Submission to the: Economic Regulation Authority

Re: Treatment of the Interconnection Service in the Proposed Access Arrangements for AlintaGas Network's Mid-West and South-West Distribution Systems (AGNGDS)

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1. Introduction

CMS Gas Transmission of Australia (CMS) lodged a submission to the Economic Regulatory Authority ("the Authority") on 14 May 2004, which expresses concerns regarding the scope of the proposed Access Arrangements for AGN GDS. In particular, CMS states that it is:

> "imperative that the Interconnection Service proposed by AGN should be treated as, or at very minimum viewed in the context of, a Reference Service. A Reference Service is required to include a set of terms and conditions (Code section 3.6)." (CMS submission, page 3)

AGN would like to take this opportunity to respond to the issues raised by CMS in relation to the proposed Interconnection Service. In summary, AGN believes that the Access Arrangements as drafted strike the right balance between providing reasonable certainty to Users and prospective Users through standard terms and conditions, whilst satisfying the Reference Tariff Principles in section 8 of the National Gas Code (the Code).

Whilst other issues have been identified in various responses to AGN's proposed Access Arrangement the major issue identified has been Interconnection Services. Other issues identified may be addressed by further correspondence or have otherwise been addressed in the Access Arrangement Information previously submitted.

This submission provides, a brief description of the AGN's proposed treatment of the Interconnection Service, a summary of CMS' arguments for why AGN's proposed approach is inappropriate, AGN's responses to CMS's arguments and a conclusion.

2. AGN's Proposed Treatment of the Interconnection Service

AGN's proposed access arrangement for AGN GDS offers to provide an Interconnection Service as a non-Reference Service. The proposed Interconnection Service provides a right to interconnect with the AGN GDS. It is proposed that the terms and conditions and prices upon which an Interconnection Service will be made available are to be negotiated by AGN and the party to whom the Interconnection Service is to be provided. It is further proposed that at all times the gas entering the GDS must comply with the Gas Quality Specification, which remains unchanged.

CMS's submission presents a number of arguments in favour of treating Interconnection Services as a Reference Service, rather than a non-Reference Service. If CMS' submission were accepted by the Authority, it follows that a Reference Tariff would need to be included in the proposed Access Arrangements for AGN GDS, in accordance with the principles set out in section 8 of the Code. In effect, standard terms and conditions for an Interconnection Service would need to be published by AGN. Given these implications, it is important to review carefully the arguments presented by CMS.

3. Summary of CMS' Arguments for Treating the Interconnection Service as a Reference Service

AGN's review of CMS' submission has identified 6 arguments for treating the Interconnection Service as a Reference Service. These arguments are paraphrased and addressed below:

3.1. CMS's Position

AGN's proposal (with respect to the Interconnection Service) is inconsistent with the Code objective to establish a framework for third party access to gas pipelines that provides rights of access to natural gas pipelines on conditions that are fair and reasonable for both Service Providers and Users. (CMS submission, page 1)

3.1.1. Alinta's Response

As a general comment, AGN would like to emphasize that the proposed Access Arrangements for AGN GDS are consistent with the provision of the Interconnection Service on fair and reasonable terms. In fact, clause 62(1) of the revised Access Arrangement states:

> "AGN may recover the reasonable capital and Non-Capital Costs it incurs as a result of a Pipeline being interconnected with the AGN GDS from the owner or operator of the Interconnected Pipeline."

Therefore, AGN does not agree with CMS' view that the proposed Access Arrangement is inconsistent with the Code objective of providing access to AGN GDS on fair and reasonable terms (argument 6(a) above).

3.2. CMS's Position

AGN's proposal is inconsistent with the promotion of competition as required by the Code and by the Minister's recent statement. "Upstream" access to the AGN GDS should also be given important consideration and be adequately addressed within the proposed AGN revised Access Arrangement. (CMS submission, pages 2, 3 and 4)

3.2.1. Alinta's Response

In relation to the potential benefits of promoting competition, AGN agrees with CMS that it is important for the Access Arrangements to take a reasonably broad view of the investment required to facilitate Full Retail Competition (FRC). In fact, the trigger provisions (clause 12) in the proposed Access Arrangements allow for FRC costs to be recovered, providing that certain regulatory tests are satisfied.

However, CMS argues that AGN should take an even broader view of the investment required to facilitate investment "upstream" of AGN GDS. In AGN's view, it is not easy to draw a clear distinction between investment that *facilitates competition* and investment that may, in fact, *distort competition in upstream or downstream markets*. In particular, an Interconnection Service that allocates costs to parties other than the interconnecting party could be said to distort rather than facilitate competition. Such an outcome would be incompatible with the Reference Tariff Principles, and in particular section 8.1(d) of the Code. For this reason, AGN does not agree with CMS' Promotion Competition argument for treating the Interconnection Service as a Reference Service.

3.3. CMS's Position

AGN will derive additional system wide benefits from interconnection such as additional market growth and security of supply. Consequently, CMS contends that the nature of the capital and non-capital costs that AGN refers to in its Access Arrangement Information as being attributable to the interconnection of the GDS by another pipeline operator, should properly be considered part of the system wide cost of pursuing the system wide benefits of FRC, which AGN proposes to pass on to all customers. (CMS submission, page 5)

3.3.1. Alinta's Position

CMS' third argument contends that the benefits from a more interconnected system are akin to the system-wide benefits that will result from the introduction of FRC. AGN accepts CMS's argument that system-wide benefits may arise from greater interconnection in some circumstances. However, there are some important differences between FRC costs and those arising from the provision of Interconnection Services that should not be overlooked / confused.

In particular, FRC is a specific program with a defined objective and timetable that has been sanctioned by Government. In addition, AGN's recovery of FRC costs will be subject to review by the Authority. In contrast, neither the Government nor the Authority has identified a specific objective in relation to "greater network interconnection". AGN notes that in a competitive market, service providers are unable to net off "system-wide benefits" from their investment costs, in the way that CMS is proposing. In the absence of regulatory direction to the contrary, therefore, AGN's view is that the costs of providing an Interconnection Service should be borne by the interconnecting party. This approach is reflected in the proposed Access Arrangements.

3.4. CMS's Position

The costs of facilitating Interconnection Services cited by AGN (in relation to operating, monitoring and otherwise managing heating value management plans to comply with Declared Heating Value Regulation*)* represent insignificant increments to the ongoing expansion and maintenance of the GDS, and AGN has to do some of this work anyway. The resulting impact on Reference Tariffs would be inconsequential. (CMS submission, page 6)

3.4.1. Alinta's Response

CMS' fourth argument is that the costs of facilitating Interconnection are insignificant, and therefore could easily be recovered through the Reference Tariff. On the face of it, this argument appears to contradict CMS' view that the Interconnection Service itself should be a Reference Service – with its own separate Reference Tariff. In any event, the clause 8.2(c) of the Code requires that:

> "A Reference Tariff (which may be based upon forecasts) is designed so that the portion of Total Revenue to be recovered from a Reference Service (referred to in paragraph (b)) is recovered from the Users of that Reference Service consistently with the principles contained in this section 8."

It is arguable that including interconnection costs in the Reference Tariff for another Reference Services is inconsistent with the Reference Tariff Principle cited above and therefore in conflict with the Code. In any event, AGN does not accept that the costs referred to by CMS will necessarily be insignificant. In AGN's view, it seems appropriate that the connecting party should pay for the full costs of Interconnection, including the costs of monitoring and managing heating value management plans to comply with Declared Heating Value Regulation. The so-called "insignificant" nature of these costs does not imply that they should be borne by the generality of Users and prospective Users, rather than the connecting party.

AGN further notes that the connecting party is the party who has the ability to influence these costs by both the selection of interconnection locations and the number of interconnections for a sub-network, as well as any pre-blending that may occur. The connecting party is in a better position to control the costs of interconnection and therefore pass these costs onto those consumers utilizing the service.

3.5. CMS's Position

It is more equitable to recover the costs of the Interconnection Service from all customers. (CMS submission, page 6)

3.5.1. Alinta's Response

CMS' fifth argument is that it is more equitable to recover the costs of the Interconnection Service from all customers. AGN does not agree with this view. From an economic efficiency perspective, it is appropriate that the costs are borne by the party that creates them. This principle ensures that the cost signals seen by all parties facilitate efficient consumption and investment decisions. An alternative treatment could distort investment decisions, by encouraging Interconnection in circumstances that only minimize a subset of the costs (i.e. excluding those costs that are passed to other parties). Such an outcome would be in conflict with Reference Tariff Principles 8.1(b)(d) and (e).

3.6. CMS's Position

AGN is confused as to the costs of providing the Interconnection Service. AGN should incur the relatively minor system costs to modify the way in which the GDS is monitored and operated in order for it to accommodate gas having slightly different gas quality specifications from that supplied solely from the DBNGP. (CMS submission, page 6)

3.6.1. Alinta's Response

CMS' sixth argument is that AGN is confused regarding the costs of providing the Interconnection Service, as opposed to the costs of facilitating interconnection (which in CMS' view should be borne by the generality of Users). AGN's view is that the proposed

Access Arrangement is clear in stating that the costs arising from the proposed Interconnection should be borne by the owner or operator of the Interconnected Pipeline (clause 62(1)). In any event, if there is genuine confusion as to the costs of providing an Interconnection Service, this does not necessarily support the proposition that a Reference Service is the more appropriate method of cost recovery. On the contrary, AGN would argue that any confusion is best addressed through the negotiation of the Interconnection Service, as proposed in the AGN GDS Access Arrangement.

AGN has worked closely with CMS in assessing various alternatives for interconnection to deal with the issues of billing implications arising from heating value variations, impact of unaccounted for gas calculations, general gas quality requirements, treatment of peak flow requirements and balancing. Alinta and CMS undertook an extensive evaluation of interconnection arrangements under the auspices of the WA Government. The alternatives considered, included amongst others processing Parmelia gas to match DBNGP gas quality, pre-blending Parmelia and DBNGP gas prior to entry into the sub-network, replicating all gate stations feeding a sub-networks and physically separating parts of a sub-network. While these were a number of options, CMS has opted for the solution with least cost to itself.

The market has already provided assistance to facilitate interconnection in the form of a swing service which provides a mechanism to handle imbalances between shippers on the Parmelia pipeline and those on the DBNGP.

4. Conclusion

In addition to the above specific responses to CMS' arguments, AGN would like to reiterate its view that in practice, it would be very difficult to define an Interconnection Service in terms of a standard price. This is because the costs associated with Interconnection are usually highly location-specific and this will tend to make the circumstances of each Interconnection Service unique, at least in some respects. Setting a standard price through a Reference Tariff is likely to lead to inappropriate outcomes for AGN, in terms of cost recovery (as required by Reference Tariff Principle 8.1(a)). Moreover, setting a standard price for Interconnection is likely to result in the presentation of distorted pricing signals to prospective Interconnecting Parties, and the generality of Users (contrary to the Reference Tariff principles set out in sections 8.1(d) and (e) of the Code). For this reason alone, it is more appropriate to provide Interconnection Services as a negotiated non-Reference Service. To this end, AGN has at all times attempted to negotiate with CMS in good faith to facilitate interconnection. This is borne out by the4 existence of two Interim Interconnection Agreements.