



5 October 2004

Mr J Cox
Acting Chairman
IPART
PO Box Q290
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Dear Sir,

Review of AGLGN Gas Access Arrangements

I attach the Energy Markets Reform Forum's comments on IPART's Consultants' Report.

Regards

Yours sincerely

Ron Hardwick

Energy Markets Reform Forum

Energy Markets Reform Forum: Comments on Consultants' Reports

AGLGN Access Arrangement Revisions

1 Access Arrangement Costs

ECG states that " AGLGN advised that the expenditure of \$2.7 million for 2002/03 (\$1.0 million actual) and 2003/2004 (\$1.7 million forecast) related to the project costs associated with the preparation of the revised Access Arrangement " and that these costs are treated as deferred expenditure and will be amortised over the period of the new access arrangement (from 2005 to 2010) . ECG further states that " AGLGN was unable to provide details of this expenditure (e.g. legal and consultants costs) " and that " ECG is not in the position to confirm whether the cost is prudent and efficient. "

Astonishingly, ECG then concludes that it " does recognize that a prudent service provider will incur costs associated with the preparation of the Access Arrangement " and " has therefore included the cost in the recommended non system asset expenditure. "

The EMRF submits that:-

- (i) regulated revenue should only be provided to AGLGN on the basis that costs are substantiated and are not based on supposition or assumption.
- (ii) it is difficult to accept that invoices from consultants and legal advisors cannot be made available (or even replicated, should originals be misplaced) for substantiation, and
- (iii) it is noteworthy that AGLGN has quite a number of employees performing regulatory functions within the organization and this means that it is even more essential all externally generated costs claims must be substantiated.

2) Disposals

AGLGN has advised that disposals of aging and redundant assets amounted to \$20.9 million during the period 1999 to 2003/04 and this was on the basis of written down value. The EMRF considers that the accepted valuation of these assets in calculating the deduction of the asset value for rolling forward of the RAB should be consistent with the valuation determined by IPART at the last Access Arrangement Review and be based on the relevant DORC asset valuation methodology applied by IPART in its 2000 determination.

IPART and its consultants (ECG) must ensure that that is the case and the relevant amounts are deducted or adjusted from the roll-forward of the RAB for the period 2004/05 to 2009/10.

3) Capital contributions

The EMRF notes that the 1999/00 to 2003/04 RAB includes an allowance for capital contributions made by customers. We note that AGLGN has recorded these contributions as required in IPART's Amendment 29 (Capital contributions in respect of new Facilities Investment) to AGLGN's Access Arrangement in 2000. There was significant controversy over this issue at the last Access Arrangement Review, and with IPART's determination.

4) Reference Tariffs and Forecast Capital Base

The EMRF notes that section 8.20 of the code allows reference tariffs to be determined on the basis of forecast capital expenditure, so long as the capital expenditure is reasonably expected to pass the requirements of section 8.16 of the code.

We also note that there was a capital underspend of \$55.9 million in the 1999/00 to 2003/04 Access Arrangement period. AGLGN would have been provided with regulated revenues which included the capital underspend, including depreciation allowances. In other words, AGLGN obtained very substantial amounts of windfall gains from the expenditure underspend. These amounts should be adjusted in the regulated revenues to be determined by IPART for the period 2004/05 to 2009/10. Moreover, for AGLGN to also claim capital allowances for projects that have been deferred (e.g. the primary pipeline loop) in the 2004/05 to 2009/10 period is a classic case akin to having the same projects paid for twice by consumers. This should not be allowed and the relevant adjustments made.

5) Information Deficiencies

The EMRF notes that ECG has been unable to obtain significant amounts of information on AGLGN's operational costs, reflecting the "nature of its contract with Agility". This is unfortunate, especially as in some important cost areas, increased expenditures, increased volume of work and increased unit costs have been claimed, especially during the 1999/00 to 2003/04 period.

The pipeline industry, through its association has consistently maintained in discussions in the National Gas Pipelines Access Committee (NGPAC) that the present code is not deficient in terms of enabling regulators reasonable access to information necessary to enable them to perform their regulatory remit. If this is the case, the EMRF insists that IPART should be able to access all the relevant cost information. ECG's methodology in ascertaining such costs, by way of "discussions" with Agility is not transparent and denies users their rights to access of cost information in order that they could ascertain their "reasonableness".

The EMRF requests that IPART rejects ECG's methodology and exercise its undeniable powers (under NSW licensing legislation) to obtain the necessary information so that users can ascertain the "reasonableness" of significant expenditure costs claims in the previous and current Access Arrangement period. In the NGPAC forum, IPART representatives have admitted that the NSW (and Victorian) licensing legislation do provide regulators with the necessary information collection powers in such situations.

6) Marketing Costs

The EMRF rejects ECG's and AGLGN's reasoning on the use of the bulk of marketing costs as incentive payments to gas retailers. The EMRF considers that if marketing costs / incentive payments were to be accepted as regulated revenues, the payments should be passed through to consumers. Unless this is done, they are effectively cross – subsidies to AGLGN's retail affiliate which is the dominant gas retailer in NSW. It has not been reasonably established why AGLGN's retail affiliate requires the incentives, given its dominance of the NSW gas retail market.

The EMRF considers that incentive payments not be included as a regulated cost.

7) Compression of Zones

The compression in the number of zones affect different stakeholders differently depending on their circumstances. The EMRF has consistently taken the position, with respect to gas and gas pipelines, that it supports competitive outcomes as they are the most sustainable way of promoting consumer interests. Gas on gas competition occurred in NSW only as a result of the EGP, and importantly, it was facilitated by a number of industrial customers willing to accept long- term contracts with the foundation gas shipper. It is critical, therefore, that these and other customers are not disadvantaged by the proposed reduction in the number of pricing zones in the AGLGN Access Arrangements. Importantly, the public interest objective of ensuring the sustainability of gas competition in NSW must be the key determinant in IPART's consideration of the AGLGN proposal.

Also of great importance is that IPART must ensure that relevant tariffs are cost reflective in terms of section 8 of the code. A compression in the number of zones will mean, for many customers, non-cost reflective tariffs, which in effect means higher tariffs. these increases are not insignificant for companies faced with international competition.

Against the above, the EMRF is strongly of the view that IPART must determine this issue on the basis of whether there are economic benefits arising from AGLGN's proposal which outweighs the effects of promulgating non-cost reflective tariffs (thereby inconsistent with Code objectives) impediments to sustaining competition and the disadvantaging of many industrial customers cost base.