

17 August 2000

Ms Julie King
Executive Officer
NGPAC
Level 13, Wakefield House
30 Wakefield Street
ADELAIDE SA 5000

Dear Ms King

**Submission By Envestra on NGPAC's Proposed Amendment of June 2000 to the
National Third Party Access Code for Natural Gas Pipeline Systems**

I refer to the Information Memorandum of June 2000 regarding two options to amend the Code to allow for the explicit recognition of across-period incentive mechanisms in Access Arrangements.

It is important that the issue of incentive mechanisms across periods be clarified in order to provide certainty to those entities considering investment in new technology, new processes and major extensions. For the natural gas industry to continue to grow and to expose itself to risk through investment in new techniques, assurance needs to be provided that incentive mechanisms which ensure an appropriate sharing of benefits will be available. This is ultimately in the long-term interests of consumers.

Of the two alternatives proposed by NGPAC, Option B seemingly offers a greater level of certainty for consumers than Option A by specifying the maximum length of the period over which a particular incentive mechanism applies. In most cases it is unlikely that the period for sharing efficiency gains would need to be longer than 10 years. However, one exception is a greenfields development where there is typically an under-recovery in earlier years. The incentive mechanism would need to provide an incentive for the Service Provider (SP) to improve efficiency even during periods of under-recovery. This may require efficiency gains obtained during periods of under-recovery to be maintained for a period longer than 10 years. Envestra therefore suggests that Option B be amended, to enable the Regulator to specify periods greater than 10 years, if it can be demonstrated that this is warranted.

Both Option A and B give power to the Regulator to determine the percentage of efficiency gains to be shared between the SP and consumers. However, neither proposal provides any certainty on the extent of efficiency gains (if any) that the SPs could expect to retain. In order to reduce regulatory uncertainty and increase the attractiveness of increasing efficiency, the SPs and Regulators should include in the Access Arrangement, details of the sharing

arrangement of the expected gains. The Code should be amended to require Access Arrangements to include sufficient detail on the manner in which efficiency gains will be shared.

A **minimum** defined period for which the efficiency gains would be retained by the SPs would also assist in increasing regulatory certainty. The NGPAC paper alludes to a 5-year retention period being the minimum based on regulatory precedent. A 5-year minimum period for efficiency carry-over is appropriate (the ORG, for example, used the 5-year minimum in the 2001 EDPR draft decision).

In summary, responses to the specific items on which public comment is sought by NGPAC are set out below:

- (1) The industry needs an across-period incentive mechanism to encourage ongoing investments, which ultimately benefit consumers. Such an incentive mechanism is consistent with the original intent of the Code (with its within-period incentive mechanism). While any forward-looking incentive mechanism will constrain the Regulator, this is necessary to provide the incentives to business to improve efficiency. It must be recognised that regulated entities are, nonetheless, commercial undertakings and require the assurance of appropriate incentives and the ability to retain gains for the benefit of shareholders in the first instance and ultimately for the benefit of consumers.
- (2) Option B would generally be acceptable. However, there may be some exceptions, such as greenfields extensions of networks. It is therefore proposed that Regulators be given the discretion to approve a period for sharing efficiency gains beyond 10 years where appropriate.
- (3) A key issue for Service Providers is the assurance of certainty to facilitate efficient investment. It is up to Regulators and to regulatory mechanisms (principally the Code) to ensure that the appropriate environment is created for positive commercial decisions to be made. This includes specifying in Access Arrangements sufficient detail on the manner in which efficiency gains will be shared.

These points could be included by amending clause 8.44 to incorporate an amended Option B as follows:

*“(b) during a period commencing at the start of an Access Arrangement approved by the relevant Regulator **for at least five years** and not exceeding ten years within which two or more Access Arrangement Periods occur, **(unless otherwise approved by the Regulator)**, that exceed the level of returns expected for that period.”*

We suggest a new sentence be added at the end of clause 8.44 as follows:

*“..... than forecast. **Rules describing how the additional returns will be shared are to be included in the Access Arrangement.**”*

Should you require any clarification of the issues raised here, please contact Mr Andrew Staniford on 08 8418 1125.

Yours sincerely,

O G Clark
Managing Director