

3 November 2011

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

50 Pirie Street
Adelaide SA 5000

Postal Address:
GPO Box 2010
Adelaide SA 5001

T 08 8201 7300
F 08 8410 8545

Dear Mr Pierce,

Reference service and rebateable service definitions

We refer to the rule request made by the Australian Energy Regulator (AER) on reference and rebateable services definitions (Rule Change Request). As it currently stands, an asset owner is potentially able to over-recover for providing the same service from given regulated assets.

The current drafting of the National Gas Rules (NGR) permits an asset owner of regulated assets to double recover for those assets because it allows the owner to:

- sell transmission allocation rights up the capacity of the regulated pipeline at auction and
- also charge tariffs on an ongoing basis for the use of the unallocated portion and for portions of allocations unused by the rights holder at a given time.

The issue that arises is that where the asset owner sells allocations for value (say at an auction) and then resells capacity and receives tariff income for capacity not used by the initial rights holder. This potentially allows the asset owner to over-recover for the cost of the asset.

The Rule Change Request seeks to limit over-recovery of regulated assets by an asset owner, allowing the AER discretion in determining whether an asset is classified as providing a reference service. This has a direct effect on whether the asset owner is required to rebate tariffs receipts earned in respect of the regulated asset. In AEMO's view, recovery over and above a normal regulated return on certain assets is not necessarily inappropriate. If a market participant is willing to pay for transmission rights that exceed the costs of the service of providing those rights, then in our view, provided that the rights are sold in a transparent and fair manner (such as at an auction) there should be no reason why the asset owner should not be allowed to benefit from that. There may be many reasons why the value of services exceeds the costs of the assets installed to provide those services including that a transmission right over a pipeline may impose greater risk on the pipeline owner or require it to provide additional services increasing the cost and value offered. We are similarly comfortable where a participant elects to fund an augmentation provided that the funder is freely allocated rights in return for the funding arrangement.

As we understand it, the Rule Change Request seeks to give the AER discretion in regards to the declaration of "reference services". Currently, a regulated pipeline is automatically placed in the asset owner's RAB with a reference tariff set to recover costs including a profit margin. Under the Rule Change Request, the AER would have the discretion to disallow the inclusion of the pipeline into the asset owner's RAB if, for instance, the asset owner was able to sell all allocations at auction for full value or a market participant funded an augmentation in return for a free allocation of rights. This would allow the service to become a rebateable

service¹ and would entitle rights holders to rebates from tariff receipts earned by the asset owner on the regulated asset. In this respect, we support the Rule change request.

A concern does arise where a particular pipeline offers a reference service for only part of its capacity. In that case, there is the issue as to how to split the asset value between the reference services (those recovered under the RAB) and the privately "negotiated" services (those that do not qualify to be recovered under the RAB). The AER should allow only the unallocated or unsold portion of the pipeline capacity (if that can be determined with any degree of certainty) to be placed in the asset owner's RAB and determine a suitable tariff in respect of that portion. But that raises the question as to what value to place on that portion of the pipeline and therefore the tariffs that go along with it. This is a matter that the AEMC should give some thought to.

In particular thought should be given to establishing criteria that would guide the AER in making a determination regarding a reference service and making an apportionment to rebateable or negotiated services. Following the usual approach employed in gas transport, the objective should be to minimise the potential for regulated investments to "crowd out" or discourage private investment. The criteria should be consistent with the Revenue and Pricing Principles in Section 24 of the Gas Law (RPPs) but need to be extended and clarified in respect of the apportionment mentioned above. The following non-exhaustive list of issues should be considered in developing the criteria:

- existence of paying foundation customers, extent of their contributions and services contracted to them
- utility of the pipeline in terms of it meeting the national gas objective (NGO)
- uncertainty in forecast demand for a service
- difficulty in determining costs for services and therefore determining a reasonable tariff
- ability of the asset owner to earn a return on its investment by offering other services in respect of the same assets.

The criteria should be developed with the intention of giving transmission investors greater certainty when faced with the AER's decision.

We would be pleased to provide further comment and assistance if required and if you have any questions regarding please do not hesitate to contact me on (08) 8201 7371.

Yours sincerely

David Swift
Executive General Manager Corporate Development

¹ The service could also be a negotiated service which implies an absence of revenue regulation. However, tariff setting regulation may still be warranted if any unused allocation portion of capacity is sold on an "as-available" basis to non-rights holders to ensure fair and equitable pricing.