

2 September 1999

Dr Ken Michael AM
Gas Access Regulator
Office of Gas Access Regulation
GPO Box 8469
PERTH BUSINESS CENTRE WA 6849

VIA FACSIMILE 9213 1999

Dear Ken

RE: ALINTAGAS DRAFT ACCESS REGIME

Thank you for your letter of 20 August 1999 advising of an extension of time for comment on AlintaGas' draft access regime for the Mid and South West Distribution Network. The Chamber very much appreciates the additional time to consult with its members on this important issue.

Following consultation with its members and other interested parties, the Chamber makes comment on the following issues which it considers ought to be investigated further as part of the access approval process.

Importance of Reference Tariffs

At the outset it is perhaps relevant to outline the importance of reference tariffs under an access arrangement. The intention is that they operate to offset the information asymmetry inevitable in any situation where customers are dealing with a large monopolistic organisation. By having a price and conditions previously agreed as being fair and reasonable for a specific service, customers have a benchmark to base their negotiations around. For this function to operate properly, however, reference tariffs must of necessity represent a fair and reasonable outcome for a service likely to be demanded by the market. Reference tariffs set at too high a level or which are not properly cost reflective, will provide insufficient information to the market, enhancing the power of the monopolist.

It is also important to note that reference tariffs are intended to be starting points for individual negotiation rather than actual price outcomes, although they also represent a safety net in the form of maximum actual tariffs. The Chamber sees this as an important criterion for judging the success of any access regime. If prices all correspond to the reference tariff then this suggests the capacity for commercially negotiated outcomes is limited and the regime is not working as effectively as it might, reducing in overall economic

efficiency. Conversely, outcomes where prices vary between users depending on their circumstances and where reference tariffs act as a guide, suggest an effective access regime which enhances economic growth and welfare.

Tariffs

The proposed reference tariffs are considerably higher than those in the current distribution regulations, although the Chamber notes that direct comparisons are difficult as current regulations only apply to the high pressure part of the system and are postage stamp rather than reference tariffs.

Nonetheless, the increases are substantial. Outcomes will vary according to usage, but some calculations suggest doubling or tripling of prices per GJ. The Chamber has been unable to find any instance where prices will actually fall. This suggests either that the new tariffs are too high or that the current tariffs were set inefficiently low.

The Chamber reiterates its earlier comments of the importance of reference tariffs that do accurately guide the market as to fair and reasonable price outcomes as a basis for negotiation.

Cost Base

Any assessment of whether the tariffs are fair and reasonable will require judgment as to the underlying asset base, rate of return and revenue requirements. The regime proposes a weighted average cost of capital (WACC) of 8%. In the Chamber's view this appears reasonable, given the risk associated with the assets and rates applied elsewhere.

The Chamber notes, however, that the rate of return depends directly on the asset base used and the revenue required. Under or over-stating of either of those factors could mean that a nominally acceptable WACC conceals unwarranted asset or revenue assumptions. The Chamber urges attention by OffGAR to these issues in particular as part of its deliberations as to whether the reference tariffs are fair and reasonable.

Standing Charge

A significant reason for these large increases is the very high standing charge under reference tariff A of \$50,000 per annum. The Chamber acknowledges the possible role of fixed charges as part of an efficient pricing system, but this needs to be considered in the context of other factors such as size compared to other pricing components. As the standing charge is fixed, it declines according to total usage. However, a 100 TJ/a customer would be paying about half of its total tariff as a standing charge.

The impact of a fixed charge of course bears most heavily on those at the minimum thresholds for use of the reference tariff and to this extent does represent a barrier to entry at that end.

The Chamber believes that the costs and benefits of the standing charge require further investigation as part of an efficient reference tariff.

Demand Charge

The Chamber notes that the demand charge element of the tariff is based upon distance as the crow flies from delivery point to the nearest transmission pipeline, irrespective of the actual distance of connection. The regime explicitly states that this “is intended to mitigate the risk of inefficient by-pass of the AlintaGas network”.

The Chamber is concerned that this places protection of AlintaGas’ revenue base above reflecting the actual costs of pipeline usage. If price signals are used which do not accurately transmit underlying costs, efficient use of the pipeline will be impeded.

While there is a risk of inefficient duplication in theory, this is the case with any competitive provision of services and, generally, this is offset by the dynamic efficiency benefits of competition. The Chamber also points out that third party access itself should be the primary mechanism for preventing inefficient bypass as it allows users to buy in infrastructure services rather than duplicate assets. Provisions within access regimes which impose a cost penalty on bypass are probably not required.

Access Information

The Chamber notes that, under the access regime, applicants will be required to submit an application in accordance with the “AlintaGas Applications Procedure”. This is therefore an integral part of the access regime and any assessment of it. To date, no details of the procedure have been provided. It is understood that the procedure will specify information required of the applicant and detail the process. These elements obviously have the potential to be extremely onerous at one extreme or, at the other, facilitate access applications. At this stage, however, no assessment can be made. The Chamber submits that any judgement on the access regime itself is incomplete without this information.

A copy of this letter has been separately emailed to Robert.Pullella@offgar.wa.gov.au and it is hoped that these comments are of assistance. Please contact Charles Crouch, Executive Officer – Economic Affairs, if any further information is required.

Yours sincerely

IAN SATCHWELL
CHIEF EXECUTIVE OFFICER