Decision

Australian
Competition &
Consumer
Commission

Final approval request for the proposed Central Ranges Pipeline

19 May 2004

File No:
S2002/67

Commissioners:
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Contents

Abbreviations

ACCC	Australian Competition and Consumer Commission
Code	National Third Party Access Code for Natural Gas Pipeline Systems
CRNG&TAI	Central Ranges Natural Gas and Telecommunications Association Incorporated
CRP	Central Ranges Pipeline
CWP	Central West Pipeline
Europacific	Europacific Consortium (consortium members are Europacific Corporation, Colonial First State Investments, Country Energy Gas and Jasdell)
FAR	final approval request
GJ	gigajoule (one thousand million joules)
IPART	Independent Pricing and Regulatory Tribunal of NSW
MHQ	maximum hourly quantity (of gas transported)
MMA	McLennan Magasanik Associates
PJ	petajoule (one thousand terajoules)
TAR	tender approval request
TJ	terajoule (one thousand gigajoules)

Summary

On 3 January 2003 the Central Ranges Natural Gas and Telecommunications Association Incorporated (CRNG&TAI) applied for regulatory approval of a tender process in relation to the proposed supply of natural gas to the Central Ranges region of NSW pursuant to section 3.21 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (Code). This application was made to the Australian Competition and Consumer Commission (ACCC) and the Independent Pricing and Regulatory Tribunal (IPART).

The ACCC's assessment of the tender approval request lodged by the CRNG&TAI was that it satisfied the requirements set out in section 3.28 of the Code. Accordingly, the tender approval request was approved pursuant to section 3.25.

The CRNG&TAI subsequently carried out a competitive tender process for the supply of natural gas to the region. The successful tenderer, Europacific Consortium, was announced on 19 November 2003. One other party, Agility, provided a submission to the CRNG&TAI as part of the tender process; however, it was not a conforming tender.

As provided by the Code, the CRNG&TAI has elected to seek final approval of the tender process (the Code does not require it to do so). It applied for approval on 27 April 2004. The assessment carried out by the ACCC, and set out in this decision document, has determined that:

- the successful tender was selected in accordance with the previously approved selection criteria
- the tender process undertaken was carried out in accordance with the procedures and rules as set out in the approved tender documentation
- the resulting reference tariffs meet the reference tariff objectives of section 8.1 of the Code and reflect a fair and reasonable cost allocation
- the revisions commencement date and the additional revenue policy that will be incorporated into the access arrangement are appropriate for the pipeline.

Accordingly, the requirements of section 3.33 of the Code have been satisfied and the ACCC has approved the final approval request submitted by the CRNG&TAI in relation to the proposed Central Ranges Pipeline (CRP).

Consequently, the proposed pipeline is a covered pipeline under the Code and the service provider is required to lodge a proposed access arrangement (with the applicable access arrangement information) with the ACCC within 90 days.

1. Introduction

1.1 Background

The Central Ranges region is located between the Orana and New England regions of NSW and includes eight local government areas. Key centres in the area include Tamworth, Mudgee and Gunnedah.

There has been considerable interest in the development of natural gas in the Central Ranges region of NSW over an extended period. Regional representatives have previously indicated to the ACCC that in their view economic development of the region would be enhanced with the introduction of natural gas.[1]

APT Pipelines (NSW) was granted a pipeline licence in January 2003 for the proposed Central Ranges transmission pipeline from Dubbo to Tamworth and Gunnedah. However, it has decided not to continue with the project.[2]

With a view to encouraging the development of the project, the CRNG&TAI elected to conduct a competitive tender process under the framework of the Code.[3] The Code sets out two stages – first the establishment of a tender process and second, once the tender has been conducted and a successful tenderer identified, confirmation of the tender process outcomes. Accordingly, the CRNG&TAI has submitted the relevant documentation to the ACCC and IPART for approval of the tender process (the tender approval request (TAR)) and its outcomes (the final approval request (FAR)).

1.2 Tender approval request

On 3 January 2003 the CRNG&TAI applied for regulatory approval of a tender process in relation to the proposed supply of natural gas to the Central Ranges region pursuant to section 3.21 of the Code.

A TAR is required to set out:[4]

- the nominated location of the proposed pipeline
- procedures and rules that will be followed in conducting the tender process
- detailed selection criteria for determining the successful tender

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1 ACCC, *Final Decision: access arrangement by AGL Pipelines (NSW) Pty Ltd for the Central West Pipeline*, 30 June 2000, pp. 6-10.

2 A copy of the pipeline licence is provided at Addenda 14 of the CRNG&TAI's tender documentation. See also CRNG&TAI, tender documentation, p. 4.

3 The CRNG&TAI is an organisation consisting of local governments and regional development agencies which has been involved in promoting the development of natural gas in the region for over five years. Tender documentation, p. 4.

4 Section 3.22.

- a possible revisions commencement date in relation to which tenderers are requested to submit tenders and propose reference tariffs.

As the supply of gas to the Central Ranges region was expected to be via a transmission pipeline and a distribution system the ACCC (in relation to transmission) and IPART (in relation to distribution) carried out parallel public consultation processes regarding the TAR. The regulators' assessment of the TAR lodged by the CRNG&TAI was that it satisfied the requirements set out in section 3.28 of the Code. Accordingly, the TAR was approved pursuant to section 3.25.[5]

Following the approval of the TAR, the CRNG&TAI carried out a competitive tender process for the supply of natural gas to the region. One conforming tender (Europacific Consortium) and one non-conforming submission (Agility) were received. The identity of the successful tenderer, Europacific Consortium, was announced on 19 November 2003.[6]

1.3 Final approval request

The Code provides (section 3.29) that where a TAR has been approved and a tender has been carried out, the person who conducted the tender may (but is not required to) apply for final approval of the tender process under section 3.32. In this instance the CRNG&TAI has elected to lodge a FAR with the ACCC and IPART.

The assessment process relating to a FAR focuses on:[7]

- affirming that the previously approved selection criteria were used to select the winning tender
- affirming that the tender process was carried out in accordance with the procedures and rules proposed in the TAR
- the reference tariffs resulting from the tender process achieving certain Code objectives
- confirming that the revisions commencement date and the additional revenue policy to be included in the subsequent access arrangement are appropriate for the pipeline.

The FAR assessment process does not require the regulator to undertake public consultation.

In assessing the FAR the ACCC has considered whether it satisfies all the criteria set out in section 3.33 of the Code. If all the criteria are met the ACCC must approve the FAR.

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5 ACCC, *Decision: Tender approval request for the proposed pipeline to the Central Ranges region*, 12 March 2003; IPART, *Decision: Tender approval request for the proposed natural gas pipeline to the Central Ranges region of NSW*, 12 March 2003.

6 The consortium members are Europacific Corporation, Colonial First State Investments, Country Energy Gas and Jasdell. Europacific tender, p. 1.

7 Section 3.33.

This decision document sets out the reasons for the ACCC's decision in regard to the FAR lodged by the CRNG&TAI on 27 April 2004. In a manner similar to the TAR approval process, the ACCC and IPART have carried out parallel assessment processes. This has included the use of a consultant to assist with the assessment of the tariff related aspects of the FAR. Nevertheless, each regulator's decision regarding the FAR is solely in respect of its relevant jurisdiction.

1.4 Access arrangement

If a FAR is approved by a regulator the proposed pipeline becomes a covered pipeline under the Code from the date of the decision and the service provider is required to lodge a proposed access arrangement (with the applicable access arrangement information) with the regulator within 90 days.[8]

While the regulator must carry out an assessment of any proposed access arrangement submitted, the items of the access arrangement determined by the tender process are not subject to regulatory assessment until the revisions submissions date.

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8 Sections 1.21, 2.2 and 3.34.

2. Regulatory environment

2.1 NSW gas industry

The total volume of natural gas consumed (including for use in electricity generation) in NSW was 136.3 PJ in 2000-2001.[9] This was supplied from South Australia and Victoria through:

- the East Australia Pipeline Ltd (EAPL) owned Moomba to Sydney Pipeline. This pipeline transports gas from Moomba to the Sydney city gate at Wilton with laterals and spur lines supplying gas to Canberra and regional centres such as Lithgow, Wagga Wagga and Griffith
- the Interconnect, which joins the Victorian GasNet System (at Barnawartha) to the Moomba to Sydney Pipeline (at Wagga Wagga) and allows northward and southward flows of gas[10]
- the Eastern Gas Pipeline (constructed by Duke Energy International and now owned by Alinta Limited) which transports Gippsland Basin gas from Longford to Horsley Park, supplying various centres en route including Canberra.

The Central West Pipeline (CWP), which is owned by APT Pipelines (NSW), is effectively a lateral of the Moomba to Sydney Pipeline although it is regarded as a separate transmission pipeline for regulatory purposes. It extends from Marsden to Dubbo.

AGL Gas Networks operates the gas distribution systems in Sydney and many NSW regional centres. Other distribution businesses operating in NSW are:

- Envestra, which supplies Albury
- Country Energy, which operates the Wagga Wagga distribution system as well as systems recently developed in locations such as Cooma and Bombala following construction of the Eastern Gas Pipeline
- ActewAGL, supplying Nowra and Bomaderry on the NSW south coast as well as Queanbeyan
- Allgas, operating in the NSW north coast area.

Full gas retail competition was introduced in NSW in January 2002. The key retailers are AGL, ActewAGL, Country Energy and Origin.

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9 ABARE, *Australian energy: national and state projections to 2019-2020*, June 2003, p. 78.

10 The Wagga Wagga to Culcairn section of the Interconnect is owned by EAPL. The remainder is owned by GasNet.

2.2 Regulatory framework

The Code sets out a regulatory framework for natural gas pipeline systems with the intention of establishing a national access regime for the sector. The primary regulatory tool of the Code is the establishment of access arrangements for pipelines. Once approved by the relevant regulator, an access arrangement sets out the reference price and non-price terms and conditions of access to particular services of that pipeline for a set period. The Code also provides a framework for pipeline coverage decisions, competitive tenders, dispute resolution, ring fencing and information disclosure.

For NSW, the key legislation bringing into effect the Code is the *Gas Pipelines Access (South Australia) Act 1997* and *Gas Pipelines Access (New South Wales) Act 1998*.[11]

Implementation of the various aspects of the Code is allocated to a number of bodies. With respect to NSW, the relevant Code and appeal bodies are:

- ACCC – regulator and arbitrator for transmission pipelines
- IPART – regulator and arbitrator for distribution pipelines
- National Competition Council – coverage advisory body
- NSW or Commonwealth Minister – coverage decision maker
- Australian Competition Tribunal – administrative review
- Federal Court – judicial review.

Competitive tenders

As noted above, the Code includes a framework for establishing a regulatory regime for new pipelines that are developed through a competitive tender process. This provides an alternative to the tariff setting process otherwise followed when establishing an access arrangement.

To implement the competitive tender provisions a person who wishes to conduct a competitive tender for the supply of natural gas to a new location must establish a tender process that fulfils certain requirements. The regulator must approve the proposed tender process and then affirm that the process was followed and that the successful tender was selected according to the selection criteria. If this is the case then the tariffs determined through the tender process become the reference tariffs for the new pipeline for the initial access arrangement period without any further regulatory assessment. It is intended that in using the tender process the tariffs will have been set in a competitive market and will achieve the objectives of section 8.1 of the Code.[12]

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[11] South Australia acted as lead legislator for the gas access legislation. NSW subsequently enacted legislation applying the SA legislation in NSW.

[12] Code, overview to section 3.

3. Final approval request

3.1 Overview of the FAR

There is no time requirement for when a person may lodge a FAR with a regulator. The Code only requires that a TAR has been approved and that a tender process has been carried out.[13] The FAR must include the items specified in section 3.33 of the Code.

The CRNG&TAI lodged a FAR with the ACCC on 27 April 2004 with respect to the proposed CRP.[14] It also lodged a FAR with IPART at that time with respect to the associated distribution system.

The FAR sets out the CRNG&TAI's claims that each of the relevant Code requirements is satisfied. Briefly, the CRNG&TAI claims:

- Europacific was selected as the winning tenderer on the basis that it satisfied the selection criteria set out in the tender documentation and as approved through the TAR process
- the tender process was carried out according to the procedures and rules for the tender as set out in the tender specifications
- it is reasonable to conclude that Europacific's reference tariffs will meet the objectives of section 8.1 of the Code as they are the outcome of an open and competitive tender process
- the competitive nature of the tender process and the existence of inter-fuel competition ensures that the costs proposed for the Central Ranges project are fair and reasonable
- the revisions commencement date of 1 July 2019 meets the requirements of the Code
- the appropriateness of the proposed additional revenue policy was considered by the CRNG&TAI as part of the tender assessment process and was accepted.

The FAR reflects the CRNG&TAI's view that the tender conducted produced a competitive outcome despite only two responses to the tender being received (of which, only one was considered to be a conforming tender). The CRNG&TAI also contends that inter-fuel competition will ensure that the price of natural gas is competitive in the region. The CRNG&TAI considers that the arrival of natural gas to the region

> will provide an important additional energy supply option for domestic consumers in the region, but more importantly will significantly improve the competitive position of a number of rural processing and manufacturing businesses.[15]

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13 Section 3.29.

14 The ACCC approved the TAR for the proposed CRP on 12 March 2003.

The FAR includes a copy of the tender documentation provided to potential tenderers, the tender received from Europacific, the submission received from Agility and a number of other documents relating to the tender process that was carried out.

3.2 Additional information

Section 3.32 of the Code provides the regulator with 28 calendar days to make its decision to approve or not approve a FAR once it has received all the information required to make the decision.

The regulator is able to require the person who lodged the FAR to provide any information or assistance reasonably required to make a decision regarding the FAR.[16]

The ACCC and IPART held pre-lodgement discussions with the CRNG&TAI in November 2003 and March 2004 to discuss the nature of information that would be required to enable the regulators to carry out the assessment required by section 3.33 of the Code. The CRNG&TAI subsequently provided supplementary information, with the assistance of Europacific, to the regulators when it lodged the FAR on 27 April 2004.

No formal information requests were made by the regulators although some clarification of statements included in the FAR and in the supplementary information were sought, and obtained, after the lodgement of the FAR.

15 CRNG&TAI letter to ACCC, 27 April 2004, p. 2.

16 Section 3.31.

4. Assessment

4.1 Preliminary requirements

Code requirements

Section 3.29 of the Code states that where a regulator has approved a TAR pursuant to section 3.25 and a tender process has been carried out, an application for final approval may be made to the regulator by the person who conducted the tender.

Section 3.29 also requires the FAR to include a statement identifying the tender selected and the reasons, based on the selection criteria, for that selection.

FAR

The FAR states that Europacific has been selected as the winning tenderer by the CRNG&TAI. Europacific was considered to have met stage 1 of the selection criteria in submitting a conforming tender. As noted by CRNG&TAI, the tender from Europacific was the only tender to satisfy this stage. The tender was then assessed against the stage 2 and 3 criteria, meeting both of these.[17]

The CRNG&TAI notes that

> By virtue of the fact that it was the only remaining tender, the Europacific tender provided the lowest sustainable distribution and transmission tariffs to Users generally over the economic life of the proposed pipeline. Hence it was selected as the winning tender.[18]

Assessment

The ACCC made a TAR decision pursuant to section 3.25 regarding the proposed CRP on 12 March 2004. The CRNG&TAI, which lodged the TAR, subsequently conducted a competitive tender process. As provided by section 3.29, the CRNG&TAI has elected to lodge a FAR, in relation to the proposed transmission pipeline, with the ACCC. A FAR has also been lodged with IPART in relation to the proposed distribution pipeline system.

The FAR submitted to the ACCC identifies Europacific as the successful tenderer. The reasons for that selection are based on the selection criteria set out in the tender documentation. The selection criteria are discussed further below in chapter 4.3.

The ACCC has concluded that the preliminary requirements for a FAR set out in section 3.29 are satisfied.

[17] CRNG&TAI FAR, 27 April 2004, p. 4.

[18] FAR, p. 4.

4.2 Changes to reference tariffs

Code requirements

The regulator may agree, pursuant to section 3.30 of the Code, to minor changes to the proposed reference tariffs as agreed between the person who conducted the tender and the successful tenderer. The regulator must be satisfied that the changes are consistent with the Code requirements for a TAR set out in section 3.28.

If the regulator agrees to such changes the amended reference tariffs are to be considered the tariffs determined through the tender process for the purpose of considering the FAR.

FAR

The CRNG&TAI has stated that there are no changes to the reference tariffs from the tender process to propose to the ACCC. However, some clarifications have been sought from Europacific by the CRNG&TAI regarding:[19]

- the definition of the CPI for the tariff path
- the description of reference services for both transmission and distribution
- the additional revenue policy.

Assessment

The ACCC is satisfied that the reference tariffs proposed by Europacific in its tender will not change as a result of the clarifications it has provided to CRNG&TAI as noted above. The tariffs resulting from the tender are as set out in the FAR.[20]

4.3 Selecting a tender

Code requirements

Section 3.29 of the Code requires that the FAR include a statement that identifies the successful tender and the reasons for the decision based on the selection criteria. In addition, section 3.33(a) requires the regulator to be satisfied that the successful tender was selected in accordance with the selection criteria set out in the approved TAR.

The selection criteria set out in the TAR must:[21]

- result in the successful tender being selected principally on the basis that it will deliver the lowest sustainable tariffs over the economic life of the proposed pipeline
- be likely to result in reference tariffs that meet the section 3.33(c) criteria of the Code.

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19 FAR, pp. 24-26.

20 FAR, p. 23.

21 Section 3.28(f).

FAR

The selection criteria are set out in Schedule 2 of the tender documentation. There are three stages to the tender process, each with certain criteria. Stage 1 requires consideration of all tenders. A tender would be considered as non-conforming if it:[22]

- does not include proposed reference tariffs and reference services
- does not provide an additional revenue policy[23]
- does not propose a residual value of the pipeline
- is inconsistent with clause 4.2 of the tender specifications,[24] or
- is a conditional tender (unless it meets certain requirements).

The stage 1 selection criteria also specify the criteria relevant to any conditional tenders that may be submitted.

The submissions from Europacific and Agility (neither of which was a conditional tender) were considered against the above criteria. The CRNG&TAI found that Europacific's tender met the stage 1 criteria but that the response from Agility did not. Consequently, Agility's submission was not considered in stages 2 and 3 of the process.[25]

At stage 2 each conforming tender is required to meet the following minimum criteria to enable progression to stage 3:

- incorporation of an appropriate additional revenue policy for the transmission and distribution pipelines having regard to the proposed tariffs
- demonstration of sufficient technical and prudential capacity to own and operate gas transmission and distribution pipelines. Tenderers that hold an active Australian distribution or transmission licence (or equivalent) will be considered to meet this requirement.

The CRNG&TAI determined that the Europacific tender did meet the stage 2 criteria. The additional revenue policy was considered and accepted for tender evaluation purposes.[26] As Country Energy Gas is a pipeline operator, the CRNG&TAI concluded that the Europacific tender satisfied the stage 2 technical criteria. In addition, on the basis that Europacific and Colonial First State were known to the CRNG&TAI as being experienced in infrastructure investment the CRNG&TAI determined that the prudential criteria were met.[27]

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22 Tender documentation, p. 38.

23 An additional revenue policy sets out the service provider's intended treatment of revenue resulting from increased volumes of gas transported on the pipeline. Additional revenue may be retained by the service provider or shared with users. See section 3.28(d)(ii).

24 Clause 4.2 states that a tender which limits the services to which access may be sought or is otherwise inconsistent with the Code will be regarded as a non-conforming tender.

25 FAR, p. 7.

26 See chapter 4.8 for further discussion of the additional revenue policy.

27 FAR, p. 11.

Tenders that succeed in meeting the stage 2 criteria would then be assessed against the stage 3 criteria. Stage 3 requires the tenders to be ranked (non conditional tenders ranking higher than conditional tenders). All non conditional tenders that succeeded in meeting the stage 2 criteria would be reviewed in stage 3. The key criteria to selecting a successful tender would be lowest sustainable tariffs with reference tariffs that:

- achieve the objectives of section 8.1 of the Code
- contain or reflect a fair and reasonable allocation of costs between users and services.

In determining which tenderer meets these criteria, the tender documentation sets out additional considerations:[28]

- the average total (transmission and distribution) reference tariff proposed for the initial access arrangement period
- the average total non reference tariff proposed for the initial access arrangement period
- residual values for the pipelines at the revisions commencement date.

Three secondary criteria are also specified for stage 3:

- locations where gas will be made available
- the number of customers that will be able to access gas
- the construction timetable.

The CRNG&TAI FAR states that in its view the Europacific tender does achieve the section 8.1 objectives and contains a fair and reasonable cost allocation. The CRNG&TAI concluded:

> By virtue of the fact that it was the only remaining tender, the Europacific tender provided the lowest sustainable distribution and transmission tariffs to Users generally over the economic life of the proposed pipeline. Hence it was selected as the winning tender.[29]

Assessment

The ACCC has reviewed the Europacific tender, the Agility submission to the CRNG&TAI, and the information provided in the FAR including the tender specification table. The ACCC has also considered the tender assessment report prepared by PricewaterhouseCoopers for the CRNG&TAI. This review confirms that the CRNG&TAI has applied the relevant selection criteria at the first and second stage of the tender assessment process.

The extent of the assessment undertaken in stage 3 of the process is not set out in detail in the FAR. The CRNG&TAI simply states that it concluded that the Europacific tender met the criteria relating to reference tariff principles and cost allocation. The ACCC has considered this statement in the FAR, the contents of the tender and the

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28 Tender documentation, p. 40.

29 FAR, p. 7.

report by PricewaterhouseCoopers, and is satisfied that the relevant stage 3 criteria were considered when selecting Europacific as the successful tenderer.[30]

The ACCC has concluded that the successful tender was selected in accordance with the selection criteria specified in the approved TAR. That is, the requirements of section 3.33(a) are satisfied by the CRNG&TAI FAR.

4.4 Procedures and rules

Code requirements

Pursuant to section 3.33(b) the regulator must be satisfied that the tender process carried out was in accordance with the procedures and rules specified in the approved TAR before it is able to approve the FAR.

FAR

As stated in the FAR, the procedures and rules for the tender process are set out in the tender documentation.

First, the tender document sets out the process for lodgement of tenders and the information required for inclusion in a tender.[31]

Second, the tender document prescribes the process to evaluate any tenders that are received. These selection criteria are set out in a three stage process:

- Stage 1 – all tenders are to be reviewed and categorised as conforming or non-conforming. If a tender is considered to be non-conforming it is not considered further.
- Stage 2 – the remaining tenders are assessed in regard to the proposed additional revenue policies and the technical and prudential attributes of the tenderers.
- Stage 3 – the proposed tariffs of the remaining tenders are assessed with regard to the objectives of section 8.1 of the Code and whether they reflect a fair and reasonable cost allocation.

Upon completing this three stage process, the CRNG&TAI is required to notify the successful tenderer. The successful tenderer is required to assist the CRNG&TAI with the preparation of a FAR. The CRNG&TAI and relevant local councils are required to assist the successful tenderer in submitting access arrangements to the regulators and other regulatory requirements.[32]

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[30] The ACCC acknowledges that the secondary criteria of stage 3 were not relevant as only one tender reached this stage of the evaluation process.

[31] Tender documentation, pp. 30-34.

[32] Tender documentation, p. 35.

In addition, the CRNG&TAI notes that it undertook to provide a minimum eight week period for parties to prepare a tender and that it would publicise the tender process widely.[33]

The CRNG&TAI outlines the progress of the tender process undertaken in the FAR:[34]

- the tender process was launched on 2 and 3 July 2003 with wide media coverage and included consultation with the Australian Gas Association and the Australian Pipeline Industry Association
- the tender box was opened on 10 October 2003 and an evaluation of the tenders received was made by the CRNG&TAI's consultant PricewaterhouseCoopers
- a recommendation to accept Europacific's tender was conveyed to the CRNG&TAI and its members
- following acceptance of this recommendation, the CRNG&TAI notified Europacific of its success in winning the tender.

The CRNG&TAI has provided a statutory declaration stating that the tender was carried out in accordance with the approved TAR.[35]

Assessment

The ACCC has reviewed the tender process undertaken by the CRNG&TAI against the procedures and rules specified in the approved TAR. This assessment has included consideration of the tender documentation, the TAR and the FAR.

As indicated by the CRNG&TAI, the tender process received considerable publicity, particularly on and around the time of the official launch in July 2003. The ACCC also acknowledges the consultation with the gas industry undertaken by the CRNG&TAI in this process and accepts its decision not to place formal press advertisements regarding the tender process.[36]

The FAR indicates that the three stages of the tender evaluation process were carried out as follows:

- Stage 1 – the two submissions received were reviewed. Europacific's tender was categorised as conforming. As Agility's submission was determined to be non-conforming, it was not considered further.
- Stage 2 – Europacific's tender was then assessed in regard to the proposed additional revenue policy and the technical and prudential attributes of the consortium members. The CRNG&TAI concluded that Europacific's tender satisfied the stage 2 requirements.

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33 FAR, p. 12.

34 FAR, pp. 13-15.

35 FAR, appendix 6.

36 FAR, p. 14.

- Stage 3 – Europacific's proposed tariffs were assessed with regard to the objectives of section 8.1 of the Code and whether they reflect a fair and reasonable cost allocation. Europacific's tender was found to meet these criteria.

Following this, the CRNG&TAI, in accordance with the process established in the TAR, notified Europacific of its success in winning the tender.[37] As anticipated in the tender documentation, Europacific has assisted the CRNG&TAI with the preparation of the FAR.

The ACCC notes the FAR does describe the actual tender process undertaken by the CRNG&TAI and acknowledges the statutory declaration provided by the CRNG&TAI. The ACCC has considered this and the tender documentation and has concluded that the tender process was conducted in accordance with the procedures and rules specified in the approved TAR. Consequently, the ACCC has concluded that the requirements of section 3.33(b) have been met.

4.5 Reference tariff objectives

Code requirements

Section 3.33(c)(i) requires the regulator to be satisfied that the reference tariffs determined from the tender process achieve the objectives set out in section 8.1 of the Code. Section 8.1 states:

> 8.1 A Reference Tariff and Reference Tariff Policy should be designed with a view to achieving the following objectives:
>
> (a) providing the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering that Service;
>
> (b) replicating the outcome of a competitive market;
>
> (c) ensuring the safe and reliable operation of the Pipeline;
>
> (d) not distorting investment decisions in Pipeline transportation systems or in upstream and downstream industries;
>
> (e) efficiency in the level and structure of the Reference Tariff; and
>
> (f) providing an incentive to the Service Provider to reduce costs and to develop the market for Reference and other Services.
>
> To the extent that any of these objectives conflict in their application to a particular Reference Tariff determination, the Relevant Regulator may determine the manner in which they can best be reconciled or which of them should prevail.

FAR

The CRNG&TAI has set out the reasons why it considers the Europacific tender meets the section 8.1 objectives of the Code. The CRNG&TAI states:[38]

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37 FAR, appendix 8.

38 FAR, pp. 15-16.

- four customer classes have been established by Europacific, three of which reflect tariff categories typically adopted elsewhere in the gas industry
- reference tariffs have been designed to generate a commercial return over the project life with the capitalisation of under-recoveries that arise early in the project life
- the tariff structure provides an incentive to reduce costs and develop the market
- due to the reference tariffs being determined through a competitive tender process, it is 'reasonable to conclude that the tariffs will only permit the recovery of the efficient costs'[39]
- due to the reference tariffs being determined through a competitive tender process, the tariffs do replicate the outcome of a competitive market
- there is no reason to suggest that the proposed reference tariffs would not ensure the safe operation of the pipeline or that they would distort investment.

Comments from Europacific are consistent with these comments from the CRNG&TAI. Europacific also states that the reference tariffs have been designed to 'meet the reasonable expectations of each Reference Service in a competitive market' and facilitate the adoption of gas by the various user groups.[40]

Supplementary information submitted to the ACCC and IPART provides additional and amended details regarding demand forecasts, costs of competing fuels, capital and non capital costs and cost allocation.

Assessment

To carry out the assessment required by section 3.33(c)(i) of the Code in regard to reference tariff objectives the ACCC and IPART have obtained the assistance of McLennan Magasanik Associates (MMA). MMA has considered the demand forecasts for the Central Ranges region, the estimated capital and non capital costs for the transmission and distribution pipelines and the cost allocation methodology.

The FAR assessment process does not provide for the regulator to amend any of the costs, demand forecasts or aspects of the reference tariff policy that arise from the tender process. However, the regulator must be satisfied that the tender does satisfy the objectives of the Code to the extent that is practicable and reasonable.

Stream of revenue that recovers efficient costs

The forecast capital cost of the CRP is $52.9 million.[41] MMA has advised that the per unit capital cost of the proposed CRP is within the cost range developed for a group of small transmission pipelines and is similar to the construction cost of the CWP which it considers to be the most relevant comparator.

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39 FAR, p. 16.

40 FAR, p. 18.

41 Europacific tender (FAR appendix 2), schedule 1.

The forecast capital expenditure includes payments to certain consortium members for various services. While these payments were not assessed by MMA to result in excessive total forecast capital expenditure, they are not transparent. This raises a potential concern that some costs may be higher than necessary. However, this concern can be allayed if the payments are established up front, set at a flat rate and are the result of arm's length transactions. Nevertheless, the ACCC notes that total forecast capital expenditure was not found to be excessive. The ACCC is satisfied that total forecast capital expenditure is not unreasonable.

The weighted average cost of capital (WACC) adopted by Europacific is 11.955 per cent (pre tax real).[42] There is no information regarding the calculation or the appropriateness of this rate of return included in the tender or the FAR. MMA has noted that this WACC will apply to the project for the duration of the initial access arrangement period and different rates of return may apply in subsequent access arrangement periods.

Operating costs for transmission and distribution have been forecast at a total of $800 000 per year, with these costs being allocated entirely to the transmission pipeline.[43] As part of this allowance will in practice be required for the operation and maintenance of the distribution system, the amount available for the transmission pipeline might be significantly less than $800 000 a year. MMA comments that the implicit allowance appears low for a regional transmission pipeline and that use of actual costs in this case appears reasonable. The operating costs for the CWP (not including distribution) were estimated at $775 000 for 2001.[44]

The MMA report indicates that the forecast capital and non capital costs for the CRP are reasonable given the demand scenario forecast by Europacific. As noted by MMA, actual costs will be used in the regulatory framework to determine the residual value for 2019. As tariffs have been set by the tender process, Europacific will have an incentive to ensure the actual costs are efficient. The ACCC has concluded that, taking into account the competitive tender process and the particular circumstances of the proposed pipeline, the forecast costs as set out in the tender are appropriate.

MMA has also assessed the forecast demand information provided in the tender, taking into account subsequent demand assessments by Europacific. The most significant customer expected in the region is the planned ethanol plant in Gunnedah, with a forecast annual load of 1.2 PJ. While the construction of this plant has not yet commenced, other potential contract customers at Gunnedah may have sufficient load to underpin the development of the pipeline from Breeza to Gunnedah.

There are a number of potential contract customers in Tamworth. Europacific has demonstrated that it has assessed the potential loads carefully and has developed a reasonable estimate of the gas requirements of these prospective customers. While new loads may emerge over time, Europacific has concentrated on the potential customers

42 FAR, p. 26.

43 Europacific tender (FAR appendix 2), schedule 1.

44 APT Pipelines (NSW), *Access arrangement information for Central West Pipeline*, pp. 21-23.

currently in business. MMA considers that this is a reasonable approach for a regional greenfields development.

Potential users of the industrial and commercial reference service include small businesses with an annual gas demand of less than 10 TJ. Europacific has identified a base of over 450 potential gas customers in Tamworth and Gunnedah. MMA considers this calculation to be reasonable and within its expectations derived from relevant industry data. However, the anticipated uptake of gas by this group would, in MMA's opinion, require a significant marketing effort.

MMA has assessed Europacific's estimation of residential demand for Tamworth and Gunnedah. It found the estimate of average usage for dwellings to be reasonable. MMA commented that the demand growth scenario, and penetration of gas into the residential sector, was consistent with a 'high' marketing effort. It noted that, given the forecast marketing expenditure of Europacific, the desired 'high' marketing effort may benefit from additional funds.

Overall, the assessment by MMA indicates that the demand forecasts for the Central Ranges region have been developed in a sound manner. The ACCC is satisfied that the forecast demand over the initial access arrangement period is reasonable.

As indicated by Europacific's tender, and noted by the CRNG&TAI, the Central Ranges project is not expected to recover total costs during the initial access arrangement period to 2019.[45] The ACCC understands that this is consistent with the nature of a regional greenfields project. It is expected to take some time for demand to develop in the new market. In recognition of the low initial revenues Europacific has established a regulatory framework that allows the capitalisation of under-recovered revenue. This provides Europacific with the opportunity to recover all efficient costs over the life of the assets. This approach is similar to the under-recovery mechanism employed for the CWP.

The ACCC notes APT's decision to not continue with the development of the Central Ranges project, and that Agility's submission to the CRNG&TAI indicates that it is unwilling to proceed with the project at this time. It also notes that a recent report regarding the development of natural gas in the northeast of NSW indicates that the supply of gas to Tamworth may be a viable proposition even though supply to other towns in the area may not.[46]

In considering the requirements of section 8.1(a) of the Code the ACCC has taken into account the information provided by the CRNG&TAI, Europacific and the views expressed by Agility. It also notes that there was only one conforming tender submitted to the CRNG&TAI. The ACCC acknowledges that there are likely to be differing views regarding the success of the Central Ranges project – these views would reflect differences in expected costs, rates of return and perceptions of risks.

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45 Modelling incorporating the WACC used by Europacific in its tender indicates that the term to recover costs is greater than the initial 15 year period although within the expected life of the pipeline.

46 Sleeman Consulting, *Facilitating the development of natural gas in northeastern New South Wales*, a report prepared for NSW Department of Mineral Resources, March 2004, p. 18.

The ACCC notes that the MMA review of the Europacific tender concludes that the costs and demand projections have been determined in a sound manner and are reasonable for the particular circumstances of the proposed pipeline. The ACCC also notes that the cost and demand projections have been developed within a competitive tender environment. On balance, the ACCC has concluded that based on the information provided, Europacific has established a regulatory framework that provides the opportunity for it to recover efficient costs over the expected life of its investment.

Replicate a competitive market outcome

The ACCC understands that the reference tariffs adopted by Europacific were established with reference to the current delivered prices of competing fuels (coal, LPG, light fuel oil and electricity) and the prices that the different user classes may be able to bear (reducing the likelihood of bypass or stranded assets). In principle, the tariffs would be expected to reflect the environment that Europacific is attempting to enter and would be consistent with a competitive market outcome.

The ACCC also acknowledges the comments from the CRNG&TAI that the tender process undertaken was open and competitive and accordingly, tariffs reflect a competitive market environment.

Competitive markets also tend to result in prices that reflect efficient costs. The forecast costs for the CRP have been found by MMA to be appropriate in the circumstances. However, tariffs are not expected to recover efficient costs in the initial years of the pipeline's life given the adoption of the under-recovery mechanism. Nevertheless, over the life of the pipeline, efficient costs are projected to be recovered through the reference tariffs.

Accordingly, the ACCC has concluded that the reference tariffs have been designed to reflect the outcome of a competitive market as required by section 8.1(b) of the Code.

Safe and reliable pipeline operation

It is reasonable to expect that the development of forecast costs by experienced gas pipeline businesses will include consideration of the costs associated with the safe and reliable operation of the pipeline. Further, the use of actual costs in the CRP regulatory framework will allow any unforeseen costs relating to the operation of the CRP to be incorporated, if necessary. There is no reason to expect that the reference tariffs or the reference tariff policy would jeopardise the operation of the pipeline.

No distortion of investment decisions

Efficient investment decisions upstream and downstream of the CRP will be facilitated by the CRP reference tariffs recovering the efficient long run costs of the pipeline. The costs forecast for the initial access arrangement period are considered to be within a reasonable range of efficient costs.

The additional revenue policy may provide some funds for the development of a distribution system serviced by the CRP. While this may provide Europacific with some advantage over a new entrant in relation to the building and operation of distribution pipelines to the towns in the Central Ranges area, in practice, there may be little material impact.

Efficiency in the level and structure of tariffs

The FAR sets out the reference tariffs adopted by Europacific in its tender. These are shown in Table 1 below.

Table 1 Central Ranges reference tariffs

	$/GJ (2003)		
Reference service	**Transmission**	**Distribution**	**Total**
Domestic consumers	6.50	3.50	10.00
Industrial & commercial	5.00	1.50	6.50
Contracts (>10 TJ)	2.50	1.20	3.70
Special contracts	1.75	0.05	1.80

Source: FAR, p. 23.

Reference tariffs have been established with reference to the market environment, capital and non capital costs. Tariffs designed to recover efficient costs and reflect the limitations imposed by the market environment may be expected to achieve the objective of being set at an appropriate level.

As noted by the CRNG&TAI, Europacific has developed four customer classes. Three of these classes (residential, industrial & commercial, contract) are often used by pipeline operators. It is also common for special arrangements to be made for the supply of gas to significant users of pipeline (as signified by the reference service 'special contracts' for the CRP). In general, establishing a number of reference services allows the services to be tailored to the needs and circumstances of each customer group. However, this type of tariff structure also provides an opportunity for some cross subsidisation between reference services. MMA has considered this aspect in relation to Europacific's proposal and has concluded that it is unlikely to include cross subsidies.

While there are four reference services, each is provided with a single throughput tariff. That is, regardless of the location of the withdrawal point, each user of a reference service will pay the same tariff for the transportation of the gas used. This approach was also adopted for the CWP.[47] In that instance, the ACCC concluded that a single volume based tariff for the entire pipeline would provide a simple tariff structure that could be easily understood and would assist in the introduction of gas to the area.[48] These considerations also apply to the CRP.

Incentives to reduce costs and develop the market

As noted previously, the under-recovery mechanism for the CRP makes use of actual costs and revenues to determine the under-recovery that is expected to arise in the initial years of the assets life. The use of actuals provides Europacific with an incentive

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47 The CWP has one reference service.

48 ACCC, *Final Decision: access arrangement by AGL Pipelines (NSW) Pty Ltd for the Central West Pipeline*, 30 June 2000, pp. 82-83.

to limit expenditure to efficient levels and develop the market to generate revenue as this would reduce under-recoveries and bring forward returns for the project's investors.

Further, the additional revenue policy provides a mechanism that can encourage market development. Any additional revenue achieved above forecast revenue can be used to assist in the funding of extending the Central Ranges distribution system to other towns in the area. Once all the towns in the area are connected to natural gas an incentive to continue to develop the business and maintain efficient costs is maintained through the equal sharing of excess revenues between Europacific and users.

The CRNG&TAI accepted the under-recovery mechanism and the proposed additional revenue policy. It noted that under-recovery mechanisms had been adopted for other pipeline businesses.[49] The ACCC agrees that these aspects of the regulatory framework for the CRP will provide incentives to reduce costs and develop the use of natural gas in the Central Ranges area.

Conclusion

The ACCC has considered each of the section 8.1 objectives, as set out above, with reference to the competitive tender process undertaken and the circumstances of the proposed pipeline project. The ACCC is satisfied that the reference tariffs determined in accordance with the tender process will achieve the reference tariff objectives set out in section 8.1 of the Code. Accordingly, the ACCC considers that the requirements of section 3.33(c)(i) are met.

4.6 Cost allocation

Code requirements

The regulator must be satisfied that the reference tariffs determined from the tender process contain or reflect an allocation of costs (between services and users) which is fair and reasonable (section 3.33(c)(ii)).

Reference tariff principles pertaining to cost allocation issues are set out in sections 8.38 to 8.42 of the Code. Section 8.38 requires that, to the extent that is commercially and technically reasonable, reference tariffs should recover costs directly attributable to the reference service and a fair and reasonable share of costs incurred jointly with other services. In addition, section 8.42 requires that the recovery of a particular user's share of costs also follows the section 8.38 principles.

FAR

The FAR sets out the reference tariffs proposed by Europacific. These are shown in Table 1 above.

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[49] FAR, p. 21.

The reference tariffs are expected to be constant in real terms throughout the initial access arrangement period and apply to the volumes transported by users regardless of their location.

Europacific states the following in relation to its cost methodology:[50]

- transmission pipeline capital costs have been allocated to the CRP, and distribution pipeline capital costs allocated to the distribution system
- transmission and distribution related operating costs have been allocated to the CRP
- transmission pipeline costs have been allocated to the reference services according to the estimated maximum hourly quantity (MHQ) of gas consumed for each service
- distribution costs for special contract and contract users were estimated and allocated to those users with the remaining distribution costs allocated in proportion to estimated MHQ of that service.

The FAR also comments that the cost allocation methodology employed by Europacific is aimed at achieving the projected overall return for the investors in the project while providing an acceptable total (bundled) tariff for users.[51]

Assessment

The assessment of the reference tariffs with respect to section 3.33(c)(ii) has made use of the review of the tariff related aspects of the FAR and the tender carried out by MMA for the ACCC and IPART.

For each reference service, a single zonal reference tariff would apply throughout the system, an approach which is consistent with that adopted for the CWP. A single zone tariff may appear to disadvantage customers located closer to the source of supply (in this case, Dubbo) when compared to a potential distance-based tariff. However, distance-based tariffs are not always viable as they may lead to excessive tariffs for the more remote customers, reducing the total number of likely customers, which may jeopardise the whole project. Also, in practice for the CRP, the single zone methodology may have similar results to other cost allocation methods given the uncertainty regarding supply to centres in addition Tamworth and Gunnedah during the initial access arrangement period.

The ACCC is satisfied that total costs are likely to be efficient and that Europacific has an incentive to maintain efficient costs. However, as discussed above, the capitalisation of forecast under-recovered revenues that arise during the initial years of the pipeline's life will result in reference tariffs in any one year that do not fully reflect the actual costs incurred in that year. In the initial years, tariffs will not recover all costs. In the concluding years of the pipeline's life costs will be over-recovered. The ACCC regards this to be a matter of timing rather than any fundamental misallocation of costs as total costs are expected to be recovered over the life of the assets.

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50 FAR, p. 19.

51 FAR, p. 19.

MMA has considered the cost allocation between reference services. It noted that apportioning costs by MHQ would be an acceptable approach as costs are largely capacity related. However, Europacific has used year 15 volumes to determine MHQ rather than, for example, a net present value of MHQ over the 15 years. Europacific's approach creates a bias against users whose demand grows over the 15 year period.

The MMA review found that the use of the MHQ cost allocation method, as outlined by Europacific, is not fully reflected by the reference tariffs. That is, users may not account for revenue in the same proportion as their costs. Some users may make a greater contribution to revenue than their costs would suggest and, conversely, some users may not contribute sufficient revenue to recover all their costs. Nevertheless, MMA has concluded that, while the tariffs are not fully cost reflective, they are unlikely to involve cross subsidies.

This finding of less than full cost reflectivity appears to be consistent with Europacific's approach to determining reference tariffs. As discussed above, the reference tariffs were established with reference to the prices of competing fuels and the prices that customers may be able to bear. This outcome reflects the competitive tender process and the market environment facing Europacific.

Total operating costs (distribution and transmission) have been allocated to the CRP. MMA noted that this is not usual practice. However, as acknowledged by MMA, the impact is limited and, in fact, the expected distribution of revenues between the transmission and distribution pipelines over the initial access arrangement period matches well the distribution of costs and, accordingly, appears reasonable.

While the allocation approach used by Europacific may not be fully cost reflective, the ACCC considers that to the extent practicable, the approach represents a reasonable accommodation of the regulatory cost allocation objectives within the technical and commercial environment faced by Europacific. Accordingly, the ACCC considers that the reference tariffs determined from the tender are likely to reflect a fair and reasonable allocation of costs and satisfy the objective of section 3.33(c)(ii) of the Code.

4.7 Revisions commencement date

Code requirements

Section 3.33(d) of the Code requires that the regulator must be satisfied that the revisions commencement date to be included in the access arrangement is 'not later than 15 years after the Access Arrangement for the proposed Pipeline is approved'. Alternatively, the revisions commencement date can be a later date if it is considered appropriate by the regulator on the basis of the proposed tariffs.

The TAR is required to specify a possible revisions commencement date for the purpose of tenderers submitting proposed tariffs. However, the date in the TAR is not intended to limit the regulator's discretion in approving or not approving a revisions commencement date under section 3.33(d).[52]

The revisions commencement date is the 'date upon which the next revisions to the Access Arrangement are intended to commence'.[53] As stated in section 2.48 of the Code, revisions to an access arrangement come into effect on the date specified by the regulator in its decision to approve the revisions. That date must be at least 14 days after the decision.

Generally, an access arrangement is required to include a revisions submission date and a revisions commencement date. As indicated by section 3.33, the revisions commencement date is considered in a FAR assessment process. A revisions submission date will be required to be nominated in any subsequently lodged access arrangement for the pipeline.

FAR

The tender documentation proposed that 1 July 2019 would be the revisions commencement date and also be the reference date to which proposed reference tariffs are to be nominated by tenders.[54] Nonetheless, it identified the revisions commencement date as an item to be determined by the tender process.[55]

The FAR identifies 1 July 2019 as the date nominated by Europacific as the revisions commencement date for the four reference services to be provided by the CRP. The CRNG&TAI notes that this date was nominated in the TAR and that it is currently 14 years after gas is expected to become available in the region and the transmission and distribution access arrangements are expected to be approved.[56]

Assessment

The provisions of section 3.33(d) of the Code suggest that an initial access arrangement period of 15 years would be appropriate for new pipelines that have been developed through the competitive tender principles of the Code. The Code acknowledges that in some circumstances a longer initial access arrangement period may be appropriate.

In this instance, based on the assumption that the access arrangement for the CRP would commence on 1 July 2004, an initial access arrangement period of 15 years was proposed with the revisions commencement date of 1 July 2019. Accordingly, as the revisions commencement date would not be later than 15 years after the start of the initial access arrangement period, this Code requirement would be satisfied.

A proposed access arrangement for the CRP has not been lodged with the ACCC to date and is not required until 90 days after this decision. As a result, the duration of the

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52 Section 2.22(d).

53 Section 3.17(b).

54 Tender documentation, pp. 22 & 31.

55 Tender documentation, p. 36.

56 FAR, p. 20.

initial access arrangement period will fall short of the intended 15 years to the extent that the start of the period falls behind the anticipated 1 July 2004 date.

The ACCC has concluded that the requirements of section 3.33(d) have been satisfied.

4.8 Additional revenue policy

Code requirements

The regulator must be satisfied that the additional revenue policy to be included in the access arrangement for the proposed pipeline will, in reference to the proposed tariffs, be appropriate.[57]

Guidance on the intention of an additional revenue policy is provided by section 3.28(d)(ii). It requires a TAR to specify that tenders must include an additional revenue policy to avoid exclusion from consideration. The policy is to describe:

> whether the additional revenue which would result if the volume of gas actually transported by the proposed Pipeline exceeds a certain volume will either be retained by the Service Provider or returned in whole or in part to Users in the form of lower charges or some other form[58]

'User' is defined in section 10.8 as 'a person who has a current contract for a Service or an entitlement to a Service as a result of an arbitration.'

The CRNG&TAI comments that there is no further guidance from the Code to assist in determining the reasonableness of the expectation that greenfield pipelines share additional revenues with users or what degree of sharing may be appropriate.[59]

FAR

Europacific provided the following explanation of its additional revenue policy in its tender:

> Initially, Additional Revenue will be used to assist in the funding of the rollout to other Towns in the Central Ranges region. Any revenue in excess of forecasts will reduce the Residual Value of both the Transmission and the Distribution Pipelines that will ultimately be passed on to all Users in the form of lower tariffs from the Revision[s] Commencement Date.
>
> Once gas has been connected to all towns excess revenue will be shared equally with the pipeline Owners and the Users for the initial Tariff Period. This will be passed on to the Users in the form of lower charges and to Owners in increased returns.[60]

While the CRNG&TAI accepted the policy under the tender evaluation process, it did request clarification of the above statement from Europacific.[61] In response, Europacific made the following clarifying points:[62]

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57 Section 3.33(e).

58 Section 3.28(d)(ii).

59 FAR, p. 20.

60 Europacific tender, p. 10.

- the residual value is to be adjusted for any under or over recoveries to ensure that Europacific obtains the return used in the tender (a pre tax real WACC of 11.955 per cent)
- for any year, the under recovery amount is calculated as operating expenditure + (capital base × return) – revenue
- while the residual values estimated in the tender are $102 million (transmission) and $38 million (distribution), the actual residual values at the revisions commencement date will be determined by actual costs and revenues[63]
- on the basis that the tendered return and the residual values are maintained, after tax profits in any year that are in excess of the return and the residual values set out in the tender (the additional revenue) will be set aside
- the amount set aside can be used to meet under recoveries in subsequent years and/or provide an income subsidy and/or fund capital expenditure to expand the distribution pipeline system, solely at the discretion of Europacific
- if the funds set aside are not used within 10 years from the year the profit was made then the amount is used to reduce tariffs for users
- once the distribution system has been extended to all towns specified in the tender (Tamworth, Gunnedah, Mudgee, Dundedoo, Coolah, Gulgong, Quirindi, Werris Creek, Coonabarabran and Gilgandra) any subsequent additional revenue funds will be shared equally between users (through reduced tariffs) and the service provider (through additional profit).

Assessment

The ACCC notes that the additional revenue policy potentially has a number of benefits for users and prospective users of the CRP:

- additional revenue may be used to fund expansion of the distribution system to towns that the CRNG&TAI, local governments and development agencies have identified as being high priority destinations for the supply of natural gas
- if all these expansions have been completed, any additional revenue may be shared equally between users and the service provider
- any additional revenue that, after 10 years, has not been used to fund expansions may be returned to users.

However, the service provider has the sole discretion regarding the use of any additional revenue obtained. It may elect to retain all the benefits provided by the policy. That is, it may decide to employ additional revenue to reduce the accumulation

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61 FAR, p. 21. See also chapter 4.4 of this decision. This clarification is not considered to be a change to the reference tariffs determined from the tender (see chapter 4.2).

62 FAR, pp. 21-22 & 25-26.

63 These forecast residual values are expressed in 2003 dollars. Assuming an annual CPI increase of 2.5%, the residual values would be $151 million (transmission) and $56 million (distribution) in 2019 dollars.

of the under recovery, provide an income subsidy or retain the funds for up to 10 years, rather than to expand the distribution system or return to, or share it with, users.

Under this scenario, users and potential users would not enjoy the potential benefits identified above. However, users would still benefit in future access arrangement periods as any reduction in the accumulated under recovery would result in a lower than forecast residual value at the end of the initial access arrangement period. This would reduce future tariffs to below the level that they would otherwise be.

The ACCC acknowledges that, if additional revenue is used to extend the distribution network in the region, there may be revenues earned from the CRP flowing to users of the distribution system. This may be considered to be a form of cross subsidy. However, factors affecting the development of regional greenfields pipelines and the CRNG&TAI's objective of developing supply in the region as a whole are also relevant. The ACCC notes that users of the distribution system will also be users of the CRP and, from a 'whole of project' perspective, users (and the service provider) would benefit from development of the gas supply system and the increased usage of the infrastructure.

As the operation of the additional revenue policy is at the sole discretion of the service provider, it is not possible to anticipate the impact the policy will have. For example, only some of the potential outcomes would result in a return of revenue to users of the CRP. The other potential outcomes could, however, provide benefits to future users of the CRP and the associated distribution system.

The ACCC has some concerns about the absolute discretion allowed to the service provider in deciding between options with quite different outcomes, and the potential impacts on users and other parties in the Central Ranges region. However, in practice, users of the system in the initial access arrangement period will generally also be users in future periods, and future users of the distribution system will also be users of the transmission system. Moreover, the ACCC recognises that it is the service provider who is best placed to make commercial judgements in the face of the uncertainties that arise in developing a regional greenfields pipeline.

The ACCC also notes that the additional revenue policy to be applied by Europacific may incorporate additional revenue generated through declining costs (as well as increased volumes).[64] As noted above, the Code description of an additional revenue policy only refers to additional revenue generated through increased volumes of gas transported on the pipeline.[65] The ACCC considers that while Europacific's additional revenue policy is broader than that suggested by the Code, it is not inconsistent with the Code.

The ACCC has had regard to the tariffs for the CRP and the circumstances faced by Europacific in developing the supply of gas in the region in its assessment of the additional revenue policy. On balance, the ACCC considers that the additional revenue

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64 The policy refers to actual after tax profit. FAR, p. 25.

65 Section 3.28(d)(ii).

policy is appropriate for the CRP on the basis of the proposed tariffs. The ACCC has concluded that the requirements of section 3.33(e) of the Code are satisfied.

5. Decision

The ACCC has concluded that it is satisfied that the FAR lodged by the CRNG&TAI meets the requirements of section 3.33 of the Code. Accordingly, pursuant to section 3.32, the ACCC approves the FAR.

The proposed CRP is now a covered pipeline under the Code.[66] The pipeline's service provider is required to submit an access arrangement (with the applicable access arrangement information) for this pipeline within 90 days after this decision.[67] The ACCC will then assess the proposed access arrangement according to the provisions of section 3 of the Code. The reference tariffs and other items identified as tender outcomes will not, as directed by section 3.34, be subject to regulatory assessment.[68]

Coverage also places obligations on a service provider in regard to ring fencing requirements (section 4 of the Code). A number of these obligations come into effect upon coverage while others arise six months after.[69]

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66 Sections 1.21 and 3.34.

67 Section 2.2(a).

68 The tender outcomes are the revisions commencement date, reference tariffs, relevant parts of the reference tariff policy and the additional revenue policy. See FAR, pp. 23-26.

69 Immediate obligations are set out in section 4.1(c), (d), (e), (f) and (g).