

Report to
IPART

Comments on AGLGN Response to IPART Draft Decision on Capital Redundancy

1 April 2005



McLennan Magasanik Associates Pty Ltd

242 Ferrars Street
South Melbourne Vic 3205

Tel: (03) 9699 3977
Fax: (03) 9690 9881
Email: mma@mmassociates.com.au
Website: www.mmassociates.com.au

Ref: J1146

Table of Contents

1	INTRODUCTION	2
2	Redundant Capital	3
2.1	Security of Supply	3
2.2	Balancing Service	4
2.3	Value of the Proposed Redundancy	5

1 INTRODUCTION

In its Draft Decision in relation to the Revised Access Arrangement for AGL Gas Networks, the Tribunal identified redundant capital on the Wilton to Wollongong pipeline and required a value equivalent to 20% of the pipeline to be removed from the capital base. The redundancy had arisen due to a significant fall in gas volumes transported through the pipeline following the completion of the Eastern Gas Pipeline (EGP) in 2000.

AGLGN's response to the Draft Decision maintains that the capital redundancy proposal contains a number of flaws. The Tribunal has requested McLennan Magasanik Associates (MMA) to review three aspects of AGLGN's response - MMA has previously assisted the Tribunal to identify the Wilton to Wollongong pipeline capacity requirements and redundant capital.

2 Redundant Capital

2.1 Security of Supply

2.1.1 AGLGN Response

AGLGN has noted that the Wilton to Wollongong pipeline fulfils two roles: it acts as a primary source of supply for users sourcing gas from Wilton and provides back-up supply security to users sourcing gas from the EGP. AGLGN suggests that if there are problems with EGP supply the capacity proposed to be written off as redundant would be essential and that the security role should not be overlooked.

2.1.2 MMA Comments

There is no doubt that the availability of two sources of supply provides a significantly higher level of security to Wollongong users than was available prior to construction of the EGP. Similar levels of security are available to other users downstream of Wilton and in Canberra.

The major beneficiaries of this additional security to date have been users sourcing gas from Moomba through the Moomba-Wilton pipeline. Following a fire at Moomba in January 2004, which significantly restricted Moomba output, additional gas was supplied through the EGP, minimising the need to curtail large users in New South Wales. AGLGN also benefited as it was able to continue to supply and charge its network customers.

In the event of a future failure in the EGP supply chain, EGP users (in Wollongong and elsewhere) would undoubtedly benefit from the additional security provided by supply from Wilton. However it cannot be said that such security is essential or necessary, because prior to construction of the EGP (and also the Interconnect at Culcairn in 1998) NSW users relied solely upon gas supply through the Moomba-Sydney pipeline (MSP). The impact of supply failures, of which there were a number, was mitigated by the significant quantities of linepack in the MSP. During the pre-1998 period no actions were taken to enhance security, such as installation of LNG or LPG injection facilities, which suggests that the level of security available from MSP linepack was considered adequate. As the EGP linepack is of a similar order of magnitude to that of the MSP, the EGP alone could provide a level of supply security similar to that enjoyed by all NSW gas users up to 1998.

To the best of our knowledge the cost of the additional gas supplied through the EGP in 2004 to offset the reduction in Moomba output was limited to commodity charges for gas and transport from Longford to the various NSW markets and the EGP has not recovered any capacity charges for this service. Analogously, if additional gas were supplied through the Wilton to Wollongong pipeline in an emergency, it should attract only incremental

commodity charges and short-term capacity charges, unless the Wollongong users supplied through the EGP are prepared to pay to reserve the capacity for an emergency.

Recovery of the redundant Wilton to Wollongong pipeline capital through reference tariffs would allocate the costs to the users taking gas from the MSP, who cannot benefit from the security it provides. This recovery/allocation would clearly be inappropriate.

2.2 Balancing Service

2.2.1 AGLGN Response

The EGP pipeline (except in the case of Bluescope Steel) supplies the nominated quantity of gas to Wollongong customers each day. Network balance between nominated and actual quantities is maintained by the Wilton to Wollongong pipeline providing a balancing service. This role for the Wilton to Wollongong pipeline is not widely recognised and AGLGN has not previously charged for this service. AGLGN does not propose to charge for the service but does not wish to be penalised by a write-down in Wilton to Wollongong pipeline regulatory value.

2.2.2 MMA Comments

The NSW retail market balancing arrangements, in which one pipeline (the EGP) delivers nominated quantities to Wollongong and Horsley Park and balancing services (meeting the difference between day-before nominations and actual quantities) are provided by the second pipeline (MSP) from Wilton, is largely a matter of convenience and simplicity of operation, particularly for AGLGN.

The balancing service could equally well be provided by all competing suppliers on a marginal cost basis, as in the Victorian and other more developed gas markets. Alternatively, at delivery points where EGP has become the dominant supplier and has the gas available to balance the whole market, such as in Wollongong, the “nominated” and “balancing” roles could be swapped. In regional centres such as Bombala, Cooma, and Nowra, where the EGP delivers the sole supply, EGP already provides the balancing service.

According to data provided by AGLGN to the Tribunal, over the past two years the daily balancing quantities in Wollongong have ranged from -7.3 TJ (from EGP supply to non-EGP users) to +8.4 TJ (from Wilton to Wollongong supply to EGP users). The maximum capacity utilisation on the Wilton to Wollongong pipeline to provide the balancing service is therefore 8.4 TJ per day.

The 1 in 20 peak daily requirements of Wilton to Wollongong pipeline users is estimated to be 17.2 TJ in 2024 (MMA estimate based on AGLGN data) so the maximum combined daily capacity requirement for transport and balancing services is 25.6 TJ. Allowance for

the non-coincidence of the peak requirements for the two services would reduce this figure. As the daily capacity of the written down 250mm diameter pipeline is estimated to be in excess of 40 TJ/day, the written down capacity is more than sufficient to provide both transportation and balancing services and the redundant capacity is not required.

It is concluded that the provision of the balancing service does not justify retention of the redundant Wilton to Wollongong pipeline capital in the capital base.

2.3 Value of the Proposed Redundancy

2.3.1 AGLGN Response

AGLGN maintains that the unit rates used by MMA and accepted by the Tribunal to value the redundant capital are inappropriate for the Wilton to Wollongong pipeline, owing to the known difficult landform characteristics on the pipeline route. AGLGN commissioned an independent engineering report from Coraldeen¹ to estimate the replacement value, with results as in Table 2-1.

Table 2-1 Comparison of Pipeline Valuations

	Diameter	ORC	DORC (1/7/05)
MMA Valuation	350mm/250mm	\$13.2m	\$10.6m
	250mm/250mm	\$10.6m	\$8.4m
Coraldeen Valuation	350mm/250mm	\$19.7m	\$12.8m
	250mm/250mm	\$16.8m	\$10.9m

AGLGN believes that the fact that current estimate of the DORC value of the reduced capacity pipeline is below the original value of the original pipeline provides evidence that the pipeline value should not be written down.

2.3.2 MMA Comments

The unit rates used by MMA were those originally used to value the whole network. While these rates may not be applicable to each pipeline separately, if they are too high for some they must be too low for others as the total ORC and DORC values and average unit rates have been agreed and cannot be changed. If the original diameter Wilton to Wollongong pipeline DORC is really \$2.2m higher than the MMA figures then the DORC of all other assets must be \$2.2m lower than previously thought. The new total network

¹ Replacement cost of gas pipeline from Wilton to Wollongong. Coraldeen Pty Ltd, 18 January 2005.

DORC with the lower diameter pipeline is therefore:

New DORC = Other Assets + \$10.9m

= Old DORC - \$2.2m - \$10.6m + \$10.9m

= Old DORC - \$2.1m

i.e. it is simply the difference in Wilton to Wollongong pipeline DORC values.

It is concluded that the absolute DORC values of the Wilton to Wollongong pipeline are not relevant and that the capital reduction is determined solely by the difference between the DORC values of the 350mm/250mm diameter and 250mm/250mm diameter pipelines.