



Submission to Productivity Commission

Review of the Gas Access Regime

Orica Mining Service Procurement Team

**Orica Australia Pty Ltd
ACN 004 117 828
15 Greenleaf Road, Kooragang Island, NSW 2304
PO Box 80 Mayfield, NSW 2304 Australia
Tel 61 2 4923 5503 Fax 61 2 4923 5507**

Date: 29/08/2003

Contents

| | |
|---|-----------|
| INTRODUCTION..... | 3 |
| 1. ORICA AND THE KOORAGANG ISLAND PLANT | 4 |
| 1.1 ORICA GROUP OF COMPANIES..... | 4 |
| 1.2 KOORAGANG ISLAND PLANT..... | 4 |
| 1.3 NATURAL GAS AT THE KOORAGANG ISLAND PLANT..... | 4 |
| 1.4 FUTURE GAS USAGE AT KOORAGANG ISLAND..... | 5 |
| 2. REVIEW OF GAS ACCESS REGIME – COMMENTARY | 6 |
| 2.1 OBJECTIVES | 6 |
| 2.2 IMPLEMENTATION | 6 |
| 2.3 ACCESS REGULATION & THE DEVELOPMENT OF A COMPLETEIVE MARKET FOR ENERGY SERVICES | 7 |
| 2.4 ACCESS REGULATION AND NEW INVESTMENT..... | 8 |
| 2.5 ACCESS ARRANGEMENT AND “LIGHT-HANDED” REGULATION | 9 |
| 3. CONCLUSION AND RECOMMENDATIONS | 11 |
| APPENDIX 1- NEGOTIATION OF TERMS AND CONDITIONS | 12 |
| REFERENCES | 14 |

INTRODUCTION

Orica is pleased to provide its views to the Productivity Commission's Review of the Gas Access Regime. Orica Mining Services, via its recent acquisition of the Incitec Kooragang Island Ammonia Plant, has become one of NSW's largest users of Natural Gas.

The Gas Access Regime has a significant impact on the cost of production for the Kooragang Island Ammonia Plant, and hence its competitiveness. Ammonia produced by this plant competes against imports which provide raw material supply to downstream fertiliser and industrial chemical production.

Orica supports the strong objectives detailed in the National Third Party Access Code for Natural Gas Pipeline Systems.

To understand the importance of the Gas Access Regime to the Orica Kooragang Island Plant, a brief description of the plant's relationship with Natural Gas is provided.

Orica has concentrated its comments to the Productivity Commission on items, which affects the Kooragang Island Ammonia manufacturing plant.

Opinions expressed in this submission are those of the Mining Services Division of Orica.

1. ORICA AND THE KOORAGANG ISLAND PLANT

1.1 ORICA GROUP OF COMPANIES

Orica is a publicly owned Australian chemical company employing around 8,000 staff across approximately 30 countries and with revenue of \$AUD4 billion annually.

Orica's operations are divided into four main business areas - Mining Services, Chemicals, Consumer Products and Agricultural Chemicals.

Mining Services

Orica is the world's leading supplier of commercial explosives and blasting technology, and is placed first or second in key Australian, Asian, European, Latin American and North American markets. Customers are offered a complete range of commercial explosives services, ranging from the supply of bulk and packaged explosives to total blasting services.

Chemicals

Orica is a leading supplier of industrial and specialty chemicals in Australia and New Zealand through its Chemicals business. Key products include chlorine and sodium hypochlorite for water treatment, and adhesives and resins for wood panel boards. The Chemnet trading and distribution business covers Australia, New Zealand, Fiji and Papua New Guinea, providing a broad range of chemicals for use in all industries.

Consumer Products

Orica markets an extensive range of consumer products through such well-known trade names as Acratex, Berger, British Paints, Cabot's, Dulux, Feast Watson, Intergrain, Levene, Polyglaze, Rota Cota, Selleys and Walpamur.

Agricultural Chemicals

Incitec Pivot is owned 70% by Orica Limited and 30% by minority shareholders. Incitec Pivot Limited is a specialist Australian-owned world-class fertiliser manufacturer and supplier serving primary producers across Eastern and Southern Australia.

Orica places great emphasis on safety and care for the environment. Orica manages all of its activities with concern for people and the environment and endeavours to communicate openly about its operations.

The same commitment extends to quality in our products, systems and services. All Orica employees and facilities are committed to the pursuit of excellence, and operate at the highest standards in the markets in which we operate.

1.2 KOORAGANG ISLAND PLANT

The 100% Orica owned Kooragang Island Plant operates within the Orica Mining Services business. The plant is located North of Newcastle in the Hunter Valley of NSW and employs 130 people. The Kooragang plant was formerly part of Incitec Ltd before being merged into the Orica group of companies.

The Kooragang Island Plant consists of three individual plants manufacturing ammonia, nitric acid and ammonium nitrate to meet the needs of Australia's mining and mineral industries. Each plant is a stand-alone manufacturing unit; the major raw materials for each plant are detailed below:

- Natural Gas for the manufacture of Ammonia.
- Ammonia for the manufacture of Nitric Acid.
- Nitric Acid and Ammonia for the manufacture of Ammonium Nitrate.

1.3 NATURAL GAS AT THE KOORAGANG ISLAND PLANT

The Ammonia plant at Kooragang Island consumes some 700,000 cubic metres of Natural Gas per day as a raw material feedstock. Alternatively expressed, the plant consumes approximately 10% of the Natural

Gas used in NSW and provided the original justification for natural gas being piped to Newcastle in 1982. Natural Gas accounts for over 85% of the Variable Costs of production of the Kooragang Island ammonia plant.

A small proportion of Natural Gas consumed at Kooragang Island is used to fire on-site boilers, however, the vast majority of the Natural Gas is used as feedstock in the manufacturing process to produce ammonia. As ammonia is an internationally traded commodity, the Kooragang Island Ammonia Plant must remain competitive with imported foreign manufactured ammonia to ensure ongoing viability. Ultimately, with readily available foreign product, Orica will base its decision on whether to manufacture or import ammonia on the commercial merits at the time of evaluation. With this in mind, the world ammonia market is dominated by producers who have access to natural gas at prices far less than those currently found on the East Coast of Australia. In many cases government support for these producers also exists through subsidisation by way of capital and tax concessions.

Orica is a Self-Contracting User with a requirement for high-pressure gas at a load factor of over 94%. Orica is one, if not the only End User with unbundled Natural Gas supply and transportation arrangements in NSW and is at the end of the longest supply chain for the transmission and distribution of Natural Gas in NSW. Not surprisingly, transportation costs represent a considerable component of the plant's total gas costs. Apart from the need to be low cost, Natural Gas must also satisfy the requirements of pressure and composition technical specifications and uninterrupted supply.

The Orica Kooragang Island Ammonia Plant and its reliance on Natural Gas is unique to the NSW gas market and gas transportation system. The following factors make Kooragang Island a unique Gas User:

1. Self-Contracting User consuming approximately 10% of the gas used in NSW.
2. User of gas primarily as a feedstock in the manufacturing process and as an energy source.
3. Plant operates 24 hours per day every day of the year with a load factor of over 94%.
4. The plant is at the end of the longest Natural Gas supply chain in NSW.
5. User of high pressure gas directly from the main trunk.

Orica's existing contract for the supply of Natural Gas to Kooragang Island is due to expire in late 2005. The pending expiry has initiated an investigation into options for the long term supply of Ammonia to the Kooragang Island site. The company has identified two major options available to secure a long-term supply of Ammonia,

1. Negotiate a new supply contract of Natural Gas which would allow the Ammonia produced to be competitive with foreign overseas imports.
2. Close down the Ammonia Plant and negotiate a long-term supply contract to import Ammonia from foreign manufacturing plants.

1.4 FUTURE GAS USAGE AT KOORAGANG ISLAND

Orica has not completed its investigations on a long term supply of Ammonia to Kooragang Island. Suffice to say, the implications of moving to imported product would have far reaching effects including:

1. A direct reduction in Orica employment levels and a significant reduction in contract labour associated with existing shut-down maintenance work on the ammonia plant;
2. A substantial reduction in gas consumption in NSW;
3. A significant reduction of Natural Gas transported to Kooragang Island and income earned by transmission and distribution pipeline owners;
4. A significant redistribution of gas transport costs for remaining gas users on the pipelines, particularly the Wilton to Newcastle distribution network;
5. A further reduction of manufacturing capabilities in Australia;
6. Indirect impact on labour numbers in unrelated industries associated with the redistribution of transport costs;
7. Contributing to a worsening of Australia's balance of trade; and
8. A significant impact on the Newcastle regional economy.

2. REVIEW OF GAS ACCESS REGIME – COMMENTARY

Against the above background, Orica would offer the following comments in response to the Productivity Commission’s Terms of Reference for the Review of the Gas Access Regime and its associated Issues Paper issued in July 2003.

2.1 OBJECTIVES

- Orica fully supports the objectives detailed in the 1997 Natural Gas Pipelines Access Arrangement being,
 - “to create a uniform national framework for third party access to gas pipelines that:
 - (a) facilitates the development and operation of a national market for natural gas; and
 - (b) prevents abuse of monopoly power; and
 - (c) promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders; and
 - (d) provides rights of access to natural gas pipelines on conditions that are fair and reasonable for owners and operators of gas transmission and distribution pipelines and persons wishing to use the services of those pipelines: and
 - (e) provides for resolution of disputes.”
- Orica believes the objectives have, to some extent been successful as evidenced by an increase in competition in the NSW Natural Gas market. The landed cost of gas, especially distribution network cost, has declined following regulatory determinations, and monopoly power curtailed to a limited extent. The potential for further significant reductions in transmission transportation cost is being held up through unreasonably extended processes involving implementation of the coverage provisions of the National Gas Code.
- Orica reconfirms its support for the current Objectives and the rights they provide for the protection of affected parties, but understands there will always be specific instances where such objectives will conflict.

2.2 IMPLEMENTATION

- Orica believes the Gas Code has undoubtedly contributed to the development of a competitive natural gas market for gas **production** and **transmission** in NSW. Orica’s experience is such that competition is now evident between transmission pipelines covered by the Gas Code and pipelines that are not. It is also Orica’s experience however that similar competition does not exist in NSW distribution networks and that current Access Arrangements fall short of simulating market competitive results.
- Orica would draw to the attention of the Productivity Commission the unique structure of the Gas Market in NSW. There are vertical ownership and contractual arrangements involved in the transmission, distribution and retail elements in the gas supply chain, and the existence of a dominant retailer. The National Competition Council, in its final recommendations involving the coverage of the Moomba Sydney Pipeline System, concluded that there was the ability and incentive to distort competition in downstream markets through vertical leveraging.
- Orica could envisage benefits to both Service Providers and Users by the introduction of a single regulator for all pipelines. This would assist in implementing one of the Code’s Objectives of developing and operating a competitive national market for natural gas ie. reduction of compliance costs.

2.3 ACCESS REGULATION & THE DEVELOPMENT OF A COMPETITIVE MARKET FOR ENERGY SERVICES

2.3.1 Commercially negotiated outcomes

- The single distribution pipeline between Sydney and Newcastle remains a monopoly service regulated by IPART. Orica effectively pays the Reference Tariffs with minor negotiated changes to the Standard Terms and Conditions. Orica's experience has clearly demonstrated that it is very difficult to negotiate with a monopoly pipeline in the presence of an Access Arrangement and Access Arrangement Information, required under the National Gas Code.
- The National Third Party Access Code for Natural Gas Pipeline Systems provides the potential for, rather than promoting commercial negotiation. To date, Orica has only been able to negotiate minor concessions on the Standard Terms and Condition detailed in its Access Arrangement with its Service Provider. Such concessions have only been achieved after prolonged (and costly) negotiations. Please refer to Appendix 1 for specific and confidential examples whereby negotiation, despite the Gas Code's objective of preventing abuse of monopoly power, has not been possible.
- It is Orica's contention that a disproportionate high reference tariffs exists on the Wilton – Newcastle pipeline that results from a monopoly situation in that part of the gas network. Excessive rates have led to the business case for continued gas purchasing by Orica being challenged by the option of plant closure and importation of foreign product. Possible implications of what Orica believes to be uncompetitive transportation costs have been highlighted in section 1.4 of this submission. The contention that distribution tariffs are disproportionately high is supported by the relativity of posted tariffs for EAPL and Wilton – Newcastle line. On a GJ/km basis the AGLGN line between Wilton in Newcastle is significantly more expensive than the EAPL line. Subject to the confines of its contractual obligations, and if requested by the Commission, Orica would be willing to provide confidential information to the Commission to illustrate the relative disparity between transmission and distribution transportation charges, and the inferences that can be made to the effectiveness of the Code in achieving its objectives of promoting a competitive market and to the unique structure of the NSW gas market.

Although the NSW regulator has discounted historical capital contributions made by large Users toward the Wilton to Newcastle pipeline, Orica is firm in its belief that the existing distribution tariff levels do not accurately reflect this contribution and have not provided a return to its business over and above that available to all Users. It is recognised that the Code does make allowances for Capital Contributions by Users toward New Facilities since the commencement of the Code, however, retrospective provisions need to be incorporated to provide a return (by way of Tariff reduction, discounts, Tariff 'holidays' or other concessions) to specific Users to reflect the risk undertaken in making historical capital contributions to incumbent distribution pipeline owners, who, via the Code, have been provided with guaranteed excessive returns from those same contributors.

- To an extent, the Gas Code and Regulators who rely upon the Code have to date concentrated on imitating a competitive environment for the establishment of Reference Tariffs where perceived monopoly power exists. As detailed above, negotiation of non-tariff factors by Orica (as a 10 PJ p.a. user) has not been successful resulting in Standard Terms and Conditions that are not reflective of outcomes in a competitive market. Accordingly, where regulation is deemed warranted (which we believe to be the case), an improvement to the Gas Code in our view would be the intervention of an independent third party nominee to make a balanced determination rather than failed negotiations defaulting to the Access Arrangement in instances of unsuccessful arbitration.
- The dispute resolution process currently detailed in Section 6 of the Gas Code is prohibitive and ineffective for End Users. As mentioned above, automatic default to the Access Arrangement in cases of failed arbitration is not reflective to similar procedures in commercially negotiated competitive contracts. As it stands, the abovementioned default in the Code does not in our view, provide Users with a viable opportunity to attain a fair and equitable outcome to disagreements if arbitration is unsuccessful. There is no incentive for the network service provider to arrive at a commercially negotiated outcome.
- Currently, Users pay all costs incurred by Service Providers in managing the Gas Access Regime. Historically, Service Providers have maintained large departments of people and resources to protect their position, including the attainment of experts. If the Code is to be serious in, as clause 8.1(a) states,

“...providing the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient cost of delivering the Reference Services...”, then Users should be afforded the right to question what is ‘efficient’ and provide returns to the Service Provider on those specific costs only. The current uncertainty around ‘efficient’ costs in Orica’s view is reason alone for the Information Disclosure requirements in Attachment A to the Code to remain unchanged and enforced with greater rigour. In summary, there should be some form of cap on the extent to which “regulatory costs” are passed through to end users by regulators.

To convert this concern into a solution for the Commission by way of example, consideration should be given to allow explicit exclusions from Operations and Maintenance expenditure that can be incorporated as a ‘Cost of Service’ by Service Providers. More specifically, without dismissing their judicial rights, the Commission may make provisions for the explicit exclusion from Non Capital costs under 8.4(c) of the Code of legal or excessive consultancy expenses incurred by Service Providers where such expense results in unsuccessful legal action instigated by a Service Provider, or is for the purposes of making claim against Users through a regulatory review process respectively. The exclusion of specific discretionary costs would, over time, create efficiencies through the management of financial risk, and create a more level playing field for all parties with an interest in the Gas Access Regime.

- There has been no consideration in the Gas Access Arrangement for large Users with very high load factors, in the “take or pay” reference tariffs arrangement. In effect, this is a cross-subsidy to small users. No concessions are afforded on pipeline transport costs to reflect the more effective and stable utilisation of the pipeline by the Kooragang Island Plant compared with all other Users. A method of valuation that could be placed on the value of Orica as a premium base load customer would be for the Total Revenue the Service Provider could not plausibly recover from other Users on the same pipeline if Orica decided to import ammonia product instead of manufacturing it at its Kooragang Island plant. That is, this introduces an incentive mechanism for commercially negotiated outcomes.

With such commercial reality in mind, we would strongly urge the Commission to consider incorporating mechanisms in the Code that make it necessary to consider concessions entitled to large stable Users whilst at the same time protecting smaller Users from a mere redistribution of costs by Service Providers.

2.3.2 Effective upstream and downstream competition

- Orica has strong support for the Hilmer Principles for third party access to promote upstream / downstream competition whilst providing **fair** returns to Service Providers.
- Rather than limiting comments to capacity trading for effective upstream and downstream competition, Orica would like to express a view to the Productivity Commission that its business is somewhat unique in that gas purchases are primarily used as feedstock in the manufacture of ammonia. Subsequently no alternatives to Natural Gas exist. Orica is therefore highly dependent on competitively priced gas to be viable as a manufacturing entity. Orica would therefore stress the importance of an effective and efficient regulated access regime to protect not only End Users, but also the public interest where there is insufficient competition to facilitate competitive negotiation of both Tariffs and other supply terms. It is the opinion of Orica that despite the emergence of some potential competition in transmission, there is a significant need for regulation in distribution networks to at best imitate a competitive environment.

2.4 ACCESS REGULATION AND NEW INVESTMENT

- Orica would like to raise two issues in relation to investment under a regulated regime:

Prudency of Capital Investment

It would appear that the Gas Code concentrates on the classification of the Cost of Service and tools used to calculate Total Revenue ie NPV, IRR, CAPM, etc. Orica is of the view that the Commission should give due consideration to the establishment of guidelines within the Code which focus on market recognised steps and tools that need to be followed by Service Providers before making capital investment decisions. This may overcome concerns of regulatory risk and truncated returns, with allowances for such factors already being incorporated into investment models. Such behaviour by the Service Provider would reflect common business practices. Furthermore provisions could be made to determine the success or failure of any investment by comparing actual investment results to those modelled. If necessary, concessions to either party could then be considered by way of periodic review.

Capital Base Determination

Orica finds it difficult to comprehend how a decision by the NSW Regulator in its 2000 decision to increase the value of the capital base of the Wilton to Newcastle trunk by \$50.7 Million¹ can be justified on grounds of market or system efficiency or improvements in gas delivery to existing user.

- Although Orica fully supports the concept of incentive mechanisms, even to the point of considering cost save sharing relationships, it is clear that the mention of incentive mechanisms in the Code have not enticed Service Providers to embrace the concept. There is a distinct possibility that guaranteed returns to Service Providers do not promote an incentive in itself to reduce costs or increase efficiencies, but through active regulatory gaming (which has been extraordinarily pervasive in NSW and successful as well) ensure that users' interests are compromised.

2.4.1 Ring fencing arrangements

- NSW has a vertical integrated supply chain for the supply, transmission and distribution of Natural Gas. Although difficult to illustrate without forthcoming transparent information from participants in vertically integrated businesses it is very difficult for an end user to be convinced the Service Provider is fulfilling the required ring fence requirements.
- The Productivity Commission's attention is drawn to the 1999/2000 NSW Access Review. During that Review, AGLGN entered into associate contracts involving very substantial amounts of gas, without the approval of the regulator. The matters only became public **after** the regulator completed the 2000 Access Review. Potential gas suppliers have publicly assessed that retail competition was foreclosed arising from that episode.

Against that background, the following are suggestions for consideration:-

- Introduce provisions in the Gas Code explicitly providing for substantial penalties where ring-fencing or associate contracts provisions are infringed upon and where competition was deterred.
- Separation of network service providers' regulated activities charts of accounts from non-regulated activities.
- Provide for regulators to have the power to obtain information from network service providers and their related parties to ensure that contracted costs are robust and are at arms-length.

2.4.2 Information gathering

- As already mentioned in section 2.3.1 above, Orica would strongly encourage the Commission to retain in full, all information gathering requirements of the Code. As the basis for conducting Reference Tariff reviews, and as the only means of obtaining information to evaluate monopolistic Service Provider requests for alternate Tariffs, both the Regulators and all Users have an extremely strong reliance on transparency and the provision of information. The submission of this data would normally be a mandatory business requirement and be part of the due diligence process in assessing a suppliers claim for price variance in a market competitive environment. If the Service Provider cannot provide the required data, an objective person would have to question the robustness and transparency of the Service Provider's management, systems and procedures. Given that many network service providers have created new corporate vehicles, such as pipeline trusts, it is imperative that regulators have the powers to legitimately obtain relevant information to ensure that they can do their reviews effectively and efficiency.

2.5 ACCESS ARRANGEMENT AND "LIGHT-HANDED" REGULATION

2.5.1 Access arrangement

- Orica reconfirms the objectives detailed in Section 8.1 of the Gas Codes provide a very workable, fair and reasonable format for the determination of Reference Tariffs. Orica would encourage the Productivity Commission to maintain the objectives as stated. We consider that they allow regulators flexibility to balance the interests of the network service providers and users, but importantly ensure that abuse of monopoly powers is prevented, or at the very least, minimised.

- The Access Arrangement appeals process appears to be an allowable tool used by the Service Provider to delay decisions by the regulator and to intimidate and place additional pressures on the regulator. Rather than adding another right of appeal by the Service Provider earlier in the regulator's decision process, Orica believes it preferable to improve the time efficiency of the existing process by reducing the Service Provider's right of appeal in the Access Arrangement from three (3) to one (1). Furthermore, Orica requests the Productivity Commission to consider equipping large Users with the same right of appeal as afforded to Service Providers under the Gas Code.
- Reference tariffs do set the maximum prices for access seekers in negotiations with pipeline owners /operator. However, the absence of competition in distribution pipelines, active incentive mechanisms, transparency in Prudent Discounts and their effect on other Users and consideration for high load customers manifests in the application of maximum tariffs by Service Providers.

2.5.2 Light handed regulation

- In the current environment, the past and ongoing behaviour of some Service Providers has made transparency difficult. Regulatory gaming has been manifest in NSW. Before any moves to Light Handed regulation could be contemplated, the end user would need to be made confident that the terms and conditions (including tariffs) at the commencement date of Light Hand regulation are fair, reasonable, transparent and market competitive. Orica believes that the first round of access reviews in NSW has only removed a proportion of monopoly rents, with potential for more rents to be reduced. Any move to light-handed regulation will seriously compromise users' interests and crucially adversely affect their economic viability. Any move to light-handed regulation will be strongly contested and evidence required to be made public for examination. Orica is aware that the UK experience with light-handed regulation of gas transportation had failed and compromised gas users' interests. Thus, it will view any move in this direction in Australia as redistribution of income from downstream industries to the monopoly service providers.

3. CONCLUSION AND RECOMMENDATIONS

Orica considers that the Productivity Commission should note the unique structure of the Gas Market in NSW, with its vertical ownerships and contractual arrangements involved in the transmission, distribution and retail elements in the gas supply chain and the existence of a dominant retailer.

Any moves to dilute provisions of the National Gas Code which protect users' interests will simply mean a redistribution of income from downstream industries to monopoly network service providers. More importantly, it will raise the input costs of downstream industries that have to compete on international and domestic markets, which have little or no ability to push such cost imposts forward.

Orica is currently examining options for a long term supply of gas to manufacture ammonia. The implications of moving to imported products, in the event of an inability to obtain gas at competitive prices are:-

1. A direct reduction in Orica employment levels and a significant reduction in contract labour associated with existing shut-down maintenance work on the ammonia plant;
2. A substantial reduction in gas consumption in NSW;
3. A significant reduction of Natural Gas transported to Kooragang Island and income earned by transmission and distribution pipeline owners;
4. A significant redistribution of gas transport costs for remaining gas users on the pipelines, particularly the Wilton to Newcastle distribution network;
5. A further reduction of manufacturing capabilities in Australia;
6. Indirect impact on labour numbers in unrelated industries associated with the redistribution of transport costs;
7. Contributing to a worsening of Australia's balance of trade; and
8. A significant impact on the Newcastle regional economy

Light-handed regulation is seen by users as a threat to their commercial interests. Experience in Australia and in the UK show the difficulties in negotiating with a monopoly network provider and the pervasiveness of regulatory gaming. To date, there is no evidence that service providers have not made adequate (and rising) returns, nor is there evidence that investments had been deterred. Pipelines have very long asset lives.

Orica makes a number of recommendations including, but not limited to the following:-

1. Improve the dispute settlement provisions of the Gas Code to provide Users with a viable opportunity to attain a fair and equitable outcome to disagreements if arbitration is unsuccessful.
2. A cap on the extent to which "regulatory costs" are passed through to end users.
3. Introduce an incentive mechanism for commercially negotiated tariffs by ensuring that costs associated with redundant and under-utilised assets are not passed through to remaining users in the event of a loss of a major load.
4. Strengthen the ring-fencing provisions of the National Gas Code, including penalties for infringement of ring-fencing and associate contracts provisions.
5. Retain the information disclosure requirements of the Code, and in light of corporate restructuring (and emergence of new corporate vehicles) of network providers, provide regulators with powers to obtain costs information to assess that they are robust and at arms length.
6. Specific recommendations are also detailed in Orica's submission.

Appendix 1- Negotiation of Terms and Conditions

This appendix details comments from Orica on the contract conditions specified in the AGL Gas Networks – Access Arrangement for NSW Network (AA), September 2000. These comments highlight Orica’s position as the “under dog” when negotiating with a Service Provider in a monopoly position.

Appendix A.1 No real ability to negotiate terms or terms and conditions:

The current Access Arrangement for “Negotiated Services” (Section 1) lacks definition and merely states that these are “Services negotiated to meet the needs of a User which differ from those in a Reference Service.” There is an implied assumption that the User can negotiate with a monopoly, this is not a valid assumption. The AA provides the option of utilizing the Dispute Resolution Procedures under the Gas Pipelines Access Law and the National Code, however, this option would not only be lengthy but also expensive. (Section 1: 1.9 Negotiated Services)

Orica believe there should be the inclusion of some “general” guidelines/ parameters for “negotiated services”, however, we would not want these to be limiting. Another alternative would be for items that *aren’t* negotiable to be clearly stated.

Appendix A.2 Broad/general statements are used in the AA, which limit Orica’s ability to negotiate the terms and conditions.

Statements in the AA require more depth and consideration must also be given to the customer and type of operation. Areas of particular concern are as follows:

Appendix A.2.1 Liability provisions:

- Schedule 2A: CI 28 AA: The liability provision in the AA is extremely one-sided in favour of Service Provider shifting all risk to the end-user.
- Similarly, Schedule 2B, CI 11, clearly states that we are liable for damages incurred from unauthorized overruns.
- No definition of “damage” has been provided
- This provision has been carried through to Service Provider’s terms and conditions. No scope has been allowed to negotiate a cap on liability or to limit liability to direct losses, which would usually be the case in commercial transactions. In our particular instance, we believe there is more damage that could be done to our plant if there was a problem with the network. The reverse seems to have been assumed.

Appendix A.2.2 The AA gives Service Provider the right to vary the gas specification “from time to time”. (Schedule 3). This is a very broad statement that is carried through to Service Provider’s terms and conditions. The Service Provider should not have this unlimited right.

As Orica uses gas primarily as a feedstock, even small changes in gas specification normally inconsequential for fuel gas use can have a large impact on feedstock efficiency and ultimately the cost of producing ammonia.

Appendix A.2.3 The wording of the AA gives Service Provider the right to discriminate against a large user in load shedding programmes with the assumption that the “process is controllable and provides the required level of responsiveness.” (Schedule 2F). Due to the wording of the liability provisions, there is no recourse to claim from Service Provider even if there is damage to plant.

The equipment used in the manufacture of ammonia can only support limited turndown. Previous experience has demonstrated to Orica that cycling (switching off and on) of the plant to respond to gas availability or other utility shortage can cause consequential damage in the ammonia plant.

Appendix A.2.4 The AA gives Service Provider a right to require a user to provide security. (Schedule 2A, CI 1) This is providing Service Provider with greater powers than would be available to them in a competitive situation i.e. this should be negotiable.

Appendix A.2.5 The Force Majeure provisions are heavily weighted in favour of Service Provider. These are not reciprocal provisions (see Schedule 2A, CI 25). Orica believes that there should be a clear right for end-users to be reimbursed for transportation charges in a Force Majeure situation.

Appendix A.2.6 The end-user is not only charged for overruns but also must keep additional capacity for a term of at least a year. There is no contemplation of improvement in plant efficiencies and a clear requirement to reset MDQ at the beginning of each year. There is no operational reason why MDQ cannot be reduced and increased on a monthly basis. Particularly in light of the focus on greenhouse emissions, the AA should provide for the ability of end-users to reset MDQ on a quarterly basis.

Appendix A.2.7 Orica is a Self Contracting User, the wording of the AA does not contemplate Self Contracting Users: Section 1 (Reference to “Users supplying Customers”)

Appendix A.2.8 Ability to swap between receipt points: (Section 5: 5.3 “Change of Receipt Point or Delivery Point”) Current wording of the AA requires Service Provider’s written consent which can be withheld on reasonable “commercial and technical grounds” or subject to reasonable “commercial and technical conditions”. This should be limited to reasonable “technical” grounds and conditions

Appendix A.2.9 Allocation: Where there is more than one Service Provider at a delivery point, allocations will automatically be “pro-rata” if there is no agreement reached. This places the end user at the mercy of one Service Provider. It should be the user’s decision on how the allocations are made.

Appendix A.2.10 Interest: The AA provides AGLGN with an entitlement to charge interest on amounts not paid within 14 days. (Schedule 2A, CI 20). This should not be an entitlement i.e. it should be negotiable.

References

1. AGL Gas Networks – Access Arrangement for NSW Network, September 2000
2. Productivity Commission – Review of the Gas Access Regime Issues Paper July 2003.