

10 February 2006



Mr Sebastian Roberts
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Dear Mr Roberts,

Re: GasNet Australia – Application under section 21 of the Gas Code in relation to forecast New Facilities Investment

TRUenergy welcomes the opportunity to comment on the GasNet's application under Section 8.21 of the Gas Code. TRUenergy endorses GasNet's application under the Gas Code to develop the Corio Loop on the basis it will deliver benefits to the market. In support of this endorsement, please find enclosed a detailed submission.

Further information or clarification on this submission should be directed to Mr Con Noutso, Manager Regulation (Access), at TRUenergy on telephone (03) 8628-1240 or at- Level 32,385 Bourke St Melbourne Vic 3000.

Yours Sincerely,

A handwritten signature in black ink, appearing to read 'Rod Sparkes', written over a light blue horizontal line.

Rod Sparkes
Manager Gas Portfolio

GasNet Australia – Application under section 8.21 of the Gas Code in relation to forecast New Facilities Investment

A. Executive Summary

TRUenergy supports GasNet's application seeking the ACCC's agreement under section 8.21 of the National Third Party Access Code for Natural Gas Pipelines (Gas Code) that actual and forecast New Facilities Investment for the Corio Loop meets the requirements of section 8.16 (a) of the Gas Code.

The key reasons for TRUenergy's support are as follows:

1. Section 8.21 of the Gas Code gives the ACCC the discretion to provide that actual and forecast New Facilities Investment proposed by a Service Provider meets the requirements of Sect 8.16 (a).
2. It is appropriate for the ACCC to take account of the regulatory precedent applied by other regulators (ESC in Victoria and OFFGAR in WA) in applying Sect 8.21 of the Gas Code.
3. GasNet's application under section 8.21 of the Gas Code satisfies Section 8.16 (a) of the Gas Code. In particular;
 - a) Section 8.16 (a) (i) of the Gas Code - the prudence test is satisfied in GasNet's application.
 - b) Section 8.16 (a) (ii) (b) – system wide benefit test is satisfied in GasNet's application on the basis the 'net market benefit' test applied by VENCORP represents an appropriate interpretation of the 'system wide benefits' test.
4. VENCORP, as an impartial entity has independently supported the "Net Market Benefit" of the proposed project. The key assumptions applied in the financial modelling used to determine the 'net market' benefit test for the Corio Loop by VENCORP are 'reasonable.' This means that the ACCC can rely on the conclusions (quantification of the system wide benefits) of the test itself put forward by GasNet in this application.
5. The 'net market' benefits test applied by VENCORP for the Corio Loop demonstrates system wide benefits to all customers based on the criteria applied by the ACCC in previous regulatory decisions. Whilst some customers might gain more benefits than others, all customers benefit. The criteria applied by the ACCC to determine whether there are system wide benefits to all customers were established in the Interconnect decision¹ and the southwest pipeline decision². Based on the principles applied in these decisions it is clear that;
 - (a) the benefits of the Corio Loop are significant and system wide, and
 - (b) there is no requirement for all parties to benefit equally.
6. The cost recovery mechanism described as Option 2 by GasNet represents a reasonable approach to recovering the costs for the Corio Loop.
7. The tariff solutions provided by GasNet in its application to the AER are acceptable subject to our proposal that the specific tariff for the south west pipeline should be re-adjusted marginally in the 2008-2012 access period in accordance with Section 8.1 (a) of the Gas Code to ensure that there is no over recovery on this section of the network

¹ Access Arrangement for the Principal Transmission System – Application for revision by GPU GasNet Pty. Ltd. 28 April 2000.

² Access Arrangement for the Principal Transmission System – Application by for Revision by GPU GasNet Pty. Ltd – South West Pipeline 29 June 2001

B. Detailed Issues

1. Section 8.21 of the Gas Code clearly provides the regulator with the discretion to provide that forecast or New facilities Investment proposed by a Service Provider meets the requirements of Sect 8.16 (a), the effect which is to bind the relevant regulator's decision when it considers revisions to its access arrangement submitted by GasNet at its next review.

TRUenergy agrees with GasNet that Section 8.21 of the Gas Code provides the regulator with the discretion to agree that New Facilities Investment or Forecast Facilities Investment meets the requirements of Section 8.16 (a), the effect being to bind the regulator at the when considering revisions at the next access arrangement. Section 8.21 of the Gas Code states;

" The relevant regulator may at any time and at its discretion agree (with or without conditions or limitations) that actual New Facilities Investment by a Service Provider meets, or forecast New Facilities Investment proposed by a service provider will meet, the requirements of Section 8.16 (a) the effect of which is to bind the relevant Regulator's decision when the relevant regulator considers revisions to an access arrangement submitted by the Service Provider. Before giving any agreement under this section 8.21, the relevant regulator must conduct public consultation in accordance with the requirements for a proposed revision to the Access Arrangement submitted under section 2.28. For the avoidance of doubt, if the relevant regulator does not agree under this section that the New Facilities Investment meets, or(in the case of New Facilities Investment) will meet, the requirements of section 8.16 (a), the relevant regulator may consider whether those requirements are met when it consider revisions to an Access Arrangement submitted by the Service Provider."

TRUenergy submits that are two key parts of Section 8.21 that allow the ACCC to grant this binding agreement under section 8.21 of the Gas Code.

- (a) It provides that "*the regulator may at any time at its discretion agree*" that Actual or Forecast New Facilities Investment meets the requirements of 8.16 (a). TRUenergy suggests that this allows the ACCC to exercise its discretion at any time during the access arrangement period.
- (b) TRUenergy agrees that the outcome of granting an agreement under section 8.21 " *is to bind the relevant regulators decision when the relevant regulator considers revisions to an Access Arrangement submitted by the Service Provider.*" This provides the regulatory certainty required by GasNet to undertake the Corio Loop before the 2008-2012-access arrangement review.

2. It is appropriate for the ACCC to take account of the regulatory precedent applied by other regulators (ESC in Victoria and OFGAR in WA) in applying Sect 8.21 of the Gas Code.

Section 8.21 of the Gas Code provides more certainty to the ACCC that it has the discretion to provide that forecast and actual New Facilities Investment proposed by GasNet for Corio Loop satisfies Sect 8.16 (a) of the Gas Code the effect which is to bind the regulator when it considers its revisions to its access arrangement submitted by GasNet at its next review.

TRUenergy submits that a number of agreements have been reached under section 8.21 of the Gas Code between gas distributors in Victoria and the ESC. Furthermore, a decision by the Office of Gas Access Regulation under section 8.21 of the Gas Code applied to Alinta has also decided that certain FRC implementation costs would meet the requirements of section 8.16 (a) of the Gas Code.

These regulatory precedents give the ACCC more comfort in applying section 8.21 in the manner requested by GasNet, given other regulators have applied section 8.21 of the Gas Code in this way. For example:

- (a) The ESC decided that Multinet's Yarra Valley gas extension agreed project costs of \$13.5M, plus a 10% margin, would meet the requirements of for roll-in under section 8.21 of the Gas Code.
- (b) OFFGAR decided the capital costs of \$12M for FRC meet section 8.16 (a) of the Gas Code under Section 8.21. It then specifically points that ³ "*the effect of my agreement of these*

³ Final Decision: recovery of FRC Costs – The Mid-West and South West Gas Distribution Networks; The Independent Gas Pipelines Access Regulator. Page1

" On 26 June 2003, AlintaGas Networks Pty. Ltd applied in writing seeking that "I exercise my discretion and agree, under section 8.21 of the Gas Code that the capital costs amounting to approximately \$12M of developing systems associated with the introduction of FRC in WA meet the requirements of section 8.16 of the Gas Code. The effect of my agreement of these costs would be to bind the Regulator's decision when the Access Arrangement is reviewed so that the agreed costs will be included in the capital base of the pipeline system with the result that distribution tariffs will increase from the time that AGN's reviewed access arrangement is approved".

costs would be to bind the regulator's decision when the next access arrangement is reviewed".

3. GasNet's application under section 8.21 of the Gas Code that the Corio Loop extension satisfies Section 8.16 (a) of the Gas Code is satisfied in this application subject to some minor adjustments. Both Sect. 8.16 (a) (i) – the prudency test & Section 8.16(a)(ii) (b) – system wide benefits need to be satisfied to comply with Section 8.16 (a).

(a) Section 8.16 (a) (i) of the Gas Code - the prudency test is satisfied.

TRUenergy agrees with GasNet that there are two parts to satisfying the section 8.16 (a) (i) of the Gas Code—the prudency test. That is;

(i) The New facility is an appropriate option for achieving the additional services

The 'net benefit' test undertaken by VENCORP that models the market benefits of a range of options demonstrate that the Corio Loop is an appropriate solution to address the impending shortfall in linepack for the Principal transmission system.

(ii) The level of investment is prudent

The Prudency Test requires the ACCC to determine whether the constructions costs associated with the Corio Loop are 'reasonable'. GasNet seeks the approval of \$70.3m dollars for the Corio Loop.

(b) Section 8.16 (a) (ii) (b) – system wide benefit test is satisfied in GasNet's application because the 'net market benefit' test represents an appropriate interpretation of the 'system wide benefits test.'

The 'net market benefit' test applied by VENCORP⁴ represents an appropriate interpretation of the 'system wide benefits' test under Section 8.16 (a) (ii) (B) on the basis that it deals with the same issues that constitute system wide benefits captured in regulatory decisions by the ACCC in the past. That is, it provides a clear methodology to capture;

- (i) System security benefits through incremental linepack, and
- (ii) Competition benefits from multiple sources of gas.

which constitute 'system wide benefits' as determined by the ACCC in past regulatory decisions. Page 42 of the Interconnect decision⁵ describes how the ACCC assessed the system wide benefits by capturing system security benefits & benefits from increased competition of the interconnect assets. Finally, page 47 of the SWP decision, details the Commission's assessment of system wide benefits by capturing system security benefits & benefits from increased competition. VENCORP has independently assessed that both have been captured in the project proposed in GasNet's application.

4. VENCORP, as an impartial entity has independently supported the "Net Market Benefit" of the proposed project. The key assumptions applied in the financial modelling used to determine the 'net market' benefit test for the Corio Loop by VENCORP are 'reasonable.' This means that the ACCC can rely on the conclusions (quantification of the system wide benefits) of the test itself put forward by GasNet in this application.

The reliability of the 'net market benefit' test applied by VENCORP is further strengthened by the 'reasonableness' of the assumptions made in the modelling. The key assumptions that underpin the reliability of the modelling results in the test include:

- The demand forecasts used to predict system demand on the South West Pipeline from 2005 to 2012 used in the net market benefit test were independently produced by the National Institute of Economic & Industry Research (NIEIR).
- The frequency and magnitude of the involuntary curtailment arising from inadequate network capability used to capture market benefits has been determined using VENCORP's independent mass balance model. VENCORP has also determined the probability of these events under the different growth scenarios.

⁴ VENCORP – Major System Augmentation Report for Victorian Principal transmission System – November 2005.

⁵ Access Arrangement for the Principal Transmission System – Application for revision by GPU GasNet Pty. Ltd. 28 April 2000.

- The reductions in involuntary load curtailment due to a supply failure used to capture market benefits have been determined using VENCORP mass balance model. The probability of curtailment due to a supply failure was based on an independent study of Charles River Associates (CRA).
- The Value of Customer Reliability (VCR) applied in the modelling to capture market benefits was determined by independent consultants McLennan, Magasanik and Associates.
- The sensitivity testing used applied to the modelling shows that in all cases the Corio Loop has both a considerably higher net market benefit than the Longford Loop. (p.37 of report)

5. The 'net market' benefits test applied by VENCORP for the Corio Loop demonstrates it provides system wide benefits to all customers based on the criteria applied by the ACCC in regulatory decisions on this issue. Whilst some customers might gain more benefits than others, all customers benefit. The criteria applied by the ACCC to determine whether there are system wide benefits to all customers were established in the Interconnect decision⁶ and the South West Pipeline⁷ decision. Based on the principles applied in these decisions;

(a) The benefits of the Corio Loop are significant and system wide.

(i) -significant benefits

The independent planner VENCORP has determined the Corio Loop option delivers the largest benefits (compared to a range of other options). It delivers a market benefit of \$93.1M. This represents a significant benefit to the market.

(ii) –system wide benefits to all customers

GasNet's application to the ACCC outlines the range of benefits that will accrue to all customers if the Corio Loop is built. On p. 16 of its application it outlines the main system wide benefits that arise from the Corio Loop including improved system capability, enhanced system capability, and competition benefits. A key question that needs to be addressed is whether the Corio Loop provides system wide benefits to all customers.

The precedent from the Interconnect decision and the SWP decision outline the criteria the ACCC applies to answer this question. In both cases, the ACCC concluded " *that on a forward looking basis it is the potential of these assets to provide system security insurance that provides system wide benefits.*" Enhanced system security provided by the Interconnect and the SWP amongst other benefits allowed the ACCC to determine that these pipelines provided system wide benefits to all customers.

On page 42 of the Interconnect decision the ACCC states:

" The Commission acknowledges that the Interconnect Assets have provided substantial system wide benefits particularly during the 1998 Victorian gas supply emergency. It also acknowledges the view that these historical benefits are sunk. GPU GasNet has attempted to quantify these benefits. Whilst the urgency of providing additional supply from non Longford sources has now passed, it is recognised that on a forward looking basis it is the potential of these assets to provide system security insurance that provides system wide benefits. The actual use of the insurance provides an indication as to whether the insurance will be required. While it maybe reasonable to assume that the likelihood of another major supply disruption is small, the events of 1998 demonstrated the risks attached to reliance on a single supply source. In addition, the Interconnect assets provide additional supply capacity which will help meet projected demand growth in the short to medium term.

The Commission considers that the Interconnect assets provided substantial system security benefits during the 1998 gas supply emergency and during 1999 and that they provide a substantial on-going benefit to users of the PTS by ameliorating expected imbalances and by reducing the probability and extent of future supply losses.

On page 52 of the SWP decision the ACCC noted again;

" The Commission acknowledges that the South West Pipeline provided some system wide benefits as part of system planning for the winter of 1999. It also acknowledges the view that these historical benefits are sunk. GPU GasNet has attempted to quantify these benefits. While the urgency of providing additional supply from non Longford sources has now passed, it is recognised that on a forward looking basis it is the potential of these assets to provide system security that provides system wide benefits. While it maybe reasonable to assume that the likelihood of another major supply interruption is small, the events of 1998

⁶ Access Arrangement for the Principal Transmission System – Application for revision by GPU GasNet Pty. Ltd. 28 April 2000.

⁷ Access Arrangement for the Principal Transmission System – Application by for Revision by GPU GasNet Pty. Ltd – South West Pipeline. 29 June 2001.

demonstrated the risks attached to being largely reliant on a single supply source. In addition, the SWP provides additional peak supply capacity which may help projected peak demand growth in the short to medium term.

TRUenergy submits that identical benefits result from GasNet's proposed pipeline augmentation. The project that underpins GasNet's application provides system wide benefits to all customers consistent with the Interconnect & SWP decision because the project;

1. provides a significant system security enhancement and increased linepack that provides system wide benefits to all customers as calculated in VENCORP's 'net market' benefit test,
2. provides additional multiple sources of gas that will help meet projected demand growth in the short to medium term, and
3. encourages a stronger flow of competitive gas from the Otway basin to compete more aggressively with other upstream basins. It is TRUenergy's expectations that the competitions benefits from the Corio Loop will be more substantial than those calculated in VENCORP's 'net market' benefit test.

(b) There is no requirement for all parties to benefit equally

TRUenergy submits the 'net market' benefits generated by the Corio Loop need not accrue equally to all users to be considered system wide. Regulatory precedent set by the ACCC and other regulators support this. The Commission stated in the Interconnect decision that the ACCC;

" Does not interpret the Code to require that system wide benefits would accrue equally and simultaneously to all users. Rather benefits should be available across the system and potentially be available to much of the customer base."

OFFGAR clearly states on page 10 of the Final Decision in the ALINTA case⁸ the regulator agreed;

" A new facility may be said to provide system wide benefit when it provides a benefit that is generally available, as opposed to being available to only a particular person or persons. However, this does not mean that that each User must benefit simultaneously or to the same extent."

6. The cost recovery mechanism described by GasNet as (Option 2) represents a reasonable approach to recovering the costs for the Corio Loop.

TRUenergy endorses GasNet's proposed cost recovery mechanism for the Corio Loop described as Option 2. We support ;

- Actual New facilities Investment incurred during the 2003-2007 regulatory period rolled into to the capital base at the commencement of 2008-2012 regulatory period
- The remainder of the costs included as Forecast New facilities Investment for the 2008-2012 regulatory period.

7. The tariff solutions provided by GasNet in its application to the AER are acceptable however we believe that minor adjustments to the tariff solution would more accurately reflect the intentions of Section 8.16 (a) (ii) (B) – the system wide benefit test.

TRUenergy questions GasNet's assertion that it is entitled to over-recover on the "economically feasible" portion of the Corio Loop on the basis that some part of the pipeline might satisfy the other tests in Section 8.16 (a) (ii). From discussions with the applicant, TRUenergy understands GasNet's position to be that a portion of the proposed augmentation satisfies Section 8.16 (a) (ii) (A). GasNet argues therefore that;

- The increased revenue generated by the economically feasible portion of the pipeline will recover 5 to 10% of the project costs of the Corio Loop.
- It is consistent with the tariff design principles in section 8 for the owner to recover that portion through the prevailing tariff, and recover the balance via a universal tariff uplift..

a) However, because GasNet has submitted an application to the ACCC for the Corio Loop under 'Section 8.16 (a) (ii) (b) –the system wide benefits ' then, as the Gas Code states, the costs of the augmentation should be funded through "a higher reference tariff for all users". TRUenergy believes that the Section 8.16 (a) (ii) (b) binds the ACCC to recover the costs from all users equally given the augmentation will provide system wide benefits to all customers. In respect of the tariff methodology proposed by GasNet

⁸ See above No: 2

1. TRUenergy questions GasNet's rationale for recovering 5 to 10% of the incremental costs of the Corio Loop from existing customers on the SWP and how this is consistent with the principles of the system wide benefit test. TRUenergy requests GasNet's advice as to tariff objectives that form the basis for adopting this approach and we seek a more detailed explanation of how the amount quarantined from the general tariff has been determined.
2. TRUenergy remains concerned that GasNet's proposed allocation of the cost recovery scheme creates a precedent where there are "winners" and "losers" in terms of recovering the costs for investments that pass the system wide benefit test. We view GasNet's suggested tariff approach to be inconsistent with the intention of the system wide benefit test.

The Commission engaged in an extensive consultation process regarding appropriate cost allocations and efficient and equitable tariff design when approving the PTS access arrangement in 1998. The Commission concluded that tariffs, once adjusted for changes required by the Commission, would;

*"recover from each user a fair and reasonable share of the costs"*⁹

It is TRUenergy's view that over-recovery of 5 to 10% on the South West Pipeline over its asset life does not represent a fair and reasonable share of cost recovery. TRUenergy suggests that this anomaly in the cost recovery of the Corio Loop should be addressed at GasNet's next access arrangement review.

⁹ ACCC, Victorian Final Decision, p.91