

Decision

Tender Approval Request for the Proposed Pipeline to the Central Ranges region

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Abbreviations

AGL	Australian Gas Light Company
APT	Australian Pipeline Trust
Code	National Third Party Access Code for Natural Gas Pipeline Systems
Commission	Australian Competition and Consumer Commission
CRNG&TAI	Central Ranges Natural Gas and Telecommunications Association Incorporated
CWP	Central West Pipeline
FAR	Final Approval Request
GJ	Gigajoule
PJ	Petajoule
TAR	Tender Approval Request
Tribunal	Independent Pricing and Regulatory Tribunal of New South Wales

Executive Summary

On 3 January 2003 the Central Ranges Natural Gas and Telecommunications Association Incorporated (CRNG&TAI) submitted a tender approval request (TAR) to the Australian Competition and Consumer Commission (the Commission) and to the Independent Pricing and Regulatory Tribunal (IPART) to conduct a competitive tender under the *National Third Party Access Code for Natural Gas Pipeline Systems* (the Code).¹ The tender option under the Code, subject to gaining regulatory approval of the tender process and administration of the process, allows reference tariffs to be set for fixed periods based on the tender outcome and without regulator scrutiny of the reference tariffs.

The proposed tender is for the construction of a transmission pipeline and distribution network to supply natural gas to the Central Ranges region of New South Wales. The proposal does not require specific towns to be supplied, however, the CRNG&TAI expects that the successful tenderer would service at a minimum Mudgee, Tamworth and Gunnedah.

Under the Code, the Commission has responsibility for the regulation of transmission pipelines and IPART has responsibility for the regulation of distribution pipelines in NSW. The application was submitted to the Commission and IPART under section 3.21. The process proposed by the CRNG&TAI requires some collaboration on the part of the Commission and IPART in assessing the TAR and the Final Approval Request for the project. While the Commission and IPART have worked co-operatively on parts of the process, each has an obligation to make its own separate decision.

Upon receipt of the TAR, the Commission and IPART jointly placed advertisements in a number of national and local newspapers providing notice of the TAR and inviting comments from interested parties by 7 February 2003. In addition, the Commission and IPART released an Issues Paper on 14 January 2003 which was forwarded to over 60 interested parties.

A total of six submissions were received in response to the public consultation process. A number of issues were raised in submissions. The more contentious being from Agility Management (in its own right and on behalf of APT and AGL) which raised concerns that the proposed selection process did not explicitly define the status and treatment of conditional bids in the selection process.

In response, the CRNG&TAI sought regulator approval to lodge an amended TAR to address the concerns raised regarding conditional tenders. In view of the nature of this amendment and the public consultation requirements of the Code, the CRNG&TAI requested that a further public consultation round be conducted on the amended TAR, with close of submissions on 6 March 2003 and an extension of one week to the

¹ The CRNG&TAI consists of eight local councils from the Central Ranges region (Coolah Shire Council, Coonabarabran Shire Council, Gilgandra Shire Council, Gunnedah Shire Council, Mudgee Shire Council, Parry Shire Council, Quirindi Shire Council, Tamworth City Council) as well as the Mudgee Region Business Enterprise Centre and the Tamworth Development Corporation.

decision date for the TAR to 14 March 2003 to facilitate this. The Commission and IPART sought public comment on the proposed amendments to the TAR. To facilitate this process an advertisement was placed in *The Australian* newspaper on 20 February 2003. There were no submissions received by the Commission regarding the amendments to the TAR.

The selection process set out in the TAR is a three stage process. Stage 1 establishes the criteria that bids must meet to be considered conforming and allow progress to the next stage. This stage also specifies the criteria which must be met in order for conditional bids to be considered conforming. Stage 2 requires bids to meet minimum prudential and technical requirements. Under Stage 3 of the amended TAR selection process, non-conditional bids will, in all cases, rank above conditional bids. The prime criteria for awarding the successful non-conditional bid will be on the basis of the lowest sustainable combined transmission and distribution tariffs over the economic life of the pipeline. Secondary criteria will be taken into account where two or more non-conditional bids provide the same or similar tariffs. Where only conditional bids are received, the same prime criteria will be applied and where necessary, secondary criteria.

Section 3.28 of the Code specifies the criteria by which the Commission must assess a TAR. This section stipulates that if the TAR satisfies all the criteria then the Commission must approve the TAR, and if any of the criteria are not met then the TAR must not be approved.

The Commission assessed the amended TAR against each of the criteria in section 3.28. In respect to the amendment to the selection criteria, the Commission found that the amended selection process is more transparent and therefore more likely to provide for an open process and encourage a greater number of bids. The preference given to non-conditional bids in the selection process was not found to violate the competitiveness of the tender process. Bids that are conditional upon future events may not be consistent with a competitive outcome if it forces the CRNG&TAI to accept a bid that is contingent on some future event, especially if the event is beyond the tenderer's control. The Commission considers that there is some justification for the CRNG&TAI to establish criteria which, in effect, force bidders to compete on the basis of their ability to meet their tender specifications.

Overall, the Commission concluded that the amended TAR satisfies each of the section 3.28 criteria. Accordingly, pursuant to section 3.25 of the Code the Commission approves the amended TAR submitted by the CRNG&TAI on 18 February 2003.

1. Introduction

On 3 January 2003, the Central Ranges Natural Gas and Telecommunications Association Incorporated (CRNG&TAI) submitted a Tender Approval Request (TAR) for the supply of natural gas to the Central Ranges region of New South Wales to the Australian Competition and Consumer Commission (the Commission) and the Independent Pricing and Regulatory Tribunal of New South Wales (IPART). The application was made under section 3.21 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the Code). A TAR was submitted to the Commission to cover the transmission aspect of the project and to IPART to cover distribution.

The proposal is for the construction of a new transmission and distribution pipeline that would most likely transport gas from an existing transmission pipeline (the Central West Pipeline (CWP) which terminates at Dubbo) to a network of distribution pipelines delivering gas to prospective users in the Central Ranges region, which extends broadly from Dubbo to Tamworth and Gunnedah. Under the proposal there are no specific towns that must be supplied with natural gas. However the CRNG&TAI expects that the successful tenderer would service at a minimum Mudgee, Tamworth and Gunnedah.

Under the Code, the Commission has responsibility for the regulation of transmission pipelines nationally² and IPART has responsibility for the regulation of distribution pipelines in NSW. Sections 3.21 to 3.36 of the Code outline the process to be followed where reference tariffs are to be determined for a proposed pipeline via a competitive tender process. On receipt of a TAR, the regulators are required to invite public consultation on issues concerning the proposal and assess its compliance with a number of criteria outlined in section 3.28 before making a decision as to whether or not to approve the request. Under the Code, approval of the proposed tender process is required before the tender can be conducted. Section 2 of this document provides a description of the full approval process required by the Code.

The process proposed by the CRNG&TAI requires some collaboration on the part of the regulators in assessing the TAR and the Final Approval Request (FAR) for this project. While the Commission and IPART have worked co-operatively on the appraisal process for the TAR, each has an obligation to make its own separate decision pursuant to the Code. Any successful tenderer will still be required to submit separate access arrangement proposals to each regulator for assessment of those elements not determined by the tender process.

Background to the tender

Upon completion of the Central West pipeline from Marsden to Dubbo in 1998, the CRNG&TAI, which consists of eight local governments and two development

² With the exception of Western Australia.

organisations, was formed to promote the development of natural gas to the Central Ranges region of NSW. In the initial stages of this project the CRNG&TAI worked with the Australian Pipeline Trust (APT) and Australian Gas Light company (AGL) to develop a project to bring gas to the Central Ranges region by extending the CWP to Tamworth and some surrounding areas. This proposal proceeded to a point where APT was granted a pipeline licence for the project from the NSW Government under the *Pipeline Act 1967*. However, APT and AGL were not ready at the time to commit to the project as projected loads were not considered sufficient to make the project economically viable and the project was put on hold.³

Accordingly, the CRNG&TAI considered a number of other options for pursuing the construction of a gas supply link to the region. After consideration of these options, it was decided that conducting a competitive tender under the Code would be the best means to facilitate the development of a gas supply link to the Central Ranges region for a number of reasons including:

- A tender process of some sort was considered necessary to bring to a head the matter of supply to the region; and
- A tender process would enable the CRNG&TAI to be confident that competitive outcomes will ensue.⁴

The timetable for the tender process is being driven by the timing requirements for an ethanol plant proposed by Primary Energy for Gunnedah. This would be the major foundation customer for the pipeline, consuming between 1.3-2.6 PJ per annum. The Commission has been advised by Primary Energy that the plant is scheduled to commence operation by late 2004.

Decision

This Decision is issued by the Commission under section 3.25 of the Code and approves the TAR (and the amendments submitted on 18 February 2003) submitted by the CRNG&TAI. The reasons for the Commission's approval are set out in section 4 below.

Final approval request

Following completion of the tender and selection of a winning bid, the CRNG&TAI must submit the outcome of the process, in the form of a Final Approval Request (FAR) to the Commission and IPART for regulator approval under section 3.32. Before granting final approval the regulators must be satisfied, amongst other things, that the tender process proposed was followed and that the successful tenderer was selected in accordance with the selection criteria set out in the TAR. Once final approval is

³ CRNG&TAI, *Tender Approval Request, Section 1 – Background and Regulatory Information*, 18 February 2003, p. 20.

⁴ CRNG&TAI, *Tender Approval Request, Cover Letter*, 3 January 2003, p. 2.

granted, the Reference Tariffs proposed by the successful tenderer will become the Reference Tariffs for the proposed pipeline.

The FAR documentation is required to include a statement detailing which bid was selected and give supporting reasons for that selection based on the selection criteria. The relevant regulators will then make a decision to approve or not approve the FAR.

Should the FAR be approved, the proposed pipeline becomes a covered pipeline pursuant to section 3.34 of the Code and the successful tenderer has 90 days to lodge a proposed access arrangement with the relevant regulators. The proposed access arrangement is only required to address those aspects of an access arrangement that were not determined by the tender process.

2. Regulatory issues

2.1 Current assessment process

Section 3.22 of the Code outlines certain items that must be addressed in a TAR. The tender documentation must: nominate the locations that the proposed pipeline will transport gas from and to; provide detail of the procedures, rules and selection criteria including the minimum requirements which a tender must meet before it will be accepted as a conforming tender; and specify one or a series of possible revisions commencement dates.

Within 14 days of receiving the TAR, the regulator must commence public consultation on the matter.⁵ This process is outlined in section 3.23 of the Code and requires that the regulator inform all parties with sufficient interest in the matter that it has received a TAR and publish a notice in a national daily newspaper. The notice must at least describe the proposed pipeline to which the TAR relates, state how copies of the TAR can be obtained, and request submissions by a specified date. After considering submissions received, the regulator must issue a decision to either approve or not approve the TAR in accordance with section 3.25 of the Code.

Appendix A outlines the regulatory process from receipt of a TAR by a regulator to the final approval of an access arrangement.

2.2 New South Wales gas industry structure and regulatory framework

NSW is the third largest user of gas in Australia and consumed over 137.8 PJ in 1999-2000⁶. Approximately 78 per cent of total gas sales is accounted for by industrial and commercial customers.⁷ All natural gas in NSW is imported from other states through three main high pressure transmission pipelines:

- the Moomba to Sydney Pipeline which transmits gas from Moomba in South Australia to the Sydney city gate at Wilton, with laterals and spur lines to Canberra and regional centres such as Lithgow, Yass and Dubbo;
- the Eastern Gas Pipeline (EGP), which transmits gas from Longford (Victoria) to Horsley Park (NSW); and
- the Interconnect Pipeline, which connects the Victorian transmission system to the NSW network via a pipeline between Barnawartha and Wagga Wagga.

⁵ Subject to section 3.27 which enables the regulator to decide not to approve a TAR at any time if it is of the opinion that the person submitting the TAR may have, or may appear to have, a conflict of interest.

⁶ ABARE, Australian Energy: projections to 2019-20, p.91.

⁷ The Australian Gas Association, Facts and Figures, from: <http://www.gas.asn.au>

AGL Gas Networks Limited operates the natural gas distribution system in the major cities in NSW, including Sydney, Newcastle and Wollongong, as well as a number of regional areas. Other distribution companies operating in NSW include Country Energy Gas Pty Ltd (which supplies Wagga Wagga, Tumut, Cooma, Adelong, Bombala and Gundagai), Envestra and Origin Energy (providing natural gas to Albury and other townships along the Victorian border), ActewAGL (supplying Nowra, Bomaderry and Queanbeyan), and Allgas/Energex (North Coast).⁸

Several suppliers have been issued with a licence to retail natural gas in NSW, including AGL Energy Sales and Marketing, AGL Retail Energy, Allgas Energy/ENERGEX retail, BHP Billiton Petroleum, Citipower, TXU Electricity and Energy Australia.⁹ Under the NSW Government's timetable for the introduction of competition in NSW, all gas customers became contestable on 1 January 2002.

The main legislation and relevant documents regulating access to gas transmission pipelines in NSW are:

- the Code, under which transmission service providers are required to submit access arrangements to the Commission for approval;
- the *Gas Pipelines Access (South Australia) Act 1997*;¹⁰ and
- the *Gas Pipelines Access (New South Wales) Act 1998*.¹¹

Code and appeal bodies in NSW with respect to transmission pipelines are:

- the Commission – regulator and arbitrator;
- the National Competition Council – Code advisory body;
- the Commonwealth Minister – coverage decision maker;
- the Federal Court – judicial review; and
- the Australian Competition Tribunal – administrative appeal.

IPART is the regulator for gas distribution systems in NSW and the Independent Competition and Regulatory Commission is the regulator for the gas distribution system in the ACT, Queanbeyan and Yarrowlumla shire.

⁸ Ibid.

⁹ Ibid.

¹⁰ South Australia acted as lead legislator for the national gas access legislation.

¹¹ NSW subsequently enacted legislation applying the SA legislation in NSW. The NSW legislation commenced on 14 August 1998.

2.3 Criteria for assessing a tender approval request

Section 3.28 of the Code sets out the criteria by which the Commission must assess a TAR. It states that the Commission must approve a TAR if the applicant meets all the elements of that section and must not approve a TAR if it does not meet all of the required elements. The requirements are:

- that the proposed pipeline is a new pipeline;
- that the proposed tender process is in the public interest, and that it will determine reference tariffs that achieve the objectives of section 8.1 of the Code;
- that the tender process will be competitive;
- the process ensures the exclusion of tenders that do not meet the minimum criteria. A tender should be excluded if it:
 - does not include a statement of the proposed reference services and their applicable reference tariffs;
 - does not include an additional revenue policy detailing how any excess revenue above that anticipated in the tender would be retained by the service provider or returned to, or shared with, users;
 - does not include a residual value for the proposed pipeline at the end of the first access arrangement period that is based on depreciation over the pipeline's economic life;
 - includes any provision that limits or purports to limit the services to which access may be sought; or
 - otherwise includes elements inconsistent with the Code.
- the tender process should only exclude from consideration any non-conforming tender (as listed above) and those that do not meet any reasonable requirements in the request for tenders or the prudential and technical requirements of the tender;
- that the selection criteria for conducting the tender should result in the successful tender being selected principally on the basis of delivering the lowest sustainable tariffs to users over the pipeline's economic life and that the reference tariffs are likely to meet the criteria in section 3.33(c) of the Code;
- that the tender documents specify which access arrangement elements, other than reference tariffs, will be determined by the tender and that those items are directly relevant to the determination of reference tariffs; and
- that the tender documentation does not specify the configuration of the proposed pipeline, including the areas to be serviced, pipeline dimensions, level of compression or other technical specifications, unless the relevant regulator is satisfied it would be appropriate to do so.

In addition, section 3.28 of the Code also requires that any other documentation supporting or relating to the tender process is consistent with the Code and does not limit:

- the services which the service provider may provide or to which access may be sought under the Code;
- the configuration of the proposed pipeline; or
- the construction or operation of other pipelines which could deliver gas to the same gas market as the proposed pipeline.

2.4 Consultative process

Pursuant to the section 3.23(b) of the Code, the Commission and IPART jointly placed advertisements in the following newspapers which provided notice of the TAR and invited submissions from interested parties:

The Australian	14 January 2003
Australian Financial Review	14 January 2003
Mudgee Guardian	14 January 2003
Tamworth Northern Daily Leader	14 January 2003
Western Magazine	20 January 2003

In addition, in order to foster the consultative process the Commission and IPART released a joint Issues Paper on 14 January 2003 and forwarded this to over 60 interested parties. Pursuant to section 3.23(b)(iii) of the Code, the Commission and IPART specified 7 February 2003 as the date by which submissions should be lodged. A total of six submissions were received from interested parties:

- Gunnedah Shire Council (22 January 2003);
- Planning NSW (23 January 2003);
- Public Interest Advocacy Centre (30 January 2003);
- Mudgee Co-operative Meat Supply (29 January 2003);
- Europacific Corporate Advisory (4 February 2003); and
- Agility Management, in its own right and on behalf of APT and AGL, (6 February 2003).

A number of issues concerning the proposed tender were raised by submissions. In particular, Agility Management submitted that the wording of the proposed selection process was not explicit regarding the treatment of conditional bids.

In response to a number of the concerns raised, the CRNG&TAI wrote to the Commission and IPART on 18 February 2003 and requested that:

- it be allowed to amend the original TAR to take account of the issues raised by Agility;
- the regulators conduct a further round of public consultation on the amended TAR; and
- the Commission and IPART delay releasing their decision on this matter until 14 March 2003 to allow for consideration of submissions on the amended TAR.

The Commission and IPART sought public consultation on the proposed amendments to the TAR. To facilitate this process an advertisement was placed in *The Australian* newspaper on Thursday 20 February 2003. There were no submissions received by the Commission regarding the amendments to the TAR.

3. Tender approval request

The CRNG&TAI submitted a TAR to the Commission and IPART for the supply of natural gas to the Central Ranges region of New South Wales. The proposal includes the construction of a new transmission pipeline that would likely transport gas from an existing transmission pipeline (the Central West Pipeline which terminates at Dubbo), in addition to the construction of a network of distribution pipelines to deliver gas to prospective users in the Central Ranges region, which extends broadly from Dubbo to Tamworth and Gunnedah. While the TAR does not identify any particular towns that must be supplied with natural gas, it notes that it is expected that the successful tenderer will serve at a minimum Mudgee, Tamworth and Gunnedah.

The tender process proposed by the CRNG&TAI will result in the determination of four elements of the access arrangement for the Central Ranges pipeline. These are the reference tariffs, the additional revenue policy, the reference tariff policy and the revisions commencement date. The tender documentation notes that whilst bidders are free to nominate a revisions commencement date, the TAR has proposed a date of 1 July 2019 in order to assess the merits of competing bids on a 'like with like' basis.

The tender process outlined by the CRNG&TAI proposes that the winning bid should be determined by a three stage process.

Stage 1

In the first stage of the tender process all bids will be assessed to determine whether they are conforming or non-conforming bids. The proposed tender rules stipulate that a bid will automatically be considered to be non-conforming and not considered further if it: does not include a statement of the proposed reference tariffs and the reference services; does not include an additional revenue policy; does not include a residual value; limits the services under which access may be sought; or includes elements that are inconsistent with the Code. In addition, a tender which is conditional upon an event or events occurring will generally be considered to be non-conforming unless it meets a number of characteristics, including:

- the condition must be explicit and unambiguous;
- the effect of conditions on the tender must also be explicit and unambiguous;
- the tender must nominate a finite date by which the conditions must be satisfied or deemed to have lapsed, which may be no more than three months after the closing date for tenders;
- conditions cannot rely on post-construction events; and
- proposed reference tariffs cannot be dependent on load or customer numbers.

All bids that are deemed to be conforming at the end of Stage 1 (whether conditional or non-conditional) will progress to the next stage and be assessed against Stage 2 criteria.

Stage 2

To meet the requirements of the Stage 2 criteria bids must incorporate an appropriate additional revenue policy and must demonstrate to the satisfaction of the CRNG&TAI that the tenderer has sufficient technical and prudential capacity to own and operate a gas transmission pipeline and a gas distribution pipeline. Only conforming bids meeting these minimum requirements (whether conditional or non-conditional) will progress to the third and final stage of the process.

Stage 3

Under the CRNG&TAI's proposed selection criteria, Stage 3 involves the division of bids into conditional and non-conditional bids and specifies that conditional bids will, in all cases, be ranked lower than non-conditional bids when awarding the tender. Conditional bids will only be considered in the event that no non-conditional tenders are submitted, or if non-conditional bids propose reference tariffs that do not meet the criteria specified in section 3.33(c).

Non-conditional bids

All non-conditional bids will be reviewed on an equal basis. The main criteria for selecting the successful tenderer will be the lowest sustainable average combined distribution and transmission tariffs (including but not limited to reference tariffs) to users generally over the economic life of the pipeline. This assessment is subject to reference tariffs achieving the objectives in section 8.1 of the Code, and containing or reflecting an allocation of costs between services and an allocation of costs between users which is fair and reasonable.

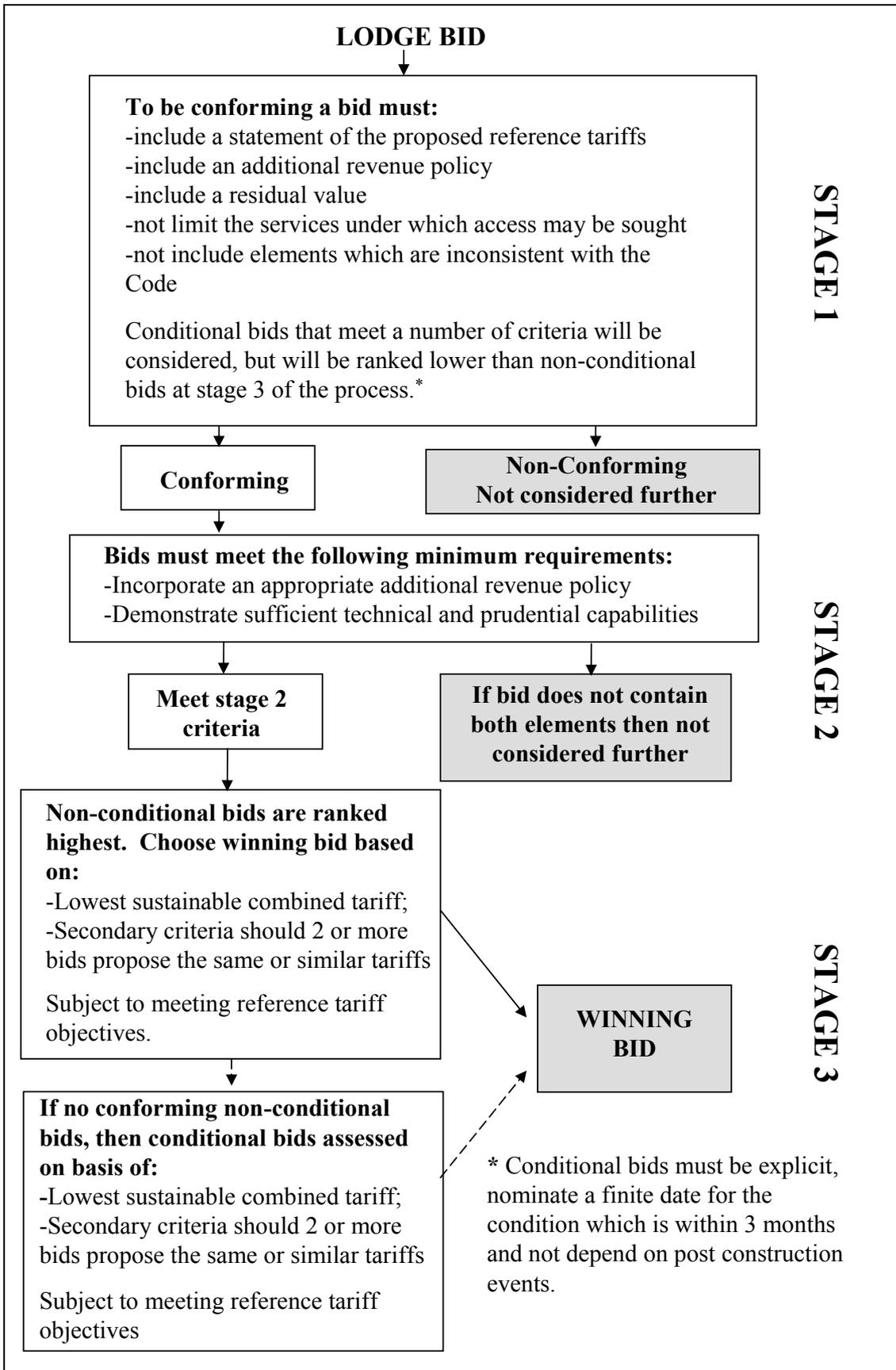
Should two non-conditional bids propose the same or similar tariffs, then bids will be assessed against three secondary criteria: the areas to which gas will be made available, the number of customers which will have access to natural gas and the proposed construction timetable.

Conditional bids

If only conditional bids are submitted (or if non-conditional bids propose reference tariffs that do not meet the criteria specified in section 3.33(c)), then the CRNG&TAI will assess these bids primarily on the basis of the lowest combined reference tariffs. However where two conditional tenders propose the same or similar level of tariffs, the CRNG&TAI will also take into consideration a number of secondary criteria: the nature of conditions, the areas to which gas will be made available, the number of customers, and the proposed construction timetable.

A graphical depiction of the selection criteria is presented in Figure 1 below.

Figure 1: Amended selection process proposed by the CRNG&TAI.



Tenderers are also required to comply with the lodgement information in clause 4 of the tender specifications and provide additional information to the CRNG&TAI to facilitate the assessment of bids according to the selection criteria. Additional information required includes:

- information on the identity of the tenderer;
- forecast volumes of gas transported and revenue for both transmission and distribution pipelines;
- details of the capital and operating costs of both transmission and distribution pipelines;
- details of the number of end users that are expected to be connected and able to be connected to the distribution pipeline;
- details of the tenderer's technical and prudential capabilities;
- a description of the areas to be reticulated with natural gas;
- a revisions commencement date; and
- details of proposed retail tariffs.

4. Assessment

Section 3.28 of the Code specifies the criteria by which the Commission must assess a TAR. It stipulates that if the TAR satisfies all the criteria then the relevant regulator must approve the TAR. Conversely, if any of the criteria are not met then the TAR must not be approved. The following is the Commission's assessment of the TAR with reference to each of these criteria.

4.1 New pipeline

The CRNG&TAI tender documentation advises that the proposed pipelines (transmission and distribution) will be new pipelines.¹² The Commission considers that this meets the requirement of section 3.28(a) of the Code.

4.2 Public interest and reference tariff objectives

The CRNG&TAI's application states that the potential for supply of natural gas to the Central Ranges region has been apparent for some time. During the evaluation of the Central West pipeline, it became clear that there exists significant potential demand in the agricultural centres to the north and east of Dubbo.¹³ The Central Ranges region is the largest NSW inland area not serviced by natural gas, and the provision of gas in the region 'would enhance the attractiveness of the region to business and residents' and will provide increased opportunity for relocation to the region.¹⁴

The CRNG&TAI advised that it had considered a number of options for progressing the construction of the proposed Central Ranges pipeline. The CRNG&TAI noted that these alternative options include direct determination of Reference Tariffs by the regulator. The CRNG&TAI submitted that conducting a competitive tender under the provisions of the Code is the most appropriate course of action because:

- a tender process will bring the matter to a conclusion, and will allow that the timing requirements of a proposed ethanol plant can be met;
- a tender process enables sponsoring agencies to be confident that competitive outcomes will ensue;
- a competitive tender has significant support from the Federal Government which has agreed to partially fund the cost of conducting the tender;

¹² CRNG&TAI, *Tender Approval Request, Cover letter*, 3 January 2003, Attachment 1, p. 8.

¹³ CRNG&TAI, *Tender Approval Request, Cover letter*, 3 January 2003, p. 1.

¹⁴ CRNG&TAI, *Tender Approval Request, Section 1 - Background and Regulatory Information*, 18 February 2003, p. 1.

- the process does not exclude companies that do not wish to have pipelines covered under the Code;
- potential bidders have not suggested that the coverage implications of conducting the tender under the Code would deter them from bidding;
- the cost of conducting a tender under the Code is expected to be no more than conducting a tender outside of the Code;
- guidelines issued by the Victorian Essential Services Commission suggest that a tender would be appropriate in circumstances where more than 1000 customers would be served within five years; and
- the CRNG&TAI is not aware of any of the potential participants in recent tender processes that indicated that coverage under the Code was a barrier to putting a tender forward.¹⁵

The CRNG&TAI considered that it is reasonable to assume that the reference tariff principles of section 8.1 of the Code are more likely to be satisfied through a tender process than via determination of reference tariffs by a regulator.¹⁶ It stated that section 3.28(b) relating to the public interest is synonymous with section 3.28(c) which relates to the competitiveness of the tender.

Submissions

In its submission of 22 January 2003, Gunnedah Shire Council advised that it has been working for almost six years to bring about the supply of natural gas the region. The Council stated that natural gas is vital to the region and will ensure increased competition between energy sources in the area. In addition, numerous surveys and community consultations have indicated wide ranging community support for the project.¹⁷

Gunnedah Shire Council also noted that the timing of the process is crucial due to the demands of a proposed ethanol plant development to be located in Gunnedah. It is argued that the loss of this plant would destroy the six years of work by the community based association and may result in the project being deferred indefinitely.¹⁸

In its submission of 30 January 2003, the Public Interest Advocacy Centre stated that it was extremely pleased that the CRNG&TAI has taken the initiative to submit the

¹⁵ CRNG&TAI, *Tender Approval Request, Cover Letter*, 3 January 2003, Attachment 5, p. 14.

¹⁶ CRNG&TAI, *Tender Approval Request, Cover Letter*, 3 January 2003, p. 2.

¹⁷ Gunnedah Shire Council submission, 22 January 2003.

¹⁸ Gunnedah Shire Council submission, 22 January 2003.

Tender Approval Request, and that as a result many households in the Central Ranges region may have access to an affordable natural gas supply.¹⁹

The Mudgee Co-operative Meat Supply Ltd stated that it supports the tender to bring the supply of natural gas to the Central Ranges region. It submitted that it looks forward to the increase in competition in the energy market that the arrival of natural gas will bring, and that the open competitive process of the tender should overcome past problems with connecting gas to the region.²⁰

Europacific advised that it has formed a consortium that is interested in constructing, operating and owning the proposed Central Ranges pipeline, and that the open competitive process should ensure that the owner/developer of the pipeline will receive a satisfactory return for the risks.²¹

Commission's considerations

The requirement of section 3.28(b) of the Code is 'that using the tender process as outlined in the TAR to determine Reference Tariffs is in the public interest and is an appropriate mechanism in the circumstances for ensuring that Reference Tariffs achieve the objectives in section 8.1.'

This section of the Code may be viewed as consisting of two elements: that using the tender process under the Code to determine reference tariffs is in the public interest; and that the tender process will ensure that reference tariffs achieve the objectives set out in section 8.1 of the Code.

Is the tender in the public interest?

The Code provides limited guidance as to what is meant by public interest. The Commission, however, considers that it may be reasonable to use a cost/benefit-based definition of the public interest. That is, if the total public benefits of conducting the tender exceed the costs associated with that tender, then the process may be viewed as being in the public interest.²²

The Commission notes that a distinction should be made between public support and public interest. While significant support for the process has been put forward by numerous parties such as the Federal Government, local councils in the region and local businesses, such support does not on its own constitute that the project is in the public interest relative to other alternatives.

What are the public costs and public benefits in this case? The public costs incorporate all of the costs incurred in conducting and arranging the tender process relative to other

¹⁹ Public Interest Advocacy Centre submission, 30 January 2003.

²⁰ Mudgee Co-operative Meat Supply Ltd submission, 29 January 2003.

²¹ Europacific Corporate Advisory Pty Ltd submission, 4 February 2003

²² This framework is adopted from Essential Services Commission, *Loddon Murray Gas Supply Group – Request to Conduct a Tender*, 26 October 2001, p. 4.

options. The Commission understands that the Minister for Local Government approved a grant of \$87 000 to facilitate the tender, which the CRNG&TAI has stated represents about half the cost of conducting the tender process.²³ On the basis of this information it is reasonable to assume that the public cost of the tender process is approximately \$174 000.

The Commission considers that one of the principal public benefits of conducting a competitive tender under the Code is that tariffs determined through the tender process are expected to reflect the outcome of a competitive market. Other potential benefits include the improved level of service generated through the tender process, and the timely introduction of natural gas to the region and the consequent development of a national market in natural gas.

A competitive tender under the Code represents one of four main options available for progressing the supply of natural gas to a region. These are as follows:

- under a sole source negotiation model the CRNG&TAI could approach potential service providers and negotiate with them individually for the provision of the service outside the regulatory regime;
- the CRNG&TAI could enter into sole source negotiations, as above, but the proposed owner of the pipeline may seek coverage of the project by voluntarily submitting an access arrangement under the Code or access undertaking under Part IIIA of the *Trade Practices Act 1974*;
- the CRNG&TAI could elect to conduct a tender outside of the provisions of the Code; or
- a competitive tender could be conducted by the CRNG&TAI under the provisions of the Code.

With regard to the first two options, the Commission considers that the proposed tender process will provide greater public benefits than those that would be generated through sole source negotiations under the current circumstances. While the costs associated with sole source negotiation are likely to be relatively small compared to those of conducting a tender, the latter is anticipated to generate tariffs formed under competitive pressures that may not be present in direct negotiations.

Moreover the Commission is of the view that the facilitation of natural gas to the region is more likely under the competitive tender process than under sole source negotiations given that no specific deadlines are required under the direct negotiations approach. This view is partly evidenced by the fact that the CRNG&TAI has been unsuccessful in its negotiations in recent years with APT and AGL to develop the pipeline to the region.

In considering the third option, a tender outside the Code, the Commission notes that for some bidders, this option is likely to offer fewer benefits than option four due to the

²³ CRNG&TAI, *Tender Approval Request: Cover Letter*, 3 January 2003, Attachment 5, p. 14.

risk of regulatory intervention at some later stage. This may deter some potential tenderers from bidding because, unlike the tender process under the Code, it offers no mechanism for service providers to lock-in tariffs for a defined period without regulatory review. Whilst the Commission is of the opinion that in the case of the proposed Central Ranges pipeline the risk of coverage is likely to be minimal, the potential nevertheless exists for a third party to seek coverage at any time. This potential is likely to increase relative to the successfulness of the pipeline operation.

Is the tender appropriate for ensuring that Reference Tariffs achieve the objectives in section 8.1 of the Code?

The second aspect of section 3.28(b) requires the Commission to be satisfied that the proposed tender is appropriate for ensuring that reference tariffs achieve the objectives set out in section 8.1 of the Code. The 8.1 objectives are:

- providing the service provider with the opportunity to recover efficient costs;
- replicating the outcome of a competitive market;
- ensuring the safe and reliable operation of the pipeline;
- not distorting investment decisions in pipeline transportation systems or in upstream and downstream industries;
- efficiency in the level and structure of the reference tariff; and
- providing an incentive to the service provider to reduce costs and to develop the market for reference and other services.

The Commission considers that provided the TAR produces a competitive outcome as required under 3.28(c) of the Code, the proposed tender should ensure that the reference tariff objectives of section 8.1 will be met. The competitive tender process should encourage bidders to put forward tariffs that allow the service provider to recover expected costs, but are not excessive given the underlying threat of a competitive or lower bid. Moreover, clause 4.1.5 of the tender specifications requires that applicants describe why the reference tariffs and reference tariff principles of their bid achieve the objectives of section 8.1, the merits of which are assessed by the CRNG&TAI at Stage 3 of the proposed selection process.

In addition, the CRNG&TAI has engaged consultants with regulatory experience to assist in the conduct of the tender and assess the tenderer's proposed reference tariffs against the Code requirements.²⁴

For the above reasons, the Commission considers that the process outlined in the TAR should be in the public interest when compared to the alternative options. Moreover, the Commission is of the opinion that the potential for competitive pressure between interested parties to supply gas to the region is expected to produce reference tariffs

²⁴ CRNG&TAI, *Tender Approval Request: Cover Letter*, 3 January 2003, Attachment 5, p. 15.

that meet the objectives specified in section 8.1 of the Code. Accordingly, section 3.28(b) of the Code is satisfied.

4.3 Tender process will be competitive

Section 3.28(c) of the Code requires a competitive outcome.

When a tender process is conducted in a competitive market, the number of potential bidders in the market is expected to apply competitive pressure on any bidder. As a result, any bidder, who does not know the details of any other bid, will be encouraged to price its bid with the aim of being the successful tenderer. That is, there will be a downward pressure on price.

The CRNG&TAI indicated that prior to submitting the TAR, it undertook an assessment process to measure the likely level of interest amongst potential bidders. This principally involved calling for expressions of interest from potential bidders in June 2002. While the results of this process have been provided to the Commission on a confidential basis, the CRNG&TAI submitted that the results indicate sufficient interest amongst potential bidders to facilitate a competitive tender. The CRNG&TAI did not provide any other additional evidence in support of this criterion.

Submissions

Agility, in its own right and on behalf of APT and AGL, submitted that the TAR process needed to make provision for subsidy requirements in order for it to be genuinely competitive, in compliance with s 3.28 of the Code.²⁵ Agility considered that the proposed Central Ranges Pipeline is likely to require government assistance/subsidy in order to be commercially viable and, therefore, the selection criteria should take into account the level and nature of any subsidy a tenderer requires in submitting a tender. In the absence of a provision for subsidy requirements in the selection criteria, Agility contended that tenderers may have to submit non-conforming bids, potentially resulting in the process being re-run or non-participation by some tenderers.

No other potential bidders raised this as an issue with the Commission.

In response to the issues raised by Agility, the CRNG&TAI submitted an amendment to the TAR on 18 February 2003 to incorporate a process for considering conditional bids.²⁶ The process confirms that conditional bids will be considered conforming bids in Stage 1, provided they meet certain criteria. Notwithstanding, conditional bids will, in all cases, be ranked lower than non-conditional bids in the selection process. In the event that no non-conditional bids are received, the amended process establishes that the successful conditional bid will be awarded principally on the basis of the lowest sustainable combined transmission and distribution tariff and then according to four secondary criteria which include the nature of the conditions attached to the bid.

²⁵ Agility submission to ACCC, 6 February 2003, pp. 2-3.

²⁶ CRNG&TAI, *Tender Approval Request, Section 2 – Tender Specifications*, 18 February 2003, Section 2, Schedule 2, pp. 14-17.

No further submissions were received from interested parties in response to the amended TAR.

Other Issues

APT (in conjunction with Agility) and AGL Gas Networks had originally proposed to develop a project to bring gas to the Central Ranges region sometime following the completion of the Central West Pipeline. This proposal proceeded to the point where APT was granted a pipeline licence for the project from the NSW Government under the *Pipelines Act 1967*. However, APT and AGL were not ready at the time to commit to the project as projected loads were not considered sufficient to make the project economically viable and the project was put on hold.²⁷ APT, in conjunction with Agility, has subsequently advised that it may now wish to submit a response to the tender.²⁸

An issue not raised in submissions, but which the Commission considers requires careful consideration, is Agility's indication that it, in conjunction with APT, is willing to negotiate with the successful tenderer for the transfer of the pipeline licence and sale/assignment of project documentation while at the same time being a potential tenderer for the project. This dual role potentially raises concerns that Agility, as vendor of the pipeline licence and project documentation, may be in a position to favour its own bid by offering these assets for sale to other bidders above commercial levels or refusing to negotiate entirely.

While it is noted that the licence transfer and project documentation will be valued by an independent expert and made available to tenderers during the tender period, this does not appear to protect other tenderers from the concerns outlined above as Agility is not bound to negotiate on the basis of this valuation.

Commission's considerations

It is the intention of the Code that a tender process should be competitive. Under these conditions the number of potential bidders in the market would apply competitive pressure on any bidder. As a result, any bidder, who does not know the details of any other bid, will be encouraged to price its bid with the aim of being the successful tenderer. That is, there will be a downward pressure on price.

In relation to this matter, the Commission notes that the tender documentation does not dictate where the pipeline is to commence from, only that it should supply at a minimum the townships of Mudgee, Tamworth and Gunnedah. This increases the options available to potential bidders in negotiating with businesses for third party access to the pipeline and in determining the route of the pipeline to the Central Ranges region. This is particularly important given that potential exists for natural gas to be supplied to this region via the Moomba-Sydney pipeline or from the proposed Coonarah gas project near Narrabri.

²⁷ CRNG&TAI, *Tender Approval Request, Section 1 – Background and Regulatory Information*, 18 February 2003, p. 20.

²⁸ Agility submission to ACCC, 6 February 2003, p. 1.

The CRNG&TAI has requested that the results of the expressions of interest remain confidential. The Commission agrees that it is important to the competitive process of the tender that this information remains confidential to ensure that the tender has the best opportunity to achieve the desired outcome. The confidentiality requirements imposed on potential tenderers also appear to support this objective.

The Commission has carefully considered the CRNG&TAI's amendments to the TAR regarding the treatment of conditional bids and the comments made by Agility on this matter. The selection criteria contained in the original TAR document²⁹ did not make specific reference to conditional tenders. As such, this could result in considerable uncertainty for tenderers and the CRNG&TAI in the event that it receives a conditional bid.

It is not clear that Agility's argument that conditional bids would be non-conforming is correct. The terms 'Conforming Tender' and 'Non-Conforming Tender' are defined in the tender specifications in section 2 of the TAR. The criteria referred to in the definition are those set out in 'Stage 1' of the selection criteria. As none of the criteria in Stage 1 require a bid to be non-conditional, the fact that a bid is conditional does not make it a 'Non-Conforming Tender'.

However, this then leaves the question as to how conditional bids will be ranked against non-conditional bids. In the Stage 3 criteria, neither the primary nor secondary criteria refer to whether or not a bid is unconditional. Applied strictly, the ranking of a bid will not be affected by whether it is conditional. However, it is arguable that some limitation on conditional bids might be implied, in that a conditional bid is arguably no bid at all if it does not respond to the invitation to construct a pipeline system but instead offers to construct a pipeline system only if some further event occurs.

Given this uncertainty, the Commission agrees that amendments to the selection criteria are necessary and that these amendments should make specific reference to the treatment of conditional bids. Notwithstanding, the Commission needs to be satisfied that the amendments proposed by the CRNG&TAI do not compromise the competitiveness of the tender process. This requires consideration of the revised Stage 1 criteria which define whether a conditional bid is conforming and the revised Stage 3 criteria which establishes that conforming conditional bids will, in all cases, be ranked lower than conforming non-conditional bids in the selection process.

The Commission does not consider that the preference given to non-conditional bids violates the competitiveness of the tender process. Bids that are conditional upon future events may not be consistent with a competitive outcome if it forces the CRNG&TAI to accept a bid that is contingent on some future event, especially if the event is beyond the tenderer's control, such as receiving a government subsidy. The Commission considers that there is some justification for the CRNG&TAI to establish criteria which, in effect, force bidders to compete on the basis of their ability to meet their tender specifications, particularly given the need to secure gas supply to meet the requirements of the proposed ethanol plant. However, the selection criteria also

²⁹ CRNG&TAI, *Tender Approval Request, Section 2 – Tender Specifications*, Schedule 2, 3 January 2003, pp. 14-15.

importantly make provision for the tender to still be awarded in the event that only conditional bids are received – there is some question as to whether this would have been possible under the original selection criteria. If, as Agility has suggested, the original tender rules would have forced bidders to submit conditional tenders, then the amended selection criteria are supportive of a competitive outcome.

Overall, the Commission considers that the revised treatment of conditional bids proposed by the CRNG&TAI is appropriate and appears to be supported by the absence of comment from potential bidders to the amended TAR. The amended selection process is more explicit and transparent than the initial proposal with regard to conditional bids. This is expected to open up the process and encourage bids from tenderers who may have been reluctant to bid given the uncertainty arising from the original selection criteria.

In respect to Agility's dual role in the process as both potential bidder (in conjunction with APT) and vendor (in conjunction with APT) of the pipeline licence and sale/assignment of project documentation, the Commission initially had some concerns as to the impact of this on the competitiveness of the process. These concerns were based on the degree to which other potential bidders would be effectively locked into negotiating with Agility.

Apart from negotiating with Agility, a successful tenderer has the option of applying to the NSW Government for a separate pipeline licence/necessary requisites to develop a pipeline link to the Central Ranges region. Although this option is likely to be a longer process compared with purchasing the licence and related documents from Agility, it would be up to any proposed tenderer to negotiate supply arrangements with the proposed ethanol plant that will satisfy its gas supply requirements. The Commission has been advised in recent discussions with Primary Energy that the commencement date of the ethanol plant is now likely to be late 2004.

No comment was made by any interested parties on this issue. Given this fact, combined with the opportunity being available to potential tenderers to obtain the necessary licence/approvals by means other than negotiating with APT/Agility and the fact that the selection process adopted does not award the tender primarily on the basis of construction timetable, the Commission considers that the potential dual roles played by Agility in the tender process is not sufficient to negatively impact on the competitiveness of the tender process.

After considering the reported level of stakeholder interest in the project, the CRNG&TAI's proposed tender process and public submissions on the issue, the Commission concludes that the CRNG&TAI's TAR meets the requirements of the section 3.28(c) of the Code.

4.4 Exclusion of certain tenders

Section 3.28(d) of the Code establishes the requirements for a conforming tender and sets out the grounds under which a tender may be excluded. Each of these is discussed below.

Reference tariffs and the reference services

Section 3.28(d)(i) of the Code states that a tender will be excluded if it does not include a statement of the reference tariffs and the reference services to which those reference tariffs would apply.

The tender procedures proposed by the CRNG&TAI require that in order for a tender not to be excluded, it must include the reference tariffs to apply to the transmission pipeline for the period up to the revisions commencement date of 1 July 2019, and to the revisions commencement date nominated under clause 4.1.24 where the date is beyond 1 July 2019. Furthermore, the tender must also include a statement of the reference services to which the reference tariffs apply.

Additional revenue policy

Section 3.28(d)(ii) of the Code states that a tender must be excluded if it does not include an additional revenue policy. Such a policy establishes whether the additional revenue, which would result if the volume of gas actually transported by the proposed pipeline exceeds a certain volume, will be retained by the service provider or returned in whole or in part to users.

The CRNG&TAI tender selection procedures require that all conforming tenders must include an additional revenue policy for the transmission pipeline under clause 4.1.9 of the tender rules. This clause states that the additional revenue policy must provide details of whether and how the additional revenue that would result if the volume of gas transported by the transmission pipeline exceeds a certain volume will either be retained or returned in whole or part to users in the form of lower charges or some other form.

Residual value based on depreciation over the pipeline's economic life

Section 3.28(d)(iii) of the Code requires that a tender process must require bidders to submit that the residual value of the proposed pipeline after the expiration of the initial reference tariff will be based on depreciation over the pipeline's economic life.

The CRNG&TAI's selection criteria require that in order for a bid not to be excluded, it must include the proposed residual value of the transmission pipeline as at 1 July 2019. The TAR states that this residual value must be based on depreciation of the transmission pipeline over the pipeline's economic life and bids must state that this is the case.

Tenders that limit or purport to limit services & elements inconsistent with the Code

The Code, under section 3.28(d)(iv), states that a bid will be excluded if it limits or purports to limit the services to which access may be sought under the Code. Section 3.28(d)(v) denotes that a bid will be excluded if it includes elements inconsistent with the Code (except for those contemplated by section 3.34 of the Code).

Clause 4.2 of the CRNG&TAI's tender documents states that any bid which limits or purports to limit the services to which access might be sought under the Code, or includes elements inconsistent with the Code, except as contemplated by section 3.34, will be considered to be a non-conforming bid.

Submissions

There were no submissions received from interested parties on this issue.

Commission's considerations

The Commission has carefully examined the tender documentation, the information requirements and selection process provided by the CRNG&TAI. The Commission considers that the procedures proposed for this tender process clearly outline the conditions that must be met by a bid to be regarded as conforming. Each of the requirements specified in section 3.28(d) of the Code have been met by the CRNG&TAI. Accordingly, the Commission concludes that the TAR satisfies section 3.28(d) of the Code.

4.5 Consideration of all conforming tenders

Stage 2 of the selection process states that bids which do not meet the following criteria will not be considered further:

- incorporate additional revenue policies that are appropriate for the transmission and distribution pipeline on the basis of the proposed tariffs (including but not limited to reference tariffs); and
- demonstrate to the satisfaction of the CRNG&TAI that the tenderer has sufficient technical and prudential capacity to own and operate a gas transmission pipeline and a gas distribution pipeline.

For the purposes of this assessment, the tender specifications require a statement of the tenderer's technical and prudential capabilities under clause 4.1.2. Additionally, clause 4.1.9 requires tenderers to submit an additional revenue policy for the transmission pipeline, while clause 4.1.11 requires a description of why the additional revenue policy for the proposed transmission pipeline is appropriate.

The tender specifications state that in considering whether the tenderer has sufficient technical and prudential capacity to own and operate a gas transmission pipeline and a gas distribution pipeline, it will have regard to the level of technical capacity required in order to obtain a distribution and/or transmission licence/authorisation in the Australian gas industry. Tenderers that can demonstrate that they hold an active distribution or transmission licence/authorisation in Australia will automatically be considered to meet this criterion.

The tender documents also advise that the criteria in Stage 2 are minimum criteria. That is, tender A would not be viewed more favourably than tender B on this issue if they both fulfil the minimum requirements.

Submissions

No submissions were received on this issue.

Commission's considerations

Section 3.28(e) of the Code states that 'the proposed procedures and rules to be followed in conducting the proposed tender will result in no tender being excluded

from consideration except in the circumstances outlined in paragraph (d) or if the tender does not conform to other reasonable requirements in the request for tenders or does not meet reasonable prudential and technical requirements’.

The Commission considers that this element of the Code relates to the reasonableness of the requirements set for potential tenderers. A well structured tender should require enough information to allow the persons conducting the tender to make an informed choice as to the successful tenderer’s background and bid. However, the requirements on those tendering should not be so onerous as to exclude or deter what would otherwise be competitive tenderers and thereby reduce the overall competitiveness of the tender process.

The Commission has considered closely the information requirements and the selection process proposed by the CRNG&TAI. Whilst the Code mandates that the selection criteria of a competitive tender must require that all bids include an additional revenue policy, the selection criteria proposed by the CRNG&TAI requires that it must be an ‘appropriate’ revenue policy under the minimum requirement of Stage 2 of the selection process. The Commission is of the view that the minimum requirement of an ‘appropriate’ revenue policy is reasonable and addresses section 3.28 (e) of the Code. This is because there is significant scope for an additional revenue policy (which details how additional revenue resulting from volumes exceeding expected volumes are shared) to unfairly advantage either potential users or the service provider. Further, the assessment of the merits of an additional revenue policy as part of the selection process make sense given that at the FAR stage the Commission is required to determine whether such a policy is appropriate.

The Commission also considers that the exclusion of bids that do not conform to minimum technical and prudential requirements is also reasonable. Logically the successful tender should have access to requisite technical and prudential abilities. The requirement, however, should not unfairly exclude potential tenderers given that they are free to purchase technical expertise from consultants or negotiate with companies holding such expertise.

Accordingly, there is no reason to expect that a competitive tender process will not occur and the Commission considers that the TAR satisfies the requirements of section 3.28(e) of the Code.

4.6 Selection criteria

Those bids that meet the Stage 1 and 2 criteria will be reviewed at Stage 3. At Stage 3 all non-conditional bids (those tenders not dependent on a future event occurring) will rank higher than conditional bids. Conditional bids will only be considered if there are no non-conditional bids or if the non-conditional bid/s produce reference tariffs that do not achieve the objectives set out in section 8.1 of the Code and do not contain a fair and reasonable allocation of costs between services and a fair and reasonable allocation of costs between users.

If non-conditional bids are submitted, the prime criteria which will be used for selecting the successful bid will be the lowest sustainable combined distribution and transmission tariffs (including but not limited to reference tariffs) to users generally

over the economic life of the proposed pipelines. In making this assessment, the CRNG&TAI will take into account:

- the average combined transmission and distribution reference tariff per GJ of gas proposed to be delivered over the initial access arrangement period;
- the average combined transmission and distribution non-reference tariff per GJ of gas proposed to be delivered over the initial access arrangement period; and
- the residual values of the proposed transmission and distribution pipelines at the revisions commencement date.

Overriding this assessment is the requirement that the reference tariffs:

- achieve the objectives of a reference tariff and reference tariff policy set out in section 8.1 of the Code;
- contain or reflect an allocation of costs between services and an allocation of costs between users which is fair and reasonable.

In the event that two or more bidders propose the same or similar tariffs, the CRNG&TAI will take into account three secondary criteria in selecting a successful tenderer. These secondary criteria are: the areas to which gas is to be made available; the number of customers which will have access to natural gas; and the proposed construction timetable.

If only conditional bids are submitted (or if non-conditional bids propose reference tariffs that do not meet the criteria specified in section 3.33(c)), then the CRNG&TAI will select the successful tenderer on the basis of the lowest combined average reference tariffs. However where two conditional tenders propose the same or similar level of tariffs, the CRNG&TAI will also take into consideration a number of secondary criteria: the nature of conditions, the areas to which gas will be made available, the number of customers, and the proposed construction timetable.

Submissions

In its submission of 6 February 2003, Agility submitted that bidders will require further information from the CRNG&TAI such as how time changes are allowed for, how load factors are allowed for and what economic life is to be used.³⁰ Agility also noted that the tariff is to be assessed over the economic life of the pipeline but that the data to be supplied in the tender is only for 15 years.³¹

Commission's considerations

Section 3.28(f) of the Code requires:

- (f) that the selection criteria to be applied in conducting the proposed tender:

³⁰ Agility Management submission, 6 February 2003, p. 4.

³¹ Agility Management submission, 6 February 2003, p. 5.

(i) will result in the successful tender being selected principally on the basis that the tender will deliver the lowest sustainable tariffs (including but not limited to Reference Tariffs) to Users generally over the economic life of the proposed Pipeline; and

(ii) are likely to result in Reference Tariffs that meet the criteria specified in section 3.33(c)

The selection process proposed in the tender documents contains a number of elements which are relevant to the assessment of the criteria against the Code provisions.

First, the primary criteria for assessing non-conditional (and if none are conforming, conditional) bids is the lowest sustainable combined reference tariffs over the economic life of the pipeline. The Commission considers that this approach is reasonable and meets the criteria set out under section 3.28(f)(i) of the Code. The criteria specifically note that the CRNG&TAI will take into account both reference and non-reference tariffs when making this assessment. In addition, the specifications state that consideration will also be given to the residual value, which will permit an assessment over the economic life of the pipeline through financial modelling techniques.

As noted, Agility raised a number of concerns with regard to this aspect of the selection criteria. Agility argued that bidders will require additional information from the CRNG&TAI relating to load assumptions, timing and economic life. While this information is imperative for an assessment of the merits of a tender proposal, the Commission considers that bidders should be free to include this information in their tenders rather than impose it as a minimum information requirement. This is because the tender process needs to be as open as possible to potential bidders and as a consequence pipeline configuration specifications cannot be limited by the tender under section 3.28(h) of the Code (see 4.8 below). The CRNG&TAI has the option under clause 5.2 of the tender specifications to seek additional information from tenderers during the tender process.

A further issue raised by Agility is that the selection process involves the assessment of tariffs over the economic life of the pipeline, but that information is only supplied by bidders for the first 15 years. As discussed, an assessment over the economic life of a proposed pipeline can be conducted by the CRNG&TAI based on the residual value information, which is required to be submitted by bidders in the TAR documents.³²

Second, the CRNG&TAI has decided to assess transmission and distribution pipeline tariffs in tandem rather than separately. The CRNG&TAI argued that it would be impractical to conduct individual tenders because a transmission company's proposal to service an area will never match a distribution company's proposal, and no transmission company will commit itself to serve an area in the absence of retail and distribution arrangements being known.³³ The Commission is of the view that this approach is reasonable and complies with the general provisions of the Code. The process ensures transparency by requiring bids to specify separate reference tariffs for

³² This argument is also proposed by the Association; see the CRNG&TAI response to submissions, 18 February 2003, p. 4.

³³ CRNG&TAI, *Tender Approval Request, Cover Letter*, 3 January 2003, p. 3.

the transmission and distribution pipelines, and it is the transmission reference tariff that would form part of the access arrangement presented to the Commission.

A third relevant characteristic of the selection criteria is that the tariffs must achieve the objectives of a reference tariff and reference tariff policy as set out in section 8.1 of the Code, and must contain or reflect a fair and reasonable allocation of costs between services and users. Clause 4.1.7 of the tender rules requires bidders to provide an explanation of how the costs of transmission have been allocated between services and users and why that allocation is fair and reasonable, while clause 4.1.5 requires bidders to provide a description of why the reference tariffs and reference tariff policy elements for the transmission pipelines achieve the objectives of section 8.1 of the Code. Under the selection criteria this information would be assessed by the CRNG&TAI at Stage 3 of the proposed selection process. The Commission considers that these information requirements and elements of the selection criteria should allow the CRNG&TAI to make an informed judgement as to whether bids meet the Code reference tariff objectives. Accordingly, the Commission considers that these clauses of the TAR have the effect of satisfying the requirements of section 3.28(f)(ii) of the Code.

A fourth element of the selection process is that in selecting a successful bid, the CRNG&TAI will consider a number of secondary criteria. These include the areas to which gas will be made available, the number of customers, the proposed construction timetable and in the case of conditional bids, the nature of the conditions. Given that these criteria are only taken into account after the tender(s) with the lowest sustainable combined reference tariffs have been selected, the Commission is of the view that this element conforms with section 3.28(f)(i) of the Code.

A final relevant element of Stage 3 of the selection criteria is the differential treatment of conditional and non-conditional tenders. The merits of this approach were discussed in detail in section 4.3 above.

For the above reasons the Commission believes that the CRNG&TAI TAR meets the requirements of section 3.28(f) of the Code.

4.7 Determination of items with the reference tariffs

Under the CRNG&TAI's proposed tender rules and procedures, the items to be determined by the tender are:

- (a) reference tariffs for the period to the revisions commencement date;
- (b) those elements of reference tariff policy that directly determine the manner in which reference tariffs will change during the period to the revisions commencement date;
- (b) the additional revenue policy; and
- (c) the revisions commencement date.

Submissions

Agility, in its submission of 6 February 2003, submitted that the revisions commencement date referred to in the tender documentation should be 15 years from the date gas is actually first transported for the pipeline user, rather than 1 July 2019. This is because of the uncertainty resulting from the greenfields nature of the project.³⁴

Commission's considerations

Section 3.28(g) of the Code requires 'that the tender documents specify which items required to be included in an Access Arrangement other than Reference Tariffs will be determined by the tender and that those items are directly relevant to the determination of Reference Tariffs'.

As noted above, the reference tariff policy represents one of the additional factors which will be determined through the tender process. The Commission considers that the inclusion of this outcome in the tender is reasonable, given that the reference tariff policy is of direct relevance to the determination of reference tariffs that will apply through to the commencement date.

Another item which is proposed to be determined through the tender is the additional revenue policy. The Commission considers that it is appropriate to allow this element to be determined through the tender process. This policy relates directly to the determination of reference tariffs as it sets out the sharing of any unanticipated benefits, and thus any adjustment to tariffs.

The tender documents also stipulate that the revisions commencement date will be an established outcome of the tender process. The Commission considers that a tender's revisions commencement date is of direct relevance to the determination of a reference tariff. This is because a period over which reference tariffs derived from the tender process will operate must logically be determined prior to the completion of the tender process.

Agility questioned the validity of the revisions commencement date of 1 July 2019 set out in the TAR, arguing that the date should be set 15 years from the date gas is actually transported for the pipeline user. The Commission notes that the CRNG&TAI has nominated a possible revisions commencement date and have called for reference tariffs to be submitted according to this date to enable a consistent assessment and comparison of tenders on a 'like with like' basis. This reference date of 1 July 2019 was nominated as it is 15 years from the time upon which gas is expected to be first available in the region and the time at which the access arrangements are expected to be approved, which is consistent with section 3.33(d) of the Code. The Commission therefore concurs with the CRNG&TAI argument that Agility's suggestion of using 15 years from the date that gas is first transported is not consistent with the Code.³⁵

³⁴ Agility Management submission, 6 February 2003, p. 4.

³⁵ CRNG&TAI response to submissions, 18 February 2003, p. 3.

The tender specifications recognise that bidders are free to propose a shorter or longer revisions date if they wish, but that a revisions commencement date of greater than 15 years can only be approved if the regulator considers it appropriate on the basis of the proposed reference tariffs, pursuant to section 3.33(d).³⁶

The Commission considers that the specified items to be determined through the proposed tender process are directly relevant to the determination of reference tariffs. Accordingly, the Commission considers that the TAR meets the requirements of 3.28(g) of the Code.

4.8 Configuration of the pipeline

The CRNG&TAI has provided the Commission with the documentation that will be given to potential bidders. This includes:

- (a) background to the tender and the regulatory regime (Section 1);
- (b) tender specifications (section 2). This document contains the rules for conducting the tender, the criteria for determining the successful tenderer as well as information that must be provided by the tenderers in submitting a tender.

The tender documentation makes clear that bidders are generally free to propose the route and the technical details of the transmission and distribution pipelines. As noted in clause 4.2.23 of the tender documentation, 'there are no specific towns which must be supplied with natural gas however it is expected that tenderers will serve, at a minimum, Mudgee, Tamworth and Gunnedah'.³⁷

Submissions

There were no submissions received on this issue.

Commission's considerations

Section 3.28(h) of the Code requires that 'the tender documents published by the person conducting the tender will not specify the configuration of the proposed Pipeline, including the areas the proposed Pipeline will service, pipeline dimensions, level of compression or other technical specifications, unless the Relevant Regulator is satisfied it would be appropriate to do so'.

The purpose of this Code requirement relating to the tender documentation is to ensure that the rules of the tender are not unnecessarily restrictive or have the effect of reducing the level of competition in the process of running the tender. For example this provision seeks to avoid unnecessary restrictions on the source of gas supply (that is, where the pipeline comes from) and to which points it is able to deliver gas.

³⁶ CRNG&TAI, *Tender Approval Request, Cover Letter*, 3 January 2003, Attachment 1, p. 8.

³⁷ CRNG&TAI, *Competitive Tender, Section 2 - Tender Specifications*, 18 February 2003, p. 9.

The Commission acknowledges that the proposal by the CRNG&TAI does not specify the configuration or technical requirements of the pipeline in any way or require specific townships to be serviced.

Accordingly, the Commission considers that tender documentation proposed by the CRNG&TAI meets the requirements of section 3.28(h) of the Code.

4.9 Other documents

The Commission is advised by the CRNG&TAI that it has provided the Commission with all documentation that will be provided to potential tenders in conducting the tender for the provision of natural gas to the Central Ranges region.

Commission's considerations

Section 3.28(i) of the Code requires that any other supporting or related tender documentation is consistent with the Code and does not limit or purport to limit the tender process. Specifically, the criterion refers to limiting the services that may be provided or to which access may be sought; the configuration of the proposed pipeline; and the construction or operation of any other pipeline that could deliver gas to the region.

The Commission has not received any other supporting or related documentation that would contravene the requirements of section 3.28(i), either through the public consultation process or from the CRNG&TAI directly. Accordingly, the Commission considers that section 3.28(i) of the Code is satisfied.

4.10 Other issues

There were a number of other issues raised by interested parties, in particular Agility, in submissions. After careful consideration of these issues, the Commission concluded that these issues were not relevant to its assessment of the TAR and therefore are not discussed in this decision document. However, the Commission considers that there is value in making the following comments in response to Agility's comments regarding the requirement for bidders to include cost information in the tender.

Requirements to disclose capital and operations expenditures

In its submission of 6 February 2003, Agility argued that the requirement to include cost information (capital expenditure and operations and maintenance expenditure) is inconsistent with a competitive tender process and inappropriate from a commercial standpoint. Agility submitted that if a bidder does not submit this information it will be deemed non-conforming, which represents a contravention of section 3.28(e) of the Code.³⁸

The Commission notes that the TAR requires from each bidder details of expected capital and non-capital expenditure, as well as depreciation, to the financial year ending 1 July 2019 and to the nominated revisions commencement date. While this

³⁸ Agility Management submission, 6 February 2003, p. 3

information is requested under clause 4.1.17 of the tender specifications, the non-disclosure of this information does not deem a bid non-conforming under Stage 1 or Stage 2 of the proposed tender selection process.

The Commission, however, recognises that the provision of this information may be imperative for the assessment of the merits of conforming bids. Under Stage 3 of the process, reference tariffs must, in the opinion of the CRNG&TAI, achieve the objectives of a reference tariff and reference tariff policy set out in section 8.1 of the Code and contain a fair and reasonable allocation of costs. The Commission considers that capital and non-capital expenditure data would be required for the CRNG&TAI to adequately make this assessment. Moreover, under clause 3.33(c) of the Code, the Commission is required to determine at the final approval stage if the reference tariffs determined in accordance with the tender process meet both the section 8.1 and fair allocation criteria. Information on operations and maintenance costs and capital costs of tenderers would be required for the Commission to make an informed decision on this matter under the requirements of the Code.

The CRNG&TAI states that capital and operations costs information is sought so that it can understand the proposed construction timetable, which is a secondary selection criteria, and the likely magnitude of tariffs beyond the revisions commencement date, which is a primary selection criteria.³⁹

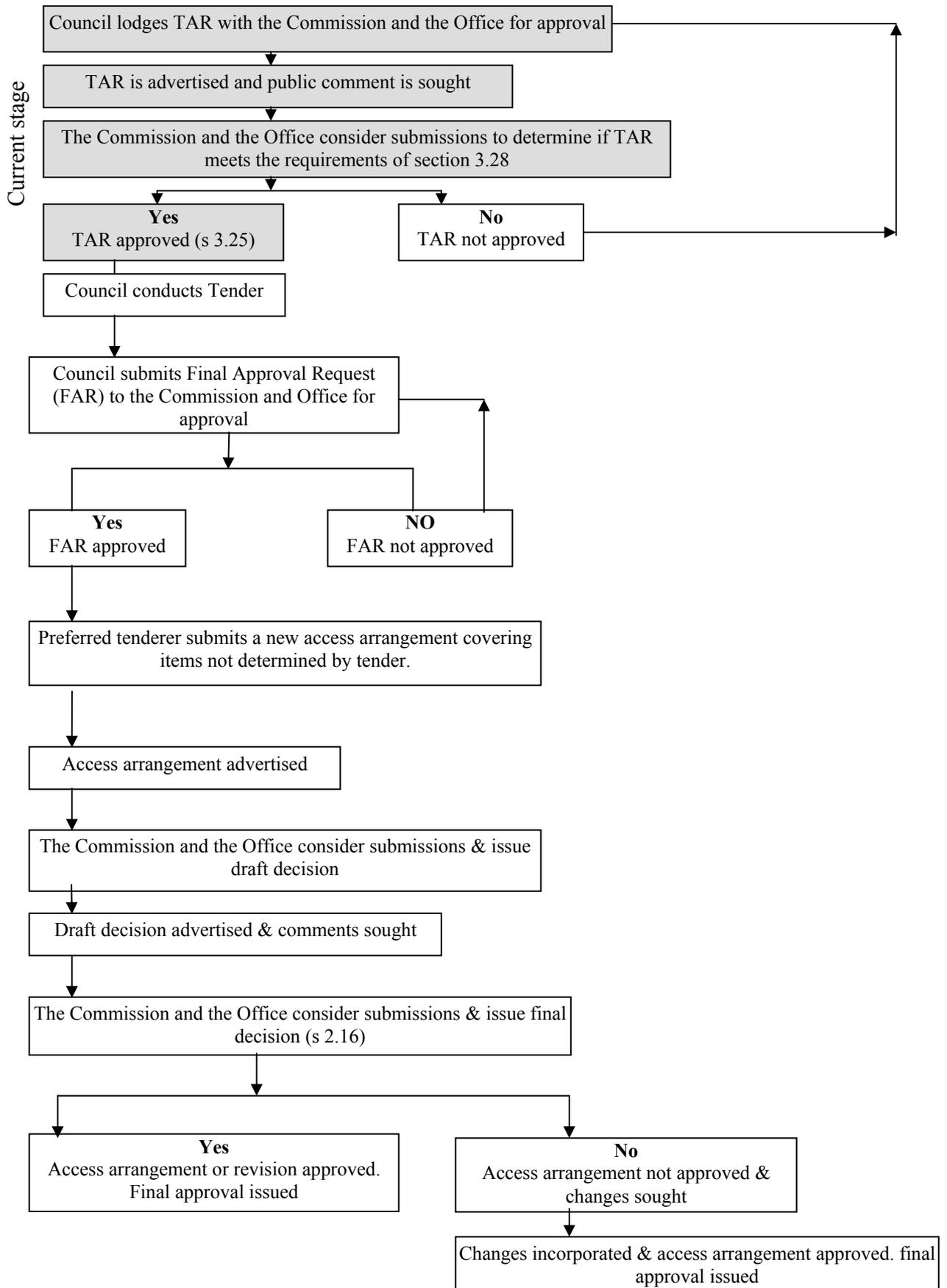
Accordingly, while the non-provision of capital and non-capital expenditure does not *a priori* classify a bid as non-conforming, such information is required for the CRNG&TAI and the Commission to assess whether bids adequately meet the selection criteria proposed in the TAR. The Commission therefore considers the request for this information is a reasonable element of the tender documentation.

³⁹ CRNG&TAI response to submissions, 18 February 2003, p. 2.

5. Decision

Pursuant to section 3.25 of the Code, the Commission approves the amended Tender Approval Request lodged by the Central Ranges Natural Gas and Telecommunications Association Incorporated on 18 February 2003.

Appendix A: Regulatory process



Appendix B: Submissions

The following interested parties provided submissions:

Gunnedah Shire Council	22 January 2003
Planning NSW	23 January 2003
Mudgee Co-operative Meat Supply Ltd	29 January 2003
Public Interest Advocacy Centre	30 January 2003
Europacific Corporate Advisory Pty Ltd	4 February 2003
Agility Management Pty Ltd (in its own right and on behalf of APT and AGL)	6 February 2003