pipeline Trust
Code	National Third Party Access Code for Natural Gas Pipeline Systems
GasNet	APA GasNet Australia Pty Ltd
GJ	Gigajoule (one thousand million joules)
NGL	National Gas Law
NGR	National Gas Rules
PJ	Petajoule (equal to one million gigajoules)
PTS	Principal Transmission System
Reference Tariff	Means a tariff specified in an access arrangement as corresponding to a reference service
Service provider	A person who owns, controls or operates the whole or any part of the pipeline or proposed pipeline
transitional Code provisions	Sections 3, 8 and 10.8 of the Code
VENCorp	Victorian Energy Networks Corporation
WACC	Weighted Average Cost of Capital
Withdrawal Point	A connection point at which gas may be withdrawn from the PTS.
WUGS	Western Underground Gas Storage facility