

**Tender Approval Request for the Proposed  
Natural Gas Pipeline to the Central Ranges  
Region of NSW**

**Decision**

12 March 2003

**INDEPENDENT PRICING AND REGULATORY TRIBUNAL  
OF NEW SOUTH WALES**



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**Gas03-01**

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## 1 INTRODUCTION

On 3 January 2003, the Central Ranges Natural Gas and Telecommunications Association Incorporated (CRNG&TAI) submitted a Tender Approval Request (TAR) to the Independent Pricing and Regulatory Tribunal of NSW (the Tribunal) and the Australian Competition and Consumer Commission (ACCC). On 18 February, it submitted amendments to the TAR in response to feedback received during public consultation.

The TAR seeks approval for the CRNG&TAI to conduct a competitive tender process for the supply of natural gas to the Central Ranges region of NSW, including the construction of a transmission pipeline and a distribution pipeline. The aim of the proposed tender process is to select an organisation to construct these new pipelines and determine the reference tariffs (and other related items) which will apply to the transportation of natural gas on these pipelines.

The TAR was submitted pursuant to section 3.21 of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the Code). Under the Code, the Tribunal is responsible for regulating distribution pipelines in NSW, and the ACCC is responsible for regulating transmission pipelines. Therefore, the Tribunal and the ACCC must both approve the TAR before the tender may be conducted under the Code.

Whilst the Tribunal and the ACCC have worked co-operatively to assess the TAR, each regulator has an obligation to make its own separate decision pursuant to the Code. The Tribunal has given detailed consideration to whether the TAR meets the criteria set out in section 3.28 of the Code, all of which must be satisfied before a decision to approve may be made. It has decided that the CRNG&TAI's TAR, submitted on 3 January 2003, and subsequently amended on 18 February 2003, does satisfy these criteria. **It has therefore decided to approve the TAR**, pursuant to section 3.25 of the Code.

This document provides more detail on the decision-making process and the Tribunal's rationale for reaching its decision:

- Chapter 2 provides an overview of the regulatory framework within which the TAR has been submitted
- Chapter 3 outlines the key elements of the TAR itself
- Chapter 4 outlines the process and criteria the Tribunal has used to assess the TAR, and its assessment of the extent to which the TAR meets each of the criteria it is required to consider.

Following completion of the tender and the selection of a successful tenderer, the CRNG&TAI may lodge a Final Approval Request with the Tribunal and the ACCC for approval of the tender outcome. The Tribunal is required to consider specific criteria under the Code before making its decision.

## 2 REGULATORY FRAMEWORK

The CRNG&TAI's TAR has been submitted to the Tribunal pursuant to section 3.21 of the Code. The Code establishes a national regime under which third parties (such as gas retailers) may access natural gas pipeline systems. Under this regime, the owner or operator of a pipeline considered to be *covered* by the Code is required to lodge an access arrangement (AA) with the relevant regulator for approval. Once approved, the AA sets out the terms, conditions and policies under which third parties may access the pipeline, including reference tariffs for key services.

When a new pipeline is being proposed or built (as is the case for this TAR), the Code allows an alternative process—a competitive tender process—to be used to determine the reference tariffs and related items which are intended to form part of an AA for a new pipeline.<sup>1</sup> The CRNG&TAI is following this process, an overview of which is provided at Appendix 1.

To conduct such a tender under the Code, the person must submit a TAR that sets out the proposed tender process to the relevant regulator for approval. The Tribunal is the relevant regulator for all TARs that relate to distribution pipelines in NSW.

If the TAR is approved, the next steps are for the person to conduct the tender and select the successful tenderer. The person may then lodge a Final Approval Request (FAR) with the Tribunal. The FAR must detail the reasons for the selection, and seek approval for the tender outcome, including the reference tariffs. If the Tribunal is satisfied that, among other things, the successful tender was selected in accordance with the selection criteria, procedures and rules specified in the approved TAR, then the FAR may be approved, and the distribution pipeline becomes a *covered* pipeline, regulated pursuant to the Code.<sup>2</sup> The successful tenderer would then be required to lodge a proposed AA with the Tribunal within 90 days of the FAR approval.<sup>3</sup> This would address AA items not determined by the competitive tender process.

The Tribunal notes that the CRNG&TAI is not bound to pursue the development of the proposed distribution pipeline under the regulatory framework of the Code and alternatively, could have sought to develop an unregulated or *uncovered* pipeline outside the Code.

However, whether or not the proposed pipeline is developed under the Code, the developer would be required to meet separate obligations under the *Gas Supply Act (NSW) 1996*. Under the Gas Supply Act, the Tribunal is responsible for the licensing of distribution pipeline owners/operators and gas retailers, and setting default retail tariffs for small retail customers (consuming less than 1 TJ per annum) that are supplied gas under a standard supply contract.

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<sup>1</sup> s3.21 of the Code.

<sup>2</sup> ss1.21 & 3.34 of the Code.

<sup>3</sup> s2.2 of the Code.

### 3 KEY ELEMENTS OF THE TENDER APPROVAL REQUEST

CRNG&TAI's TAR requests the Tribunal's approval for a process by which it will seek tenders for a proposal to develop gas supply to the Central Ranges region. The TAR comprises a covering letter and five supporting attachments. The second of these attachments describes the documentation the CRNG&TAI will issue to prospective tenderers at the start of the tender process, and provides background and regulatory information related to the proposal. It also sets out detailed Tender Specifications, including the tender process and rules, required tender information, and the criteria it will use to select the successful tenderer.

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—and a new network of distribution pipelines that will deliver gas to prospective users in the Central Ranges region. This region extends broadly from Dubbo to Tamworth and Gunnedah. Although the proposal does not specify which towns the new pipelines are to supply, the CRNG&TAI expects that the successful tenderer will serve at a minimum, Mudgee, Tamworth and Gunnedah.<sup>4</sup>

The proposed tender process will determine four key items that will be included in the AA for the new pipelines.<sup>5</sup> These are:

- the reference tariffs
- a revisions commencement date (which establishes the length of the initial regulatory period, or how long the initial AA will apply)<sup>6</sup>
- the reference tariff policy (to the extent that it determines the manner in which tariffs change over the initial regulatory period)
- an additional revenue policy (which determines how additional revenue generated when the actual quantity of gas transported exceeds a certain volume will be shared between the pipeline owner/operator and users).<sup>7</sup>

The proposed selection process involves three stages of assessment:

- The first two stages aim to screen out all tenders that do not qualify as *conforming* tenders (consistent with exclusionary provisions in the Code), or that do not meet minimum criteria (relating to the additional revenue policy and technical and prudential attributes of the tenderer). The TAR provides for the consideration of *conditional* tenders as conforming tenders, where they meet certain criteria. This screening process is to ensure that the tenders that proceed to the third stage can be assessed on an equal basis and that there is sufficient information for the CRNG&TAI to undertake an informed assessment and select the best tender.
- The third stage is to select the successful tender, which will be the tender that offers the *lowest average sustainable distribution and transmission tariffs over the economic life of the pipeline*, subject to the tender meeting the pricing and cost allocation objectives under the Code. If two or more tenders offer the same or similar tariffs, secondary criteria will be applied. These include area to be served, number of end users that will have

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<sup>4</sup> CRNG&TAI, *TAR Attachment 1*, 3 January 2003, p 5.

<sup>5</sup> CRNG&TAI, *TAR Attachment 2, Section 1*, 18 February 2003, p 18.

<sup>6</sup> The CRNG&TAI has proposed a revisions commencement date of 1 July 2019 (which indicates a regulatory period of 15 years); however it states that tenderers are free to nominate an alternative date.

<sup>7</sup> s3.28(d) of the Gas Code.

access, the construction timetable and, in relation to a conditional tender, the nature of conditions. Conditional tenders are to rank below non-conditional tenders to encourage the latter.

A full copy of the original TAR plus amendments may be obtained from the Tribunal's website: [www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au).

## 4 ASSESSMENT OF THE TAR AGAINST GAS CODE CRITERIA

Section 3 of the Code<sup>8</sup> sets out the process the Tribunal must follow when determining whether or not to approve a TAR. This process includes:

- seeking public comment on the TAR and considering the submissions it receives
- assessing the TAR against the specific requirements set out in the Code.

### 4.1 Seeking and considering public comment

As noted in Chapter 1, both the Tribunal and the ACCC are required to approve the CRNG&TAI's TAR because its proposal includes both a distribution pipeline and a transmission pipeline. In view of this, the regulators undertook a joint public consultation process. This process is outlined in Appendix 2.

The Tribunal received six submissions from interested parties, which are listed in Appendix 3. It has considered the content of these submissions, together with the CRNG&TAI's formal response, in its assessment of the TAR. It believes that the CRNG&TAI's formal response and amended TAR adequately addressed the views expressed in these submissions which were directed at specific Code requirements. The Tribunal's consideration of comments in relation to the specific requirements of the Code is discussed in the relevant sections below.

### 4.2 Assessing the TAR against the specific requirements of the Code

In assessing the TAR against the specific requirements of the Code, the Tribunal has considered whether the TAR satisfies **all** the specific criteria contained in sections 3.28(a) to 3.28(i) of the Code, and whether the TAR has been made on trivial or vexatious grounds or involves a conflict of interest (pursuant to ss3.26 & 3.27 of the Code, respectively).

In accordance with the Code, the Tribunal **must** decide to approve the TAR if satisfied of all the Code criteria and must decide not to approve the TAR if not satisfied of all the criteria.<sup>9</sup> The Tribunal believes that the TAR does satisfy the requirements of each of the criteria of the Code. Its reasons are summarised below.

#### 4.2.1 Section 3.28(a) – New pipeline

*Section 3.28(a) of the Code provides that the Tribunal must be satisfied that the proposed pipeline will be a new pipeline.*

Under the Code, reference tariffs can only be set by a competitive tender process if the pipeline to which the tariffs apply is a new pipeline. The TAR indicates that the proposed distribution pipeline is a new pipeline<sup>10</sup> that would reticulate natural gas to townships within the Central Ranges region of NSW. This area is not currently served by an established distribution pipeline. **Therefore, the Tribunal is satisfied that the TAR meets the requirements of section 3.28(a) of the Code.**

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<sup>8</sup> Specifically ss3.21 - 3.28.

<sup>9</sup> s3.28 of the Code.

<sup>10</sup> CRNG&TAI, *TAR Attachment 1*, 3 January 2003, p 8.

#### 4.2.2 Section 3.28(b) – Public interest and reference tariff objectives

*Section 3.28(b) of the Code provides that the Tribunal must be satisfied 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.*

The objectives in section 8.1 are as follows:

- *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;*
- *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 Code does not provide any guidance on the meaning of *public interest* or *appropriate mechanism*. In considering whether the tender process is in the public interest and an appropriate mechanism for ensuring reference tariffs achieve s8.1 objectives, the Tribunal has assessed the TAR's level of transparency, fairness and consistency with the Code, the general level of stakeholder support for the TAR, and the extent to which the CRNG&TAI has considered alternative options for developing the supply of natural gas to the region.

The CRNG&TAI submits that the proposed project has widespread support (including financial support) from the Federal government, community stakeholders, and several potential developers.<sup>11</sup> The Tribunal notes that it received several letters of support from a variety of stakeholders prior to and during the public consultation process.<sup>12</sup>

The Tribunal understands that the CRNG&TAI has considered a number of options for progressing gas supply to the Central Ranges region (including a tender process outside the Code and direct negotiations with potential developers). The CRNG&TAI highlights several benefits to its chosen approach, including the timely development of gas supply for prospective foundation load customers and confidence that competitive outcomes will ensue, relative to independent negotiations with prospective developers. Moreover, the CRNG&TAI has indicated that it does not consider that the prospect of a regulated or *covered* pipeline will adversely impact on the expected number of tenders.<sup>13</sup>

The CRNG&TAI submits that the proposed tender process is open, competitive and non-restrictive. It also suggests that the satisfaction of s3.28(b) criteria is linked to and dependent on the satisfaction of s3.28(c) of the Code, which requires that the tender process promote a competitive outcome.<sup>14</sup> That is, to the extent that a competitive tender process can be established, then the s8.1 pricing objectives relating to investor returns, competitive market, no distortion of investment decisions, efficiency in level and structure of tariffs, incentives for

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<sup>11</sup> CRNG&TAI, *TAR Attachment 5*, 3 January 2003, p 14.

<sup>12</sup> Submissions received during the public consultation process by the Gunnedah Shire Council, Public Interest Advocacy Centre, Mudgee Co-operative Meat Supply Ltd and Europacific Corporate Advisory Pty Ltd express support for the proposed tender process and development.

<sup>13</sup> CRNG&TAI, *TAR Cover letter*, 3 January 2003, p 2.

<sup>14</sup> CRNG&TAI, *TAR Attachment 5*, 3 January 2003, p 14.

market development and pipeline safety and reliability are also more likely to be satisfied. The Tribunal accepts that there is an interrelationship between these two criteria and refers to its consideration under section 4.2.3 below.

The Tribunal notes that the proposed primary selection criteria explicitly provides for the successful tenderer to be chosen on the basis of the lowest sustainable tariffs. It also requires tenderers to explain how their tenders achieve the objectives in s8.1 of the Code, why cost allocations are fair and reasonable, and to demonstrate how they meet minimum technical and prudential criteria.<sup>15</sup>

In light of the above, the Tribunal considers that provided the tender is conducted in accordance with the process outlined in the TAR, the objectives of section 8.1 of the Code are likely to be met. Moreover, it considers that this should produce an outcome which is in the public interest and is an appropriate mechanism to ensure that the reference tariffs achieve Code objectives.<sup>16</sup> It has not received any public submissions which would lead it to form a contrary view. **Therefore, the Tribunal is satisfied that the TAR meets the requirements of section 3.28(b) of the Code.**

#### 4.2.3 Section 3.28(c) – Competitive tender process

*Section 3.28(c) of the Code provides that the Tribunal must be satisfied that the number and character of tenders likely to be received would be such as to ensure a competitive outcome*

Under the competitive tender process proposed by the CRNG&TAI, the reference tariffs and other related items determined by that process will not be scrutinised by the Tribunal as they would be in a normal AA process. (The Code presumes that reference tariffs will have been set in a competitive market and meet the pricing objectives of section 8.1.) As a consequence, it is important that the tender process is structured to facilitate a competitive outcome. Under competitive conditions, it is expected that downward pressure on prices will prevail, which will ultimately support other Code objectives, particularly efficient pricing outcomes for both users and developers of pipelines.

The Code does not provide guidance on what constitutes a *competitive outcome*. However the Tribunal has considered some generally accepted competitive tendering principles<sup>17</sup> to assist it in assessing competitiveness based on the characteristics of the relevant market and the TAR itself. Some of these key principles include:

- **Strength of the market.** The Tribunal notes the generally accepted argument that the lower population densities of regional areas compared with urban areas means that the commercial viability of large infrastructure projects may be marginal at best.<sup>18</sup> However it understands that the CRNG&TAI has conducted preliminary inquiries via an expression of interest process which indicates some degree of market interest.

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<sup>15</sup> CRNG&TAI, *TAR Attachment 2, Section 2*, 18 February 2003, cls 4.1.6, 4.1.8 & 4.1.22

<sup>16</sup> In the event that the CRNG&TAI submits a subsequent application for approval of the outcome of the tender (a FAR), the Tribunal will need to fully consider the section 8.1 factors pursuant to s3.33(c) of the Code. For this decision on the TAR (i.e. the approval of the tender process), the Tribunal need only be satisfied that the tender process will provide an appropriate mechanism to achieve these objectives.

<sup>17</sup> Industry Commission, *Competitive Tendering and Contracting by Public Sector Agencies*, (24 Jan 1996); NSW Council on the Cost and Quality of Government, *Service Competition Guidelines*, Chapter 3: How to Undertake Competitive Tendering, January 1999.

<sup>18</sup> ACCC & NCC, *Regional development of natural gas transmission pipeline – a guide for regional areas considering alternatives for progressing the supply of natural gas* (October 2002), p v.

- **Number of tenders.** Given the technical and capital requirements of the proposed project, it is reasonable to expect that a small number of tenderers would be involved. However this does not, of itself, indicate a less than competitive outcome. The perception of competitive pressure would also be relevant. The Tribunal understands that the TAR requires tenderers to sign a statutory declaration to the effect that no collusive (or anti-competitive) behaviour has occurred.
- **Project specifications.** Ideally, project specifications should be simple enough to encourage tenders, and reduce barriers to entry at the outset. The CRNG&TAI submits that the tender process and rules have been designed to reduce the degree of complexity for potential tenderers, and to maximise the number of potential tenderers by setting minimal technical and prudential requirements.<sup>19</sup> Generally, the TAR clearly outlines the information requirements, tender rules and procedures and selection criteria which apply to all tenders. The Tribunal also considers the tender exclusionary conditions (discussed in sections 4.2.4 and 4.2.5 below) to be reasonable, and notes that the TAR does not dictate the configuration of the pipeline, as discussed in section 4.2.8 below.
- **In-house tenders and advantages of incumbency.** The TAR prohibits tendering by any of the members of the CRNG&TAI, and there is no incumbent provider. However the Tribunal did consider whether the preliminary investigations conducted by APT, Agility, and AGLGN may give any related parties in AGL a competitive advantage. As a result of these earlier investigations, APT holds a pipeline licence and, along with Agility, holds other documentation relating to the construction of the proposed pipeline. APT and Agility have agreed to negotiate the sale / assignment of the licence and related information to a successful tenderer. However, APT and Agility remain potential tenderers.<sup>20</sup> This dual role raises possible concerns that, to the extent that this licence and documentation has a potential value to tenderers, APT and Agility and its related parties (including AGL) may be able to adversely impact the competitiveness of the tender process. The Tribunal understands that APT's pipeline licence relates to the construction of a proposed *transmission* pipeline, rather than a distribution pipeline. Despite the Tribunal having a direct interest only in the latter, it notes that the purchase or assignment of such information is not a mandatory condition of the TAR, and that a practical alternative for a tenderer to apply for a pipeline licence and seek other approvals of its own accord does exist, should a tenderer not wish to negotiate with APT and Agility.<sup>21</sup> Further, the Tribunal notes that the CRNG&TAI has attempted to lessen any potential competitive advantage by seeking the agreement of APT and Agility to obtain and make available an independent expert valuation on the information it holds, as a basis for any future negotiations.
- **General perception and confidence about legitimacy of the process.** The Tribunal considers that the proposed rules and process appear to promote fairness, transparency, impartiality and independence in the evaluation process.

The Tribunal also considered the claim in Agility Management Pty Ltd's submission that the competitiveness of the tender will be compromised if the tender does not make provision for subsidy requirements (which may be included in a conditional tender) and does not include

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<sup>19</sup> CRNG&TAI, *TAR Attachment 5*, 3 January 2003, p 15.

<sup>20</sup> CRNG&TAI, *TAR Attachment 2, Section 1*, 18 February 2003, p 20.

<sup>21</sup> The Tribunal understands that the key prospective foundation load customer, Primary Energy Pty, will likely require a gas supply by end of 2004.

selection criteria which clarify the treatment of such conditional tenders.<sup>22</sup> To address these specific concerns, the CRNG&TAI amended the TAR to clarify the treatment of conditional tenders, including when they may be considered conforming tenders, and how they will be assessed relative to other conditional and non-conditional tenders. This is discussed in greater detail in section 4.2.6 below. Agility also claimed that the requirement in the TAR for certain cost information to be provided is inconsistent with a competitive process. This is discussed in section 4.2.5 below.

The Tribunal considers that the CRNG&TAI has adequately addressed these submission comments, and its amendments do not compromise the competitiveness of the tender outcome. In particular, the amendments that clarify the treatment of conditional tenders explicitly provide for the event that only conditional tenders are received. To the extent that this was not clear in the original TAR, this may encourage additional tenders, and at least provides greater clarity in respect to the evaluation process.

The Tribunal notes that in assessing the TAR against the criteria in section 3.28 of the Code, its role is not to suggest a better process or one that would ensure *the* most competitive tender outcome. Rather, its assessment is limited to whether the proposed TAR would be such as to ensure a competitive outcome.

Based on its evaluation of the TAR against competitive tendering principles and the CRNG&TAI's amendments, and in the absence of any submissions supporting the contrary view, **the Tribunal is satisfied that the TAR meets the requirements of section 3.28(c) of the Code.**

#### **4.2.4 Section 3.28(d) – Exclusion of certain tenders**

*Section 3.28(d) of the Code provides that the Tribunal must be satisfied that the proposed procedures and rules to be followed in conducting the proposed tender will result in a tender being excluded from consideration if it:*

- (i) does not include a statement of the reference tariffs the tenderer proposes and the reference services to which those reference tariffs would apply*
- (ii) does not include a policy on 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 (Additional Revenue Policy)*
- (iii) does not provide 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*
- (iv) limits or purports to limit the services to which access might be sought under the Code*
- (v) otherwise includes elements inconsistent with this Code except as contemplated by s3.34.*

Section 3.28(d) establishes a number of minimum conditions that a tender must meet to be considered in the tender process.

The CRNG&TAI's TAR includes formal rules and procedures for conducting the tender process in its Tender Specifications (Attachment 2, Section 2). Under clauses 4.1 and 4.2 of these specifications, a tender is required to include certain minimum information (including

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<sup>22</sup> Agility submission, dated 6 February 2003: Comment 1.3, pp 2-3.

that envisaged by s3.28(d)(i)-(iii) of the Code), and will be considered a non-conforming tender under certain circumstances (a direct reference to s3.28(d)(iv)-(v) of the Code).

The TAR also establishes three stages of assessment for tenders (Schedule 2 to the Tender Specifications). As part of stage one, the TAR has explicitly adopted the above exclusionary criteria referred to in s3.28(d) of the Code. It is a condition of the TAR that any tender that does not meet the exclusionary conditions, will be considered a 'non-conforming' tender, and be excluded from consideration in the ensuing stages of the selection process.

The Tribunal has examined the tender documentation, information requirements and selection process and rules provided in the TAR. It considers that the TAR clearly outlines the conditions that must be met for a tender to be considered or otherwise excluded, and that the TAR's exclusionary conditions are consistent with the Code and indeed are a direct reflection of the Code requirements. The Tribunal also considers that the exclusionary conditions are necessary to enable the CRNG&TAI to consistently compare tenders, and support other objectives of the Code, such as a competitive process and achievement of pricing principles. The Tribunal did not receive any submissions that would lead it to form a contrary view. **It is therefore satisfied that the TAR meets the requirements of section 3.28(d) of the Code.**

#### 4.2.5 Section 3.28(e) – Consideration of all conforming tenders

*Section 3.28(e) of the Code provides that the Tribunal must be satisfied 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.*

Section 3.28(e) relates to the 'reasonableness' of the requirements proposed for potential tenders. In considering whether the rules and procedures that may lead to the exclusion of a tender are reasonable, the Tribunal has taken into account the impact of exclusionary conditions on the overall competitiveness of the tender process, and other Code objectives, and the need for the CRNG&TAI to have adequate information to make an informed assessment of tenders.

As previously noted, the Tribunal considers the initial stage of the selection process to contain acceptable rules, consistent with s3.28(d) of the Code. In response to Agility's submission comments, the CRNG&TAI has also amended the initial stage of the TAR to explicitly clarify the status of conditional tenders. The Tribunal understands that a conditional tender may be excluded from consideration where it does not meet certain conditions.

As indicated under section 4.2.3 above, the Tribunal does not consider that this is an unreasonable requirement, as it clarifies the treatment of conditional tenders and thereby may provide greater certainty and encourage more tenders than if the TAR did not include such a requirement. The Tribunal also considers that minimum requirements for conditional tenders supports a more consistent and informed assessment of such tenders and prevents the tenderer transferring conditional risks onto the CRNG&TAI.

Under stage two of the selection process, the TAR indicates that conforming tenders will be assessed to ensure that they meet minimum criteria, specifically appropriate additional revenue policies and sufficient technical and prudential capacity. The Tribunal considers

that these minimum criteria are reasonable and consistent with the Code, given the Code explicitly recognises these factors under s3.28(d) and s3.28(e), and that the Tribunal will be required to assess the appropriateness of the additional revenue policy during its consideration of a FAR.<sup>23</sup>

The Tribunal understands that all tenders that meet the requirements of stages one and two will then be assessed against selection criteria in stage three of the selection process, which is discussed in more detail under section 4.2.6 below. Relevant to the Tribunal's consideration of the TAR under s3.28(e), the TAR ranks conditional tenders below non-conditional tenders. Therefore, in the event that at least one non-conditional and conforming tender is received, this tender rule would effectively exclude any conditional tenders from consideration (subject to the non-conditional tender meeting other objectives). The Tribunal understands that the CRNG&TAI wants to encourage non-conditional tenders and does not consider that this is an unreasonable requirement in a commercial tendering environment. It also notes that this clarification was made to address comments submitted by Agility regarding conditional tenders.

The Agility submission also contends that the tender requirement to include capital and non-capital costs is 'inconsistent with a competitive tender process and inappropriate from a commercial perspective', and that 'an assessment that a tender is non-conforming because of the non-inclusion of [these costs] will contravene the requirement of s3.28(e) of the Code'<sup>24</sup> The CRNG&TAI has refuted this argument on the basis that it needs such cost information to understand the likely magnitude of tariffs beyond the initial regulatory period and to adequately understand tenderers' proposed construction timetables (secondary criteria).<sup>25</sup> The Tribunal supports the CRNG&TAI's view.

The Tribunal understands that the proposed Tender Specifications reflect a similar broad process to that approved in the case of the Loddon Murray tender.<sup>26</sup> As in that case, the Tender Specifications proposed by the CRNG&TAI appear to ensure that the objectives of the Code will be met, and that requirements in relation to probity, fairness and due process will be observed by tenderers and the CRNG&TAI. The Tribunal has not received any other submission comments on this aspect of the TAR. **The Tribunal is satisfied that the TAR meets the requirements of section 3.28(e) of the Code.**

#### **4.2.6 Section 3.28(f) – Selection criteria**

*Section 3.28(f) of the Code provides that the Tribunal must be satisfied that the selection criteria to be applied in conducting the proposed tender:*

- (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)*
  - achieve objectives in s8.1
  - 'fair and reasonable' allocation of costs between services and users

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<sup>23</sup> s3.33(e) of the Code.

<sup>24</sup> Agility submission, dated 6 February 2003: Comment 1.4, p 3.

<sup>25</sup> CRNG&TAI, *TAR Comments on Submissions letter*, 18 February 2003, Comment 1.4, p 2.

<sup>26</sup> The Loddon Murray Gas Supply Group in Victoria submitted a TAR to the ACCC and the Essential Services Commission of Victoria (ESC) in April 2001 for a competitive tender process to build a transmission and distribution pipeline to supply gas to that region.

In the third stage of the tender process, the CRNG&TAI proposes to select the successful tender by applying two levels of criteria. Before applying these criteria, the TAR provides that conditional tenders will be ranked below non-conditional tenders.

With respect to s3.28(f)(i), the TAR establishes the primary criterion as the *lowest sustainable combined distribution and transmission tariffs* over the economic life of the proposed pipeline, based on the:

- average combined transmission and distribution reference and non-reference tariff (dollars per gigajoule) for the initial regulatory period
- residual value of the proposed pipeline at the end of the initial regulatory period

subject to the reference tariffs achieving the objectives of s8.1 of the Code and containing or reflecting an allocation of costs between services and users which is fair and reasonable.<sup>27</sup>

The TAR also sets out secondary non-price criteria, which is intended to differentiate any tenders that offer the same or *similar* tariffs, namely:

- areas to which gas is to be made available
- number of end users which will have access to gas
- proposed construction timetable
- nature of conditions (in the case of conditional tenders).

While *combined* tariffs are not usually assessed for determining AA elements for individual pipelines, the CRNG&TAI has proposed a joint tender in recognition of the interrelationship between transmission and distribution components. It also submits that the proposed approach is similar to that approved by the ESC and ACCC in the Loddon Murray project.<sup>28</sup> In that case, the concept of joint tariffs was supported, in part, on the basis of the same argument.<sup>29</sup>

However, the TAR does require tenderers to state, within their one bid, separate tariffs for each component of transmission and distribution, to ensure transparency in the information that will be used for assessment of AA elements not determined by the tender process.

A key difference between the CRNG&TAI and the Loddon Murray TAR is the explicit acceptance and relegation of conditional tenders *vis-a-vis* non-conditional tenders. Under this condition, it would be conceivable for a higher tariff (and non-conditional) tender to rank over a lower tariff (but conditional tender). Although this outcome would seem inconsistent with the Code requirement (that lowest tariffs be the principal criterion for selecting the successful tender), the CRNG&TAI does indicate that conditional tenders may be considered where it is of the opinion that non-conditional tenders propose reference tariffs that would not achieve Code objectives.<sup>30</sup> This may give it some flexibility to consider lower tariff, conditional options.

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<sup>27</sup> CRNG&TAI, *TAR Attachment 2, Section 2, Schedule 2*, 18 February 2003, pp 15-17.

<sup>28</sup> CRNG&TAI, *TAR Cover letter*, 3 January 2003, p 3.

<sup>29</sup> ACCC, *Decision – Tender Approval Request for the Proposed Pipeline to the Loddon Murray Region*, 1 November 2001, p 16.

<sup>30</sup> CRNG&TAI, *TAR Attachment 2, Section 2, Schedule 2*, 18 February 2003, p 15.

The Tribunal also notes that the CRNG&TAI has made this clarification to address concerns raised by Agility in its submission regarding the treatment of conditional tenders. The CRNG&TAI has deliberately ranked non-conditional over conditional tenders, to encourage the former. The Tribunal accepts the argument, from a commercial perspective, that a non-conditional tender would be preferable, since conditional tenders invariably involve some risks associated with being able to meet the underlying condition.

Agility also submitted that tenderers will require additional information from the CRNG&TAI relating to load assumptions, timing and economic life.<sup>31</sup> While the Tribunal accepts that this information would assist in a comparison and assessment of tenders, it notes that this may detract from the openness and competitiveness of the tender process, and it would therefore be appropriate for tenderers to provide this information themselves.

The Tribunal notes that the TAR incorporates secondary non-price criteria into the third stage of the evaluation process which will only apply in the event that two or more tenders submit the same or *similar* tariffs. Despite there being some level of subjectivity involved with interpreting the undefined term *similar*, this aspect of the TAR does not appear to compromise the requirement that tariffs remain the *principal* criterion for selecting the successful tender.

The Tribunal notes that the assessment of the merits of commercial tenders is realistically not straightforward and that the CRNG&TAI will need to apply some level of subjectivity to assess merits of tenders based on varying assumptions, just as tenderers would want some defining boundaries within which to couch their tender.

Should a FAR (being an application to approve the outcome of the tender process) be submitted, the Tribunal will then have to assess the tender outcome against the criteria in s3.33 of the Code which requires compliance with the tender rules, procedures and selection criteria, and the achievement of Code objectives.

On balance, the Tribunal considers that the CRNG&TAI's primary criteria are consistent with s3.28(f)(i) of the Code in that application of the selection criteria should result in the successful tenderer being selected *principally* on the basis of lowest sustainable tariffs. The Tribunal has not received any submissions on this matter, except for the Agility submission which requested clarification of the treatment of conditional tenders.

With respect to the requirements of s3.28(f)(ii), the TAR requires each bid to contain an explanation of:

- why the reference tariffs and underlying policy achieve the objectives in s8.1 of the Code
- the manner in which costs have been allocated between services and users, and why that allocation is fair and reasonable.

Consequently, the Tribunal also considers that the TAR adequately addresses the requirements of s3.28(f)(ii), in that it explicitly requires an explanation of tenderers' pricing and cost allocation methodologies and how they achieve Code objectives. **It is satisfied that the TAR meets the requirements of section 3.28(f) of the Code.**

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<sup>31</sup> Agility submission, 6 February 2003: Comment 2.2, p 4.

#### 4.2.7 Section 3.28(g) – Determination of items with reference tariffs

*Section 3.28(g) of the Code provides that the Tribunal must be satisfied 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.*

The TAR outlines four AA items that are to be determined by the proposed tender process:

- the reference tariffs for reference services for the initial regulatory period
- the reference tariff policy, to the extent that it determines the manner in which the reference tariffs will change over the initial regulatory period
- an additional revenue policy
- the revisions commencement date.<sup>32</sup>

The CRNG&TAI has kept these items to a minimum to ensure that the comparison and assessment of competing bids is not complicated. It also contends that other items to be determined as part of a subsequent AA approval process are not fundamental to the determination of tariffs.<sup>33</sup>

Agility submitted that the revisions commencement date should be 15 years from the date that gas is first transported, rather than the specific date that the CRNG&TAI has proposed.<sup>34</sup> The CRNG&TAI responded<sup>35</sup> that a specific date is required under the Code, this will promote consistent evaluation of tenders, and that in any case, tenderers are free to nominate their own specific date. The Tribunal agrees with this view.

The Tribunal considers that the items that the CRNG&TAI has listed as being determined by the tender process (other than reference tariffs) are directly relevant to the determination of reference tariffs. The Tribunal did not receive any submissions to support the contrary view.

The Tribunal notes that if a successful tenderer is selected, these specific items will be submitted as part of the CRNG&TAI's FAR, and will become *deemed* elements in the assessment of the successful tenderer's proposed AA. That is, they will not form part of the Tribunal's consideration in its assessment of the successful tenderer's proposed AA.

**The Tribunal is satisfied that the TAR meets the requirements of section 3.28(g) of the Code.**

#### 4.2.8 Section 3.28(h) – Configuration of the pipeline

*Section 3.28(h) of the Code provides that the Tribunal must be satisfied 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.*

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<sup>32</sup> CRNG&TAI, *TAR Attachment 2, Section 1*, 18 February 2003, p 18.

<sup>33</sup> CRNG&TAI, *TAR Attachment 1*, 3 January 2003, pp 8-9.

<sup>34</sup> Agility submission, 6 February 2003, Comment 2.3, p 4.

<sup>35</sup> CRNG&TAI, *TAR Comments on Submission letter*, 18 February 2003, Comment 2.3, p 3.

The apparent effect of this provision is to ensure that there are no restrictions on the source of gas supply, to which points gas may be delivered, and the general conveyance of gas, which may result in a less competitive tender process, and possibly an inefficient development outcome.

The Tribunal understands that the proposed transmission pipeline (which is regulated by the ACCC) is expected to take natural gas from the termination point of the Central West Pipeline at Dubbo and enable gas supply to reach prospective users in the Central Ranges region.

As indicated previously, the Tribunal is responsible for the regulation of the proposed distribution pipeline. The TAR indicates that the location and nature of the proposed distribution pipeline (including route, configuration, areas to be served and other technical specifications) are up to tenderers to determine. There are no specific towns which must be supplied with natural gas within the Central Ranges region; however it is *expected* that tenderers will serve, at a minimum, Mudgee, Tamworth and Gunnedah.<sup>36</sup> The TAR also includes a map which shows a potential layout for the pipeline system.

Despite there being a strongly supported option for gas supply to the Central Ranges region to be sourced from the Central West Pipeline and delivered to several main townships, the TAR does not appear to restrict the configuration of the distribution pipeline. The Tribunal also notes that the townships specified are those with the highest populations, and highest forecast load profiles and therefore it may be reasonably expected that a prospective tenderer would consider reticulation to these areas. Therefore, it considers that it is not inappropriate to specify these townships.

The Tribunal is not aware of any information, whether in the TAR or in submissions, which would indicate inconsistency with s3.28(h) of the Code, with respect to the proposed distribution pipeline. **It is therefore satisfied that the TAR meets the requirements of section 3.28(h) of the Code.**

#### **4.2.9 Section 3.28(i) – Other documents**

*Section 3.28(i) of the Code provides that the Tribunal must be satisfied that any document supporting or relating to the tender process is consistent with this Code and does not purport to limit:*

- (i) the services which the service provider may provide or to which access may be sought under this Code;*
- (ii) the configuration of the proposed pipeline including the areas the proposed pipeline will service, pipeline dimensions, level of compression and other technical specifications unless the relevant regulator is satisfied it would be appropriate to do so; or*
- (iii) the construction or operation of other pipelines which could deliver gas to the same gas market as the proposed pipeline.*

Section 3.28(i) of the Code extends the Tribunal's consideration of the TAR to include any documents that support or relate to the tender process. The Tribunal understands that, with the exception of the pipeline licence information and independent valuation referred to in section 4.2.3 above, the TAR contains all documentation that will be made available to potential tenderers. The Tribunal also considers that this additional information will not

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<sup>36</sup> CRNG&TAI, TAR Attachment 1, 3 January 2003, p 5.

affect the configuration of the distribution pipeline, for the same reasons that it believes these documents will not affect the competitiveness of the tender process (see section 4.2.3 above).

The Tribunal is not aware of any other documents that would purport to limit access to services, or the operation or construction of other pipelines that could deliver gas to the same market. Nor have any submissions indicated the existence of such documents or inconsistency with section 3.28(i) of the Code.

**The Tribunal is satisfied that the TAR meets the requirements of section 3.28(i) of the Code.**

#### **4.2.10 Section 3.27 – Conflict of interest**

*Section 3.27 of the Code provides that the Tribunal may at any time decide not to approve a TAR if it is of the opinion that the person who submitted the TAR may have, or may appear to have, a conflict of interest if it conducted the tender process. The Tribunal may decide not to approve without public consultation.*

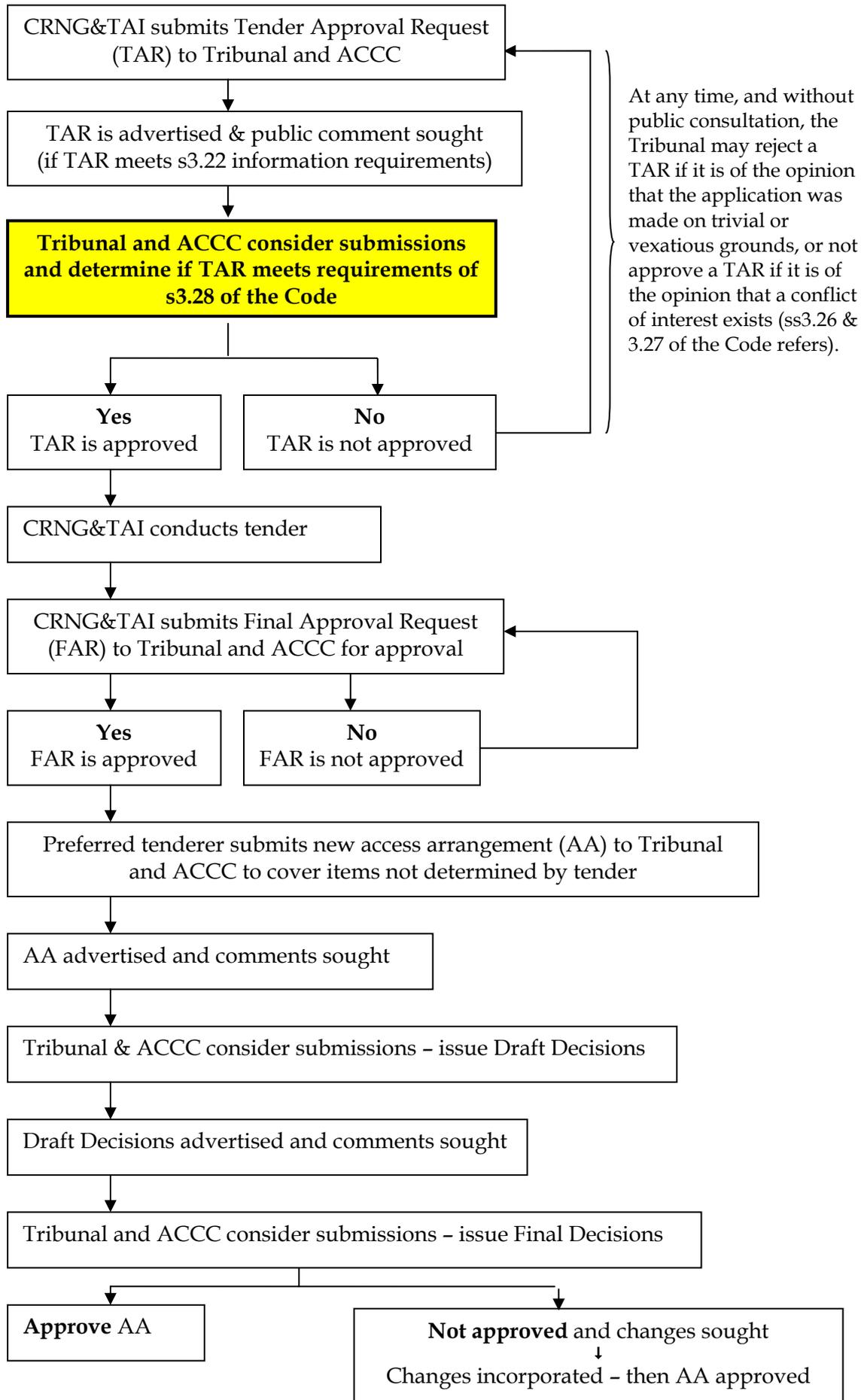
The Tribunal has no reason to believe that the CRNG&TAI may have, or may appear to have, a conflict of interest if it conducted the tender process.

#### **4.2.11 Section 3.26 – Trivial or vexatious grounds**

*Section 3.26 of the Code provides for the Tribunal to reject a TAR without further consideration if it is of the opinion that the application has been made on trivial or vexatious grounds.*

The Tribunal has no reason to believe that the CRNG&TAI's application has been made on trivial or vexatious grounds.

## APPENDIX 1 REGULATORY APPROVAL PROCESS



## APPENDIX 2 PUBLIC CONSULTATION PROCESS

The Tribunal and the ACCC jointly advised over 60 interested parties of the TAR, placed joint advertisements to provide public notice of the TAR and called for submissions from interested parties by 5:00pm, Friday 7 February 2003. The advertisements were placed in the following national and regional newspapers:

- *Australian* – 14 January 2003
- *Australian Financial Review* – 14 January 2003
- *Tamworth Northern Daily Leader* – 14 January 2003
- *Mudgee Guardian* – 14 January 2003
- *Western Magazine* – 20 January 2003.

The Tribunal and ACCC also released a joint Issues Paper to focus interested parties on the requirements of the Code.

The Tribunal received six public submissions. At the same time, the CRNG&TAI advised the Tribunal and the ACCC of two minor corrections to the TAR. These were brought to the attention of interested parties.

On 18 February 2003, the CRNG&TAI submitted a formal response to comments raised in these submissions, along with amendments to the TAR. The Tribunal and ACCC then facilitated further public consultation, by placing a joint advertisement in the *Australian* newspaper on 20 February 2003 and contacting interested parties directly to notify them of the amendments, and calling for submissions from interested parties by 5:00pm, Thursday 6 March 2003. The Tribunal did not receive any additional submissions.

In light of the additional consultation that was undertaken in relation to the amendments, the CRNG&TAI recognised the need for the Tribunal and the ACCC to take additional time, beyond that envisaged by the Code, to make its decision on the TAR.<sup>37</sup>

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<sup>37</sup> CRNG&TAI, *TAR – Comments on Submissions letter*, 18 February 2003, p 5.

### APPENDIX 3 LIST OF SUBMISSIONS

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| Organisation  | Name                 | Date            |
|---|----------------------|-----------------|
| Agility Management Pty Ltd (in its own right, and on behalf of AGL and APT) <sup>38</sup> | Mr Neil Cain         | 7 February 2003 |
| Europacific Corporate Advisory  | Mr David Paterson    | 4 February 2003 |
| Gunnedah Shire Council  | Mrs RG Swain         | 22 January 2003 |
| Mudgee Cooperative Meat Supply Ltd  | Mr Arthur Brackenrig | 29 January 2003 |
| planningNSW   | Mr Sam Haddad        | 23 January 2003 |
| Public Interest Advocacy Centre   | Ms Trish Benson      | 31 January 2003 |

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<sup>38</sup> AGL – Australian Gas Light Company; APT – The Australian Pipeline Trust