



INFORMATION PAPER

To Assist with Submissions on the
AlintaGas Networks Pty Ltd
Proposal for Recovery of
Costs Associated with the Introduction of
Full Retail Contestability
in the Mid-West and South-West
Gas Distribution Networks

**Independent Gas Pipelines Access Regulator
Western Australia**

4 July 2003



1 INTRODUCTION

On 26 June 2003, AlintaGas Networks Pty Ltd (“AGN”) submitted a proposal that seeks the exercise of my discretion to agree, under section 8.21 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (“Code”), that the costs of developing systems associated with the introduction of “full retail contestability” (“FRC”) in Western Australia meet the requirements of section 8.16 of the Code, the effect of which is binding on the Regulator’s consideration of revisions to AGN’s Access Arrangement.

AGN first submitted a proposal seeking approval of costs related to FRC on 24 June 2002. On 27 December 2002, I issued an information paper explaining that costs of the type proposed to be recovered by AGN did not fall within the terms of section 8.21 of the Code and that, accordingly, I was unable to provide a binding approval of the proposed investment. There was no other specific power under the Code enabling me to give a binding approval that would enable AGN to be assured of recovering its FRC development costs.

This matter was subsequently referred to the National Gas Pipelines Advisory Committee (“NGPAC”), which has responsibility for recommending changes to the Code. NGPAC recommended to the Ministers responsible for the Gas Pipelines Access Law in each jurisdiction that the Code be amended to provide for the recovery of costs such as AGN’s capital costs relating to the introduction of FRC. The necessary amendments to the Code, incorporated in the Seventh Amending Agreement, were gazetted in South Australia on 17 April 2003.

In the light of the amendments to the Code, AGN has now made a new application under section 8.21 of the Code seeking my agreement that under section 8.21 of the Code the proposed FRC costs meet the requirements of section 8.16 of the Code.

A copy of the current application from AGN is available at no cost from the Office of Gas Access Regulation (“OffGAR”) web site (www.offgar.wa.gov.au). Printed copies of the documentation are available directly from OffGAR for \$10.00 per copy. Requests for the document can be made to:

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A notice was issued to interested parties and advertisements were published in *The West Australian* and *The Australian* on Friday 4 July 2003, advising that the proposal had been lodged by AGN. The notice and advertisements invited public submissions to be lodged with OffGAR by 4pm Friday 1 August 2003 Western Standard Time.

After considering all public submissions, I am required to issue a Draft Decision. The Code requires that if the Regulator proposes to not agree the application for FRC costs, the Draft Decision must state the amendments (or nature of the amendments) that need to be made for it to be agreed.

After publication of the Draft Decision, interested parties will be given a further opportunity to make submissions. The closing date for submissions on the Draft Decision will be specified at the time the Draft Decision is released. The Regulator is then required to issue a Final Decision on the application for agreement of FRC costs after considering these submissions.

The purpose of this Information Paper is to:

- provide further information on the processes involved in a section 8.21 approval of New Facilities Investment under the Code as part of the public consultation process; and
- provide a summary of the AGN application.

2 CODE PROVISIONS

Section 8.21 of the Code (as amended by the Seventh Amending Agreement) provides for the agreement by the Regulator to the recovery of proposed costs associated with New Facilities Investment, stating that:

- 8.21 The Relevant Regulator may at any time 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 forecast New Facilities Investment) will meet, the requirements of section 8.16(a), the Relevant Regulator may consider whether those requirements are met when it considers revisions to an Access Arrangement submitted by the Service Provider.

As set out in the Information Paper of 27 December, 2002, I was unable to agree that the New Facilities Investment proposed by AGN in its application of 24 June 2002 would meet the requirements of Section 8.16, or to provide a binding approval of the proposed costs, due to the terms in which section 8.21 of the Code was then drafted. The problem was that the power expressed in section 8.21 is a power that relates to "New Facilities", and the Code definition of "New Facilities" at that time did not extend to costs of a nature such as those proposed by AGN.

Following the Seventh Amending Agreement, gazetted on 17 April 2003, the Code now defines "New Facility" as follows:

"New Facility" means:

- (a) any extension to, or expansion of the Capacity of, a Covered Pipeline which is to be treated as part of the Covered Pipeline in accordance with the Extensions/Expansions Policy contained in the Access Arrangement for that Covered Pipeline;
- (b) any expansion of the Capacity of a Covered Pipeline required to be installed under section 6.22; and
- (c) any capital asset constructed, developed or acquired to enable the Service Provider to provide Services including, but not limited to, assets required for the purposes of facilitating competition in retail markets for Natural Gas.

In the light of the amendments to the Code, AGN has made a new application for the recovery of its FRC costs.

In determining whether to agree costs under section 8.21, I must determine whether those costs meet the requirements of section 8.16(a), which now states :

- 8.16 (a) Subject to sections 8.16(b) and sections 8.20 to 8.22, the Capital Base may be increased under section 8.15 by the amount of the actual New Facilities Investment in the immediately preceding Access Arrangement Period provided that:
- (i) that amount does not exceed the amount that would be invested by a prudent Service Provider acting efficiently, in accordance with accepted good industry practice, and to achieve the lowest sustainable cost of providing Services; and
 - (ii) one of the following conditions is satisfied:
 - (A) the Anticipated Incremental Revenue generated by the New Facility exceeds the New Facilities Investment; or
 - (B) the Service Provider and/or Users satisfy the Relevant Regulator that the New Facility has system-wide benefits that, in the Relevant Regulator's opinion, justify the approval of a higher Reference Tariff for all Users; or
 - (C) the New Facility is necessary to maintain the safety, integrity or Contracted Capacity of Services.

For the purpose of administering section 8.16(a)(i), section 8.17 provides that the Regulator must consider:

- (a) whether the New Facility exhibits economies of scale or scope and the increments in which Capacity can be added; and
- (b) whether the lowest sustainable cost of delivering Services over a reasonable time frame may require the installation of a New Facility with Capacity sufficient to meet forecast sales of Services over that time frame.

The effect of any agreement by the Regulator would be to bind the Regulator to a decision that the costs of this investment by AGN may be added to its capital base when its Access Arrangement is reviewed in March 2004 and reference tariffs for use of its Mid-West and South-West Gas Distribution Networks would then be adjusted accordingly.

In relation to public consultation, the Code requires that any application under section 8.21 of the Code must be treated as if it were a proposed revision to the Access Arrangement submitted under section 2.28 of the Code:

- 2.28 By the date provided for in the Access Arrangement as the Revisions Submission Date (or as otherwise required by an Access Arrangement), the Service Provider must, and at any other time the Service Provider may, submit to the Relevant Regulator proposed revisions to the Access Arrangement together with the applicable Access Arrangement Information.

Accordingly, in treating AGN's application as if it were a proposed revision to the Access Arrangement, I am required to call public submissions for a period of at least 28 days following the release of any notice. The notice in relation to AGN's application was published on 4 July, 2003. Submissions on this application must be received by 4 pm Friday 1 August 2003. I am then required to issue a Draft Decision and call a further period for public submissions of at least 14 days following the release of the Draft Decision.

In assessing AGN's earlier application, I appointed Evans and Peck as technical consultants. Parties making submissions on the current AGN application may find it useful to refer to the Evans and Peck report, published on the OffGAR website in December, 2002. To further assist me in assessing AGN's proposal, I will be appointing a technical consultant to carry out some additional work on the specifications, functionality and costs of the proposed system. There will be an opportunity following the Draft Decision to comment on any further technical analysis.

3 AGN'S APPLICATION

3.1 BACKGROUND

The AGN network consists of those pipelines owned and operated by AGN comprising the high pressure system and the medium pressure/low pressure system.¹ The networks covered by the Access Arrangement include the following natural gas reticulation areas:

- Perth Region, North Sheet
- Perth Region, South Sheet
- Country Region, Bunbury
- Country Region, Busselton
- Country Region, Eneabba
- Country Region, Geraldton
- Country Region, Harvey

The Access Arrangement for the Mid-West and South-West Gas Distribution Systems was approved on 18 July 2000.

The application by AGN has been made in accordance with clause 37(1) of its Access Arrangement for the Mid-West and South-West Gas Distribution Networks, which outlines the protocol for dealing with any new facilities investment that AGN proposes during the Access Arrangement period and is expressed in similar terms to section 8.21 of the Code.

As the major provider of gas distribution access services, AGN expects to incur new facilities investment mainly in relation to the development and implementation of a Network Management Information System ("NMIS") and additional operating costs necessary for the introduction of FRC.

AGN has also requested that I provide a non-binding acknowledgement that Non Capital Costs associated with the NMIS are likely to satisfy the requirements of section 8.37 of the Code, which states that:

- 8.37 A Reference Tariff may provide for the recovery of all Non Capital Costs (or forecast Non Capital Costs, as relevant) except for any such costs that would not be incurred by a prudent Service Provider, acting efficiently, in accordance with accepted and good industry practice, and to achieve the lowest sustainable cost of delivering the Reference Service.

¹ High pressure system and medium pressure/low pressure system are defined on pages 1 and 2 of the Access Arrangement document.

3.2 PROPOSED COSTS

AGN's estimates of FRC Capital Costs and FRC Non Capital Costs are set out in its application. AGN states that it has followed an extensive and detailed process to derive the cost estimates. AGN stresses that the FRC Capital Costs are those costs that it is in the course of incurring, or will incur, in providing "gas distribution system" ("GDS") Services. They do not include any costs associated with:

- developing market rules and arrangements;
- the establishment of the Retail Energy Market Company ("REMCo", the market operator and administrator of the market rules) and its associated systems; or
- retailers' costs in establishing and operating an interface with REMCo's systems and amending internal processes and systems to allow for FRC.

3.2.1 FRC Capital Costs

AGN estimates FRC Capital Costs at \$12 million. AGN states that it is confident with this estimate, having undertaken a detailed requirements study that incorporates the latest release of the Retail Market Rules from REMCo.

AGN advises that the FRC Capital Costs are attributable to the investment that it is currently in the process of undertaking in relation to a NMIS.² AGN expects to implement the NMIS to cover all deregulation systems requirements, including:

- handling CATS (Customer Transfer) transactions, including:
 - responding to market transactions; and
 - providing data to REMCo;
- network usage billing;
- managing e-commerce work-flows;
- providing public access to internal data;
- meter reading management; and
- meter data management.

AGN advises that it expects to enter into a capped price contract (or contracts) with a system vendor (or vendors) in July 2003. AGN states that it is currently undertaking considerable investment in preparation for the major phase of the NMIS project, which will commence once the capped price contract (or contracts) is entered into.

AGN submits that the estimate of FRC Capital Costs reflects the additional capital costs that are attributable to the development, acquisition and implementation of NMIS. It has also factored into this cost an allowance for a return on the capital invested for the period between the time of the investment and the commencement of next Access Arrangement period. AGN states that, in calculating the return on this investment, the overall return will be such that the NPV of the investment would be zero when discounting the investment at the relevant weighted average cost of capital.

AGN states in its submission that FRC Capital Costs would be allocated on the basis of anticipated NMIS usage, and that it does not expect Reference Tariff A and Reference

² To avoid doubt, AGN points out that the NMIS is different to the system that REMCo will develop to administer and manage the market rules in the retail gas market.

Tariff B1 to materially increase if all the proposed FRC Capital Costs were to be approved.

3.2.2 FRC Non Capital Costs

AGN estimates that FRC Non Capital Costs will be in the order of \$1.3 million per annum. Unlike FRC Capital Costs, AGN does not expect to be able to provide firm estimates of FRC Non Capital Costs until FRC is fully implemented or close to implementation.

The estimated total FRC Non Capital Costs are made up as follows.

Cost Item	Estimated cost
Operations & Maintenance Costs - Systems and Processes	\$ 1.200M per annum
Retail Market Administrator & Gas Industry Ombudsman	\$ 0.100M per annum

(i) Operations and maintenance costs - systems and processes

AGN expects the NMIS will give rise to ongoing operating and maintenance costs. In addition, AGN expects that it will require staff to manage, control and administer the associated FRC processes and functions performed by the NMIS.

(ii) Retail Market Administrator and Gas Industry Ombudsman Scheme

Work undertaken by the Gas Retail Deregulation Project Steering Group has identified other arrangements and entities required to support FRC. They are likely to include:

- a market governance entity (Retail Market Administrator); and
- an Ombudsman scheme (Gas Industry Ombudsman Scheme).

It is expected that AGN will be required to be a member of, and contribute to the operation of, those entities and schemes. AGN expects the associated costs will be incurred by it in the delivery of GDS Services, including the Reference Services.

AGN submits that it is not seeking the Regulator's agreement that FRC Non Capital Costs are likely to satisfy the requirements of section 8.37 of the Code, but merely requests that the Regulator provide a non-binding acknowledgement that FRC Non Capital Costs are likely to satisfy section 8.37 of the Code.

**KEN MICHAEL
GAS ACCESS REGULATOR**

4 July 2003