21 June 2012

Mr Sebastian Roberts
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Submitted by email: VicGAAR@accc.gov.au

Dear Mr Roberts

APA GASNET 2013-17 ACCESS ARRANGEMENT PROPOSAL

Origin Energy Limited (Origin) welcomes the opportunity to comment on APA GasNet's proposed revisions to its Access Arrangement for the Victorian Transmission System (VTS) to apply from 1 January 2013 to 31 December 2017 (the Proposed Access Arrangement).

Our key comments on the Proposed Access Arrangement relate to APA GasNet's forecasts of capital expenditure and demand and the consequence of these for tariffs.

1. Forecast Capital Expenditure

a) Level of Expenditure

APA GasNet proposes significant forecast capital expenditure amounting to $364.3 million over the Access Arrangement period.[1] The majority of this ($289.1 million or approximately 79 percent of total capital expenditure) takes the form of augmentation capital expenditure to increase the capacity of transmission assets. This augmentation expenditure is allocated entirely to the first three years of the Access Arrangement period.

On an opening capital base of $620.6 million in 2013[2], total forecast capital expenditure over the Access Arrangement period equals approximately 59 percent of this amount. When depreciation is also included, this represents an approximate 38 percent increase in the closing capital base from 2012 to 2017.

Origin questions this considerable level of capital expenditure given it occurs in a time of only moderate forecast demand growth. As shown in the below table, the depressed demand over the previous Access Arrangement period is forecast to continue into the first two years of this Access Arrangement period. There is then a moderate increase in average demand over the final three years of the Access Arrangement period.

[1] APA GasNet 2012, *Access Arrangement Information*, March, p. 10. We note the Access Arrangement Submission and Access Arrangement Information contain four tables for forecast capital expenditure: table 6.5 on p. 92 and table 7.5 on p. 125 of the Submission and table 3.3 on p. 9 and table 3.4 on page 10 of the Information. Each table contains different capital expenditure figures. While we have elected to refer to table 3.4 of the Information in our submission, it is confusing that there are a number of tables and no clear explanation for the differences between each table. This does not help interested stakeholders, and presumably also the Australian Energy Regulator (AER), with their assessments of the Proposed Access Arrangement.

[2] APA GasNet 2012, *Access Arrangement Information*, March, p. 12

Origin Energy Limited ABN 30 000 051 696 • Level 45, Australia Square, 264-278 George Street, Sydney NSW 2000
GPO Box 5376, Sydney NSW 2001 • Telephone (02) 8345 5000 • Facsimile (02) 9252 9244 • www.originenergy.com.au

Table: Average demand (actual for 2008 to 2011, forecast for 2012 to 2017)[3]

TJ/day	2008	2009	2010	2011	2012F	2013F	2014F	2015F	2016F	2017F
Average	675	645	648	651	655	615	614	645	657	664

We urge the AER to examine closely APA GasNet's proposed level of capital expenditure, particular augmentation expenditure, against this demand profile. Rule 79 of the National Gas Rules sets out specific criteria for assessing whether new capital expenditure conforms and can hence be included in the regulated capital base. Significant capital expenditure with no commensurate increase in demand does not on face value appear justifiable against Rule 79.

As an example, significant augmentation expenditure of $158.1 million is assigned to the Gas to Culcairn Project, which aims to expand South West Pipeline and Northern Zone capacity.[4] APA GasNet notes this project is at the request of shippers in order to increase the injection capacity of the South West Pipeline as well as the capacity of the system for withdrawals at Culcairn. It also suggests this project is warranted under Rule 79(2)(a) as the overall economic value of the project is positive.

The justification for the substantial amount of capital expenditure for this project is not immediately apparent from the Access Arrangement Submission. That shippers have requested the project does not in and of itself demonstrate its positive economic benefit. The limited public information provided in the Access Arrangement Submission makes it difficult for stakeholders to assess the amount of capital expenditure allocated to this project in order to understand the validity of APA GasNet's proposal that it is conforming capital expenditure.

Any capital expenditure needs to be supported by a robust business case that takes account of prevailing and future expected market conditions. As a starting point, the appraisal of any augmentation capital expenditure should consider both forecast demand for the particular project and the level and viability of committed gas volumes to supply that demand. Other factors specific to each proposed project should then be included. For example, an analysis of APA GasNet's auction of Authorised Maximum Daily Quantity Credit Certificates for the South West Pipeline expansion that was held in early-mid 2011 would be an appropriate input into the AER's assessment of the Gas to Culcairn Project.

b) Timing of Expenditure

As a sub point to the overall amount of capital expenditure, Origin also suggests the AER examine the timing of the capital expenditure. We noted above that all augmentation capital expenditure is allocated to the first three years of the Access Arrangement period. Of this amount, the majority ($289.1 million or 79 percent of the total expenditure over the Access Arrangement period) is allocated to 2014 alone.[5] This is largely because construction will commence or be completed in this single year for each of APA GasNet's five proposed augmentation projects. In addition to our reservations about the overall level of expenditure, Origin also questions the feasibility of such a concentration of expenditure in a single year. We ask that the AER carefully consider whether this pattern of expenditure is manageable and whether it may be more appropriate to prioritise projects in order to smooth augmentation expenditure over the period.

[3] APA GasNet 2012, *Access Arrangement Information*, March, p. 5 and 15
[4] APA GasNet 2012, *Access Arrangement Submission*, March, p. 96
[5] APA GasNet 2012, *Access Arrangement Information*, March, p. 10

c) Impact on Tariffs

The considerable growth in capital expenditure is a key driver behind the significant increase in transmission tariffs over the Access Arrangement period. As noted above, there is limited information available for stakeholders to undertake a comprehensive assessment of forecast capital expenditure themselves in order to understand the justification and feasibility of the amount proposed. Subsequently, stakeholders cannot be certain that the proposed tariffs are justified and hence, efficient.

Origin acknowledges APA GasNet cannot include all the details to support its forecast capital expenditure in the public part of its Access Arrangement Submission due to the commercially sensitive nature of some of this information. Given this, stakeholders need an assurance that the AER will conduct a thorough examination of APA GasNet's proposed capital expenditure, particularly against the forecast demand profile. Accepting the need to preserve commercial confidence, the AER's Draft Report needs to outline sufficiently its considerations and decisions in this area. This will give stakeholders the confidence that a robust assessment has been made on behalf of pipeline users and that any decisions made align with the National Gas Objective. As capital expenditure flows through to tariff levels, we need to be assured that any increase forecast capital expenditure and the resultant increase in tariffs are in the long term interests of consumers.

2. Forecast Demand

a) Forecast Volumes

A second important factor used to derive tariffs is APA GasNet's volume forecasts. For the majority of gas demand, APA GasNet uses the forecasts prepared by the Australian Energy Market Operator (AEMO) as part of the AEMO annual planning processes. It notes, however, that the AEMO forecasts do not address all gas flows through the VTS. As such, it supplements these forecasts with its own estimates of: interstate gas transfers; storage refill volumes; and annual and peak day volumes associated with gas-fired power generators.[6]

The unclear justification for APA GasNet's forecast capital expenditure over the Access Arrangement period leads us to also question how APA GasNet formulates its forecast demand, including the structure of that demand across the VTS. This is particularly pertinent for those areas where it supplements AEMO's forecasts with its own.

This concern is compounded when a comparison is made of APA GasNet's forecast volumes against the actual volumes that transpired over the previous Access Arrangement period (i.e. from 2008 to 2012).[7] For example, actual volumes have exceeded forecast volumes on a year-on-year basis for the Culcairn withdrawal point. In 2011, actual annual exports exceeded forecast annual exports by approximately 3.16 PJ. As a result, APA GasNet was able to recover significant excess revenue over its regulated return for this one point. This trend at Culcairn is likely to continue as to date this year, actual volumes have been higher than forecast volumes.

[6] APA GasNet 2012, *Access Arrangement Submission*, March, pp. 60-61

[7] APA Group 2008, *GasNet Australia Access Arrangement Information*, June, p. 20; APA GasNet 2012, *Access Arrangement Submission*, March, p. 54

b) Impact on Tariffs

A regulated asset owner should be limited in its ability to recover either more or less than its regulated return for providing a regulated service. Forecast demand is an important driver of tariffs and hence APA GasNet's revenue earning capacity over the Access Arrangement period.

As explained in the above Culcairn example, as actual volumes exceed forecast volumes, APA GasNet is able to recover excess revenue especially as tariffs increase annually. Given APA GasNet has a regulated rate of return, then an increase in volume at a point should precipitate a reduction in the tariff to achieve the same net revenue. This warrants investigation by the AER.

Origin's ability to review APA GasNet's forecast demand for the VTS is limited to a comparison with our estimates of our own portfolio demand. We cannot comprehensively assess the appropriateness of its forecasts as we do not have the full complement of VTS demand information outside of our own portfolio. As such, we ask that the AER focus on verifying the accuracy of APA GasNet's forecast demand both in aggregate and across the range of points in the VTS. Similar to our earlier comments on the AER's review of forecast capital expenditure, we ask that the AER provide sufficient detail of its considerations and decisions in relation to forecast demand in its Draft Report. This will assure stakeholders of the efficient pricing of APA GasNet's tariffs in the long-term interests of consumers.

3. Further Discussions

Should you have any questions or wish to discuss this information further, please contact Hannah Heath (Manager, Regulatory Policy) on (02) 9503 5500 or hannah.heath@originenergy.com.au.

Yours sincerely,

Phil Moody
Group Manager – Commercial, Analysis and Risk Services
Energy Risk Management