CMS GAS TRANSMISSION of AUSTRALIA

PUBLIC SUBMISSION No. 1

PROPOSED HAULAGE CONTRACT

between

ALINTAGAS NETWORKS Pty. Ltd.
and
ALINTAGAS SALES Pty. Ltd.

Submitted to OffGAR on 3 April 2001

INTRODUCTION

CMS Gas Transmission of Australia (CMS) makes this public submission regarding the proposed Haulage Contract between AlintaGas Networks Pty. Ltd. (AGN) and AlintaGas Sales Pty. Ltd. (AGS). This submission is made in response to the invitation by the Office of Gas Access Regulation (OffGAR) appearing in the related Issues Paper dated 9 March 2001.

The intended purpose of this brief submission is to identify and discuss several particularly salient aspects of the proposed Haulage Contract, and request that appropriate amendments be made to it.

OVERVIEW OF EXISTING DISTRIBUTION MARKET

At present, AGS holds a substantial and enduring competitive advantage over other traders in the Mid West and South West gas distribution markets.

This advantage is derived from the substantial unutilised capacity AGS currently has contracted in the Dampier to Bunbury Natural Gas Pipeline (DBNGP).

TARIFF DISCOUNTS

Clause 15 of the proposed Haulage Contract provides for AGN giving AGS an unspecified discount on Distribution System transport tariffs.

Assuming (for the purposes of a case study) a discount of 20 percent in AGN tariff, the difference in delivered gas price is $ 0.38/GJ, as shown in the table below.

CASE STUDY
Delivered Gas Price: AlintaGas Sales Pays Discounted Tariff

AlintaGas Sales		**New Trader**	
gas purchase cost $/GJ (typical)	2.00	gas purchase cost $/GJ (typical)	2.00
DBNGP transport $/GJ (reservation is sunk cost) *note 1*	1.25	DBNGP transport $/GJ (trader pays full cost) *note 1, note 2*	1.25
distribution cost $/GJ (20% discount assumed)	**1.52**	distribution cost $/GJ (assumed)	**1.90**
margin $/GJ (assumed)	0.20	margin $/GJ (assumed)	0.20
delivered gas price $/GJ	4.97	delivered gas price $/GJ	5.35

note 1: assumes prevailing DBNGP tariff and proposed DBNGP Reference Tariff
note 2: assumes load factor of 0.75

In this case study, a discount of 20 percent was assumed. However, it is possible that considerably greater discounts could be offered. It follows that the greater the discount, the greater the competitive advantage.

However, it is also apparent from an examination (in the table below) of the marginal revenue obtained by AlintaGas Limited, the parent of both AGN and AGS, that it is substantially in its interests to enter into the proposed Haulage Contract rather than obtain new business from third parties.

MARGINAL REVENUE
derived by
ALINTAGAS LIMITED
from Transport in AGN Distribution System and Trading Activities vs. New Trader holding a Reference Service

AlintaGas Sales Associate Contract		**New Trader Reference Service Contract**	
DBNGP reservation $/GJ (sunk cost recovered)	1.00	DBNGP reservation $/GJ	0.00
distribution cost $/GJ	1.52	distribution cost $/GJ	1.90
margin $/GJ (assumed)	0.20	margin $/GJ	0.00
total marginal revenue $/GJ	**2.72**	**total marginal revenue $/GJ**	**1.90**

It is clear that retaining its subsidiary's (i.e. AGS') business, even with a distribution discount (i.e. $ 1.52/GJ vs. $ 1.90/GJ), is far more attractive (by $ 1.82/GJ, being $ 2.72/GJ minus $ 1.90/GJ) than receiving the full distribution charge ($ 1.90/GJ) and losing business to a competitor.

It is therefore apparent that if AGN is permitted to extend to AGS a discount on the transport tariffs applicable to use of the AGN Distribution System, AGS will enjoy a significant and unfair competitive advantage over its competitors.

CMS therefore proposes that the ***transport tariff applicable to the proposed Haulage Contract be transparently made available to AGS' competitors.***

CMS further proposes that ***this information be made available as soon as possible*** to enable new market entrants to begin with a 'level playing field' and fully evaluate the market environment when developing strategies.

CONTRACT DURATION

Clause 3 of the proposed Haulage Contract provides for a contract duration of any length. Clause 4 of the proposed Haulage Contract provides for complete flexibility in changing the contract termination date.

Consequently, AGS faces absolutely no risk of holding stranded capacity under the proposed Haulage Contract.

Clauses 1 of Schedules 4, 5, and 6 of the AGN Access Arrangement specify contract duration as being one year or more. The AGN Access Arrangement does not provide for changing the contract termination date. Further, the AGN Access Arrangement requires that the Queuing Policy applies to all capacity increases, while the proposed Haulage Contract requires queuing for capacity to new delivery points only.

Consequently, a User of the AGN Distribution System operating under the AGN Access Arrangement faces the risk of holding stranded capacity.

The fact that AGS would not face 'reservation risk' while its competitors would, gives AGS a significant commercial advantage.

Therefore, CMS proposes that the ***terms of the proposed Haulage Contract and the AGN Access Arrangement regarding contract duration and change of termination date be made consistent, transparent, and available to AGS' competitors.***

It should be noted that in the event that AGS gains the business of an end user which was formerly supplied by a competitor, AGN is entitled to charge the reservation component of its contract with the competitor while simultaneously collecting transport revenue from AGS. Such 'double dipping' is of direct benefit to the parent company of AGN and AGS.

AMORTISATION OF USER SPECIFIC DELIVERY FACILITIES

Clauses 6(3)(j) and 6(4)(j) state that User Specific Delivery Facilities are to be amortised over a period specified in the relevant Register.

It is feasible that both the method of amortisation and the period of amortisation specified in the proposed Haulage Contract could result in amortisation charges applicable to AGS being less than those applicable to a competitor operating under the AGN Access Arrangement.

In turn, this could lead to AGS enjoying an unfair competitive advantage over the competitor.

Therefore, CMS proposes that the ***terms of the proposed Haulage Contract and the AGN Access Arrangement regarding amortisation of User Specific Delivery Facilities be made consistent, transparent and available to AGS' competitors***.

PROVISION OF OPERATIONAL INFORMATION

Both the proposed Haulage Contract and the AGN Access Arrangement provide for AGN to supply its customers with a variety of operational information within certain time periods.

The extent of the information provided in the proposed Haulage Contract is greater than that specified in the AGN Access Arrangement. Further, the time in which AGN is required to supply information under the proposed Haulage Contract is shorter than the corresponding time periods in the AGN Access Arrangement.

This disparity in the nature and timing of information supply gives AGS an unfair competitive advantage over its competitors.

Therefore, CMS proposes that the ***terms of the proposed Haulage Contract and the AGN Access Arrangement regarding the nature and timing of supply of operational information to Users of the AGN Distribution System be made consistent, transparent and available to AGS' competitors***.

RELEASE OF INFORMATION CONTAINED IN DELIVERY POINT REGISTER

The Draft Decision on CMS' application for waiver of Ring Fencing obligations for the Parmelia Pipeline states (in part, bold type added by CMS):

> A natural gas pipeline Service Provider that has an Access Arrangement under the Code transports natural gas on behalf of third parties such as gas producers, gas marketers, and gas consumers. If the pipeline Service Provider is also a participant in the gas production or the gas sales businesses, then the legislators believed that a ***potential for anti-competitive behaviour*** might exist.
>
> The Report by the Independent Committee of Inquiry into National Competition Policy (1993), (The Hilmer Report), examined this problem and reported that (p241):
>
> > …the preferred response to this concern is usually to ensure that natural monopoly elements are fully separated from potentially competitive elements through appropriate structural reforms. In this regard it is important to stress that ***mere "accounting separation" will not be sufficient to remove***

> ***the incentives for misuse of control over access to an essential facility***. Full separation of ownership or control is required. In fact, failure to make such separation despite deregulation and privatisation is seen as a major reason why infrastructure reform in the UK has been disappointing.
>
> Where such structural reforms have not occurred, the challenge from a Competition Policy perspective is to provide a mechanism that will support competitive market outcomes by ***protecting the interests of potential new entrants*** while ensuring the owner of the natural monopoly element is not unduly disadvantaged.

> Ring fencing is part of that mechanism. With ring fencing particular emphasis is placed on the ***separation of business activities***, marketing information, and accounting details and staff between the natural monopoly (gas transport) activity and the ***competitive activity (gas production or gas sales)***.

and

> The purpose of the ring fencing requirements is to put in place institutional structures that will deliver benefits through their potential to ***generate not only competition*** in the natural gas industry, but also the ***growth and development*** of that industry.

and

> If the "not carry on a Related Business" requirement were to be waived for a Service Provider, the legislation still seeks to ensure that the ***gas transport arrangements on behalf of the Related Business are carried on under terms and conditions that do not lessen, prevent or hinder competition in the market***. In other words, an arrangement should be in place to provide for the Regulator's approval of the gas transport terms and conditions for the Related Business.

The above text indicates that the Western Australian Independent Gas Pipelines Access Regulator (the Regulator) is <u>actively</u> committed to upholding the promotion of competition in the Western Australian gas market, and the facilitation of new entrants into the gas market.

At present, AGS is the only User of the AGN Distribution System. Hence it faces <u>no competition</u> from other gas traders on its former monopoly territory.

Competition from gas traders using alternative means of delivery comes from the Parmelia Pipeline. This <u>competition is insignificant</u>, to say the least.

The analysis appearing in the first section of this submission demonstrates that AGS enjoys a competitive advantage over its current and potential future capacity deriving from its prior over-commitment to transport capacity on the

DBNGP. This advantage will persist for the duration of the current AGN Access Arrangement.

The proposed Haulage Contract is notable for its failure to provide details relating to the specific operations of the virtual monopoly AlintaGas Limited. Under the proposed Haulage Contract, the aggregate corporate entity AlintaGas will retain most if not all of its monopoly advantages and hence monopoly power.

CMS therefore considers that the Regulator can realise his stated objective of promoting competition and facilitating entry to the distribution market by new gas traders by mandating that AlintaGas releases all details of its proposed Haulage Contract.

Consequently, CMS proposes that the ***content of the Delivery Point Register and any other unreleased parts of the proposed Haulage Contract be made available to all Users of the AGN Distribution System and all end users of gas supplied by that system.***

CMS further proposes that ***this information be made available as soon as possible*** to enable new market entrants to begin with a 'level playing field' and fully evaluate the market environment when developing strategies.