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association Ltd

26 October 2009

Mr Eamonn Corrigan
Australian Energy Market Commission
Level 5, 201 Elizabeth Steet
SYDNEY NSW 2000

Dear Mr Corrigan

Review into the Use of Total Factor Productivity for the Determination of Prices and Revenues

APIA would like to take this opportunity, as offered at the October 2009 Total Factor Productivity (TFP) Workshop in Sydney, to provide some further comments regarding the use of TFP for the determination of prices and revenues for gas transmission infrastructure.

APIA considers that the TFP approach is not a useful one for gas transmission pipelines: it is unlikely to deliver benefits above those that the building block approach can deliver, primarily as there is not a large enough data set to warrant developing the benchmarks on which TFP is based. Furthermore, every pipeline in Australia is faced with unique circumstances, which means that there is little merit in applying a comparative benchmarking process to these pipelines.

If you wish to discuss further please contact Stuart Ronan on (02) 9693 0038.

Yours sincerely

CHERYL CARTWRIGHT
Chief Executive

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Introduction

The Australian Pipeline Industry Association (APIA) welcomes the opportunity to provide a submission to the Australian Energy Market Commission's (AEMC) 28 August Design Discussion Paper relating to the Review into the Use of Total Factor Productivity (TFP) for the Determination of Prices and Revenues - project reference number 'EMO0006'.

APIA is the peak national body representing the interests of Australia's transmission pipeline sector. APIA's membership is predominantly involved in high-pressure gas transmission.

APIA understands that the objective of the AEMC Review is to determine whether the use of a TFP methodology can deliver benefits above the benefits delivered by a building block approach.

Given a large number of the TFP design features are yet to be finalised, it is difficult for APIA to assess the merit of implementing a new regime.

APIA Concerns

Network Focus of TFP Debate

The TFP debate in relation to gas infrastructure has been almost exclusively focussed on gas networks. To the extent that this focus indicates that, if introduced, TFP will only apply to gas networks and not to gas transmission pipelines then APIA has no comment.

However if TFP is intended to apply to gas pipelines as well as gas networks then APIA is concerned that the debate to date has focussed almost exclusively on network infrastructure. Implementing a new regulatory methodology for pipelines without explicit debate of pipeline issues is unlikely to lead to desirable policy outcomes.

TFP is inappropriate for Pipelines

In its presentation to the AEMC public forum on 11 February 2009, APIA observed that regardless of TFP's applicability to gas networks, it is not viable for pipelines. This point appears to have been tacitly accepted by the AEMC, given the focus on TFP for gas networks rather than gas pipelines in the consultation to date.

The key reasons why TFP is inappropriate for pipelines are:

- There are relatively few regulated pipelines in Australia, meaning that the sample size for comparisons may be too small to create a stable industry benchmark, as one or two pipelines may greatly influence the benchmark. There are four large heavy regulation pipelines in Australia[1] (including two in Western Australia). Of these, three are owned or operated by a single company[2]. There are also four smaller heavy regulation pipelines[3]. Of these pipelines, three are owned or operated by a single company[4]. Some of these pipelines may become light regulation pipelines[5] or uncovered pipelines in the future..
- All of these pipelines are different. Individual pipelines are significantly different from each other, even if information is collected on a consistent basis. There are differences in:
    - Pipeline length.
    - The location of the pipeline. The terrain, soil type and remoteness of the pipeline are major determinants of capital expenditure and operating expenditure.
    - Pipeline age.
    - Pipeline volume loads.
    - Pipeline volume profiles.
    - The nature of end users and end markets.
    - The competitive position of gas in end markets.
    - The nature of gas market structures which determine how gas and pipeline services are traded. These structures differ for different pipelines.
    - Pipeline configuration, including compression. This is a major determinant of operating cost.

Given that the above factors vary widely between transmission pipelines, any data collected is unlikely to result in the calculation of a meaningful industry-wide productivity growth rate. Attempts to normalise the data to take account of these differences are likely to increase the potential for disputes and are likely to be inaccurate given the small pipeline sample size.

Other reasons why TFP is inappropriate for pipelines include:

- TFP does not deal well with lumpy capital projects. Unlike networks, which generally have steady capital expenditure profiles, many gas pipelines go through periods of basically no capital expenditure, punctuated by periods of intensive capital expenditure as the pipeline is compressed, looped or extended.
- TFP does not deal well with assets where the asset's future usage will be different from its past usage. Unlike networks, which generally serve a relatively stable residential and commercial market, many gas transmission pipelines are now serving different end use markets than those for which they

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[1] The Dampier Bunbury Pipeline, the Goldfields Gas pipeline, the Roma Brisbane Pipeline and the Victorian Principal Transmission System.

[2] The APA Group owns and / or operates the Goldfields Gas pipeline, the Roma Brisbane Pipeline and the Victorian Principal Transmission System.

[3] The Central Ranges Pipeline, the Central West Pipeline, the Dawson Valley Pipeline and the Amadeus Basin to Darwin Pipeline.

[4] The APA Group owns and / or operates the Central Ranges Pipeline, the Central West Pipeline and the Amadeus Basin to Darwin Pipeline.

[5] The Central West Pipeline is currently subject to a light regulation application

were originally planned, in particular many gas pipelines are now serving power generation markets.

Given the small sample size and problems of comparability the assessment of an industry TFP for transmission pipelines is problematic.

APIA understands from its members that regulated pipelines are unlikely to consider using TFP if it is introduced.

Costs and Time Frames of Data Collection

TFP requires that high quality data be collected over a long time frame (eg 5-10 years) prior to TFP implementation. Given that businesses have existing systems for collecting data, any change in data collection requirements will require significant lead times and will be costly.

APIA believes that data collection will be particularly costly for:

- smaller pipelines, where costs may be disproportionate to pipeline size; and
- pipelines which, although regulated, do not charge regulated tariffs and as such cannot pass the costs of regulation through to shippers.

APIA also has concerns about the intrusiveness of data collection and the potential that data collected for TFP may be used in other processes unrelated to TFP.

Support for "Opt In" Approach

If TFP is to be introduced as an alternative to building blocks for transmission and/or networks, APIA is strongly of the view that it must be a matter for the service provider alone to choose to move from building blocks to TFP and vice versa.

The use of TFP should not be mandatory, and a regulator should not have the power to direct a regulated infrastructure provider to use one allowable regulatory method in preference to another allowable method.

Conclusion

APIA is of the view that the TFP method is inappropriate for gas transmission pipelines in Australia due to both the small data set and the major differences between pipelines in the dataset.

TFP would be costly and problematic for transmission pipelines with little or no likelihood of it being used by industry participants. As such pipelines should be excluded from the scope of a TFP alternative to building blocks.