Joint Submission to IPART

AGLGN Proposed Gas Swap Service and Trunk Zone Structure

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Energy Australia

We are writing to you as retailers, wholesalers and transmission pipelines owners that are actively involved in the gas market in New South Wales and are therefore interested parties to the review of AGLGN's Access Arrangement.

We refer to the Independent Pricing and Regulatory Tribunal's (IPART's) letter to AGL requesting further information regarding AGLGN's proposed trunk zone structure and AGL's subsequent response to that request dated 27 August 2004. Given the significant implications for shippers on the Eastern Gas Pipeline (EGP) associated with the proposed trunk zone aggregation, we consider it appropriate to comment on AGL's response and, perhaps more importantly, to offer an alternative mechanism.

AGLGN is proposing to introduce a Gas Swap Service. To give effect to this service it is proposing that three currently existing zones be aggregated into one zone (thereby reduce the current zones from seven to five). By implementing this aggregation, AGLGN is then able to offer a Gas Swap Service with two functionalities - a User Swap and a Receipt Point Swap.

While we believe the proposed Gas Swap Service (or more particularly the Receipt Point Swap) would offer additional flexibility to that under the current Access Arrangement, unfortunately we also believe that the proposed pricing arrangements associated with the aggregation of the zones would unfairly discriminate against shippers on the EGP and distort the efficiency of the market. .

It is accepted that the functionality associated with the Gas Swap Service would have a positive effect on competition, consistent with the objectives of the Gas Code. However, if the current price differential for users of the Eastern Gas Pipeline (due to the lower portion of usage) is eroded, then this positive effect on competition will be outweighed by the anti-competitive effect associated with the proposed pricing arrangements.

We also note that the pricing arrangements for the proposed Zone A represent a departure from one of the key cost allocation principles contained in the Gas Code (section 8.38) – cost reflectivity. This is because a user would be required to pay for transportation across the entire length of the proposed Zone A regardless of the length of the pipe actually being used. For example, where a shipper only transports gas over a very short section of the overall Zone, then that shipper would be required to pay as if the entire length of the pipeline had been used. This is the situation facing shippers on the EGP injecting into the AGLGN trunk at Horsley Park. The ultimate effect of the proposal would be that EGP shippers would be required to pay a disproportionate amount of AGLGN's revenue from within the Trunk Zone A, which in turn would distort the market.[1]

[1] For more information on the impact associated with the proposed pricing arrangements on EGP shippers refer to previous submissions to IPART on the AGLGN Access Arrangement by Alinta (27 April and 21 June 2004) and Energy Australia (20 April 2004)

Importantly however, while we have significant concerns with AGLGN's proposed pricing arrangement, we believe that we have identified a solution that provides most, if not all, of the benefits under AGLGN's proposed arrangement, but without the anti-competitive effects.

Proposed New Approach: Collapsed zone with differential pricing

We are proposing that AGLGN's Gas Swap Service (incorporating the Receipt Point Swap and User Swap) be accepted in its entirety except for the pricing arrangement. That is, we do not object to the collapsing of the seven zones into five to create a new Trunk Zone A. However, rather than maintaining the same tariff for all receipt points within Trunk Zone A, we are proposing differential pricing depending on the location of the Receipt Point. All other aspects of AGLGN's proposed Gas Swap Service would be retained.

Assuming the 2003-04 tariffs ($/GJ per day) contained in AGLGN's current Access Arrangement our proposed tariffs would be as follows[2]:

Horsley Park – Newcastle	$0.3109
Wilton – Newcastle	$0.3368

By accepting AGLGN's proposed Gas Swap Service (save for pricing) and creating a new Trunk Zone A all of the benefits identified by AGLGN in its submission to IPART on 27 August would be retained. The only exception to this is that there would be some minor administrative tasks that would not be required under AGLGN's proposal. These tasks are essentially of a billing nature – that is, where a shipper swaps a Receipt Point it would be necessary to enter the Receipt Point details into the billing package to enable the correct calculation of the transportation tariff. This is a simple administrative task similar to that necessary for balancing purposes.

We accept that by maintaining the pricing differential some minor efficiencies are forgone (associated with billing entries) however, when considered against the anti-competitive effects of AGLGN's proposed pricing arrangements, the cost of the forgone efficiencies are far outweighed by the benefits of our proposal. The forgone efficiencies also need to be considered in the context of the number of Gas Swaps that are likely to take place – a very small number in all likelihood.

It is important to emphasise that the intent of our proposal is for costs associated with utilising the Gas Swap Service (including the billing costs) to be captured by the tariff for that Service and ultimately borne by those whose actions give rise to the costs. That is, a typical user-pays arrangement.

Benefits identified by AGL with respect to the zone aggregation

AGL in its response of 27 August identified a number of advantages associated with the aggregation of the zones[3]:

> *"The ability to accommodate simple and timely short term requests for use of different receipt points*
>
> *De-commercialising such requests from a level which necessitates contractual variations to recover charges for incremental contracted capacity under Service Agreements*

[2] It is recognised that this tariff assumption is unrealistic as the 2004-05 prices will be different to the 2003-04 prices for a number of reasons.
[3] AGL Submission to IPART, 27 August 2004

Standardising the provision of such requests into an operational function, much the same as daily balancing nominations"

We simply note that all of these advantages are retained under our proposal.

It is useful to explain how we see our proposal working in a practical sense. A user would enter into a transportation agreement with AGLGN. That transportation agreement would refer to an MDQ and a Receipt Point within Trunk Zone A. The agreement would identify the different tariff depending on the nominated Receipt Point. It would be apparent within the transportation agreement that a shipper would be able to swap Receipts Points within Trunk Zone A, but only where that shipper has also entered into a Gas Swap Service.

Where a user wishes to swap Receipt Points that user enters into a Gas Swap Service (as is the case proposed by AGLGN). There will be a fee for that service (to cover, among other things, costs associated with administering the swap from a billing perspective) to be paid only when a Gas Swap takes place (again, as proposed by AGLGN).

Accordingly, all of the advantages identified above by AGLGN would be enjoyed, including the removal of the need for contractual variations where a Receipt Point Swap is in fact utilised.

Comparison of benefits of AGLGN's proposal and our proposal

In addition to the above-noted benefits attributed to the zone aggregation AGL also provided a comparison of the benefits associated with five zones as opposed to seven. However in providing that comparison AGL did so in the context of the aggregated zone having just the one tariff for all receipt points within that zone. A comparison of AGL's proposal (aggregated zone with one tariff) against our proposal (aggregated zone with differential tariffs) is shown as Attachment 1 to this submission.

In its letter to IPART on this issue dated 27 August 2004, AGLGN presented a comparison of the proposed new five zone structure with the current seven zone structure. AGLGN observed that the seven zone structure would include additional trunk charges for capacity utilised by a retailer for trading purposes. However, shippers of gas on the EGP would argue that it is considerably more efficient to pay slightly higher trunk charges on the rare occasions that gas is injected at Wilton, rather than be subjected to a permanent trunk charge increase for a section of the pipeline that is not utilised for the majority of the time.

Additional matters for consideration

AGL noted in its letter dated 27 August that as a result of the GMC Business Rules there is a somewhat convoluted process to give effect to a Receipt Point Swap and observes that its proposal would remove these difficulties. AGLGN also notes a number of additional benefits associated with removing GMCo from Receipt Point Swaps. As our proposed approach is consistent with that of AGLGN (save for the pricing) the same benefits are enjoyed under both proposals.

AGL made some observations regarding the materiality of the cost to EGP shippers associated with the pricing arrangements attached to the zone aggregation. In particular, AGL noted that the effective price increase for EGP shippers is $0.026/GJ, and then contrasted this against the delivered price of gas. We believe a more relevant analysis is to simply assess the cost impact on shippers delivering into Horsley Park from the EGP.

Given confidentiality reasons Alinta is not able to reveal the current delivered quantities into Horsley Park. However, Alinta has advised that up to 50TJ/d is a reasonable estimation. At $0.026/GJ, and at a 100% load factor, this represents an annual increase to EGP shippers of just under $500,000 or, conservatively, $2.5 million over the period of the proposed AGLGN Access Arrangement. This amount is substantially higher if a more realistic load factor is used in the analysis. Contrary to AGL's observation, this is clearly a material amount.

The materiality is also reinforced when considered in the context of a new entrant entering the NSW gas market. As AGL is the dominant incumbent retailer the bundled price that it offers into the market effectively sets a ceiling as to what new entrants can charge. Therefore, for new entrants utilising the EGP to service the Sydney market the cost increase of AGLGN's proposal would, by competitive necessity, come straight off their bottom line. That is, new entrants could not pass through the tariff increase as it would make them uncompetitive relative to the incumbent. Accordingly, this tariff increase would have a detrimental impact on the introduction of new entrants into the Sydney retail market.

It should also be remembered that the $0.026 tariff increase represents a greater than 100% increase in Trunk charges for EGP shippers.

The tariff associated with the Gas Swap Service is only one consideration in assessing the viability of entering into a Receipt Point Swap. Other matters requiring consideration include the costs of gas injected at the alternate Receipt Point and the additional charges associated with transportation on an alternative transmission pipeline. Short term gas supply agreements and as-available transportation agreements are typically significantly higher than long term supply and transportation arrangements. These additional costs are important in the context of assessing the likely frequency of Receipt Points Swaps being entered into. Clearly the additional costs through the supply chain associated with short term arrangements reduces the attractiveness of such transactions, and therefore the likely extent of uptake of the Gas Swap Service.

A further point worth remembering is that prior to the EGP connecting to the Sydney market, AGLGN's tariff for the Trunk Zones between Wilton and Horsley Park were somewhere in the vicinity of $0.25GJ/d higher than that currently charged. That is, as a result of the EGP entry there was a very significant reduction in the charge from Wilton to Horsley Park. AGLGN is now proposing to remove that differential all together.

It is also useful to comment on AGLGN's comparison of the size of its proposed Trunk Zone A to zones on other pipelines. While it is true that there are other pipelines within Australia with larger zones than the proposed Trunk Zone A, none of these larger zones in question contain an interconnected, competing pipeline servicing the same market.. It is clear that the EGP and that portion of the Trunk duplicated by the EGP are in direct competition to delivered gas to Horsley Park. We believe it is this competitive reality that renders irrelevant any comparison of the length of AGLGN's proposed Zone A with zones on other pipelines.

Attachment 1

	AGLGN Proposal	**Our Proposal**
Consistency of AA charges seen by end users	End customers charged as per Access Arrangement. No costs of capacity utilised for trading rolled into transportation charges.	Users would be charged consistent with the Access Arrangement. Users will be charged for transportation based on their MDQ attributed to a Receipt Point. Where a users wishes to utilise a Gas Swap Service a fee is charged accordingly.
Gas Balancing	Quantities are exactly accounted for in network calculations. Network Calculations reconcile against pipeline and shipper imbalances.	As we are also proposing collapsing the seven zones into five, the same benefits accrue under our proposal.
Gas Swap administration	The same for all users irrespective of which receipt point and type of swap they utilise.	Administration of the Gas Swap Service would be the same for all users irrespective of receipt point. There will be a different tariff in respect of the transportation contract depending on location of the Receipt Point - this is limited to a billing entry along the same lines as gas balancing.
Market responsiveness	Gas Swaps can be initiated at will – can cater for spontaneous trade decisions.	Gas Swaps can be initiated at will – can cater for spontaneous trade decisions.
Consistency and transparency of costs	Only pay for gas swap transaction charge on a “as used” basis. Same cost implications for all users.	Gas Swap charge would be the same for all users – there would however be a differential in respect of the transportation contract depending on location of Receipt Points. This differential recognises the greater length of Trunk Zone A utilised by those users injecting at Wilton compared to Horsley Park.