



SUBMISSION 56: Other Tariff Matters



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DBNGP (WA) Transmission Pty Limited
ABN 69 081 609 190
Level 6, 12-14 The Esplanade
Perth WA 6000

Contact: Trent Leach, Manager Regulatory and Government Policy
Telephone: 08 9223 4357
Email: trent.leach@dbp.net.au

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1. INTRODUCTION

- 1.1 On 14 March 2011, the Economic Regulation Authority (**ERA**) made its draft decision (**Draft Decision**) in relation to the full access arrangement proposal filed by DBNGP (WA) Transmission Pty Ltd (**DBP**) on 1 April 2010 (**Original AA Proposal**).
- 1.2 The Draft Decision indicates that the ERA:
 - (a) is not prepared to approve the Original AA Proposal; and
 - (b) requires 109 amendments to the Original AA Proposal in order to make the access arrangement proposal acceptable to the ERA.
- 1.3 The Draft Decision also fixes a period for amendment of the Original AA Proposal (**revision period**), which revision period expired on 18 April 2011.
- 1.4 On 18 April 2011, DBP submitted the following documents pursuant to Rule 60 of the NGR, which make up the amended access arrangement proposal (**Amended AA Proposal**):
 - (a) Amended Proposed Revised Access Arrangement; and
 - (b) Amended Proposed Revised Access Arrangement Information.
- 1.5 Rule 59(5)(c)(iii) of the NGR requires the ERA to allow at least 20 business days from the end of the revision period for submissions to be made (in relation to both the Draft Decision and the Amended AA Proposal). The ERA has advised that interested parties are able to make submissions on the ERA's Draft Decision up until 4:00pm (WST) Friday 20 May 2011.
- 1.6 While DBP has submitted to the ERA that the Amended AA Proposal contains the information that the NGA (which includes the WA National Gas Access Law text (**NGL**) and the National Gas Rules (**NGR**) requires to be included in order to enable it to be approved by the Economic Regulation Authority (**ERA**), on 18 April 2011, DBP also submitted that DBP will also be filing the following supporting submissions that explain and substantiate the amendments and additions in the Amended AA Proposal that have been made to address various matters raised in the Draft Decision:
- 1.7 Submission (47) Revised Amended Access Arrangement Proposal (this was filed on 18 April 2011)
 - (a) Submission (48) Overarching
 - (b) Submission (49) Response to Specific Amendments
 - (c) Submission (50) Reference Service
 - (d) Submission (51) Terms & Conditions
 - (e) Submission (52) Opening Capital Base
 - (f) Submission (53) Capital Expenditure
 - (g) Submission (54) Operating Expenditure
 - (h) Submission (55) Rate of Return

- (i) Submission (56) Other Tariff Matters (being this submission)
 - (j) Submission (57) Non Tariff Matters
- 1.8 In this Submission, DBP addresses the following amendments in the Draft Decision and the ERA's reasoning associated with each of these amendments:
- (a) Amendment #11 – rebate mechanism.
 - (b) The Application of Rule 95 and the reasoning of the ERA on this point in paragraphs 954 to 962 of the Draft Decision, which all lead to amendment 12.
 - (c) Amendments #14 & 15 – tariff variation mechanisms.
- 1.9 As a final introductory matter, DBP has issues with the manner in which the ERA has both exercised its discretion in relation to its assessment of these elements of the Access Arrangement (ie rebate mechanism, tariff structure and tariff variation mechanisms) and undertaken its task under the NGL and NGR of assessing the relevant provisions of the Original AA Proposal's compliance and consistency with the relevant requirements of the NGL and NGR. This matter is addressed in more detail in submission 48 filed on or about the date of this submission. Throughout this submission, DBP draws the ERA's attention to this point where relevant.

2. THE PROPOSED REBATE MECHANISM

- 2.1 Under paragraph 941 of the Draft Decision, the ERA is of the view that the Access Arrangement should make an explicit declaration that non-reference services for gas transportation are rebateable services. In taking this view, the ERA considered the amount of revenue and sale of non-reference services in the 2005 - 2010 period (see paragraph 937 of the Draft Decision).

The proposed revised access arrangement should be amended to include a statement that services for gas transportation that are other than services in the nature of reference services are rebateable services within the meaning of rule 93(4).

The access arrangement should also include a rebate mechanism that provides for a share of revenue from rebateable services to be rebated to users of services that are in the nature of reference services. The rebate mechanism should provide for the share of revenue to be rebated as:

Value of revenue to be rebated= $0.8 \times (R - (C \times Q))$

where

R is the revenue from the rebateable service (\$);

C is the commodity tariff of the full haul, part haul or back haul reference service, as relevant (\$/GJ); and

Q is the throughput quantity of the rebateable service.

- 2.2 Accordingly, the ERA requires the following in Amendment 11
- 2.3 DBP submits that this amendment is invalid for a number of reasons.
- 2.4 Firstly, it is invalid because the law prohibits the ERA from imposing it. Paragraph 7.13(a)(ii) of the 2006 Access Arrangement contains a fixed principle (**Fixed Principle**). It provides that the ERA must not:
- (a) “take into account directly or indirectly for the purposes of setting a reference Tariff or determining or applying the Reference Tariff policy which applies on or after 1 January 2011; or
 - (b) otherwise take into account directly or indirectly, in performing any of its functions under the Code:
 - (i) the revenue earned by Operator (i.e. DBP) during the period commencing on 1 July 2005 and ending on 31 December 2015 for the sale of any Services which is in excess of the amount (in net present value terms) equal to the sum of:
 - (A) the revenue that would have been earned had any of those Services which were Full Haul Services been sold at the Reference Tariff; and
 - (B) the revenue actually earned from the sale of those Services which were Services other than Full Haul Services.”
- 2.5 The Fixed Principle is mandated by law as a result of section 21(5) of the National Gas Access (WA) Act 2005 (Act) and clause 26 of Part 4 of the Schedule to the NGL.

- 2.6 DBP submits therefore that the Fixed Principle prohibits the ERA from imposing Amendment 11.
- 2.7 The Fixed Principle provides that the ERA must not consider (before 2031) the amount of revenue earned by DBP for non-reference services in the 2005 to 2015 period. That is, the ERA is prohibited from taking into account in any way in relation to any decision with respect to the proposed access arrangement (or any of its statutory functions or powers for that matter) the revenue earned with respect to the non-reference services. It follows then, that the ERA cannot propose a rebate mechanism for revenue that it is not entitled to consider for any purpose.
- 2.8 The second reason for why the mechanism is invalid (and this reason applies even if DBP's first reason does not apply) is that it provides for revenue earned by a service provider to be rebated to users of services that are in the nature of reference services. The NGR only allows a rebate mechanism to provide for rebates to users of reference services.
- 2.9 Paragraph 944 of the Draft Decision provides that the ERA considers that the rebate mechanism should provide for 80 per cent of revenue in excess of the incremental cost of service provision to be rebated to "users of services that are in the nature of reference services".
- 2.10 Pursuant to rule 93(3)(a) of the NGR, the ERA may permit the allocation of the costs of rebateable services, in whole or part, to reference services if:
- (a) the ERA is satisfied that the service provider will apply an appropriate portion of the revenue generated from the sale of rebateable services to provide price rebates (or refunds) "to the users of reference services"; and
 - (b) any other conditions determined by the ERA are satisfied.
- 2.11 The "users of reference services" for whom the NGR allows a rebate mechanism to be provided for in an access arrangement is a very specific category of users. It does not extend to cover "users of services that are in the nature of reference services".
- 2.12 The NGR has not been drafted in a manner which would permit an interpretation that allowed the category of users to be expanded beyond "users of reference services" to include users who are not using reference services but are using services which are "like" or are of a similar nature to reference services. There does not appear to be any justification for this interpretation.
- 2.13 Even if the first two reasons are not correct (which DBP does not accept), the third reason for the invalidity of the amendment is that it is not consistent with the national gas objective and the revenue and pricing principles in the NGL. This is so for the following reasons:
- (a) It would have the effect of fundamentally altering the arrangements struck between DBP and its shippers in 2004 as to the revenue DBP would be allowed to earn. It will provide shippers of these services with a gain in circumstances where their contract was negotiated under the express acknowledgement that it would sit outside the regulatory regime until at least 2016.
 - (b) There is no certainty that the mechanism would allow DBP with the opportunity to recover its incremental costs of providing the services

2.14 The final reason is that the amendment is uncertain and unworkable. There are a number of examples to substantiate this:

- (a) It is unclear what is meant by “throughput quantity”
- (b) What is a service for gas transportation that is otherwise in the nature of a reference service? Would this extend to the Alcoa Exempt Contract
- (c) It is not clear what is the basis for the 80% rebate requirement. What analysis has been done to demonstrate that this will enable DBP to recover its incremental costs? DBP submits that this does not enable DBP to recover its incremental costs

3. ALLOCATION OF REVENUE BETWEEN DIFFERENT COMPONENTS THAT MAKE UP THE REFERENCE TARIFF

- 3.1 If there is a statutory power, the amendment is inconsistent with the revenue and pricing principles
- 3.2 In the Original AA Proposal, DBP proposed continuing with the structure for the DBNGP reference tariffs which was approved by the ERA in 2005, and with the allocation of costs to the components of those tariffs which was also accepted by the regulator. The reference tariff was structured as a two-part tariff comprising:
- (a) a capacity reservation tariff (a number of dollars per GJ km of contracted capacity); and
 - (b) a commodity tariff (a number of dollars per GJ km of throughput).
- 3.3 The commodity tariff was set to recover those costs which varied with pipeline throughput. The only explicitly “throughput-related” cost was the cost of compressor fuel. All other costs were to be recovered via the capacity reservation tariff.
- 3.4 In paragraph 956 of the Draft Decision, the ERA argued that the allocation of costs which DBP proposed was not consistent with the requirements of Rule 95(2) and 95(3). The ERA considered that costs categorised by DBP as field expenses and reactive maintenance were closely correlated with throughput and should be recovered via the commodity tariff.

Applying Rule 95

- 3.5 The relevant parts of Rule 95 are as follows:
- (2) *The portion of total revenue referable to a particular reference service is determined as follows:*
 - (a) *costs directly attributable to each reference service are to be allocated to that service; and*
 - (b) *other costs attributable to reference services are to be allocated between them on a basis (which must be consistent with the revenue and pricing principles) determined or approved by the AER.*
 - (3) *The portion of total revenue referable to providing a reference service to a particular user or class of users is determined as follows:*
 - (a) *costs directly attributable to supplying the user or class of users are to be allocated to the relevant user or class; and*
 - (b) *other costs are to be allocated between the user or class of users and other users or classes of users on a basis (which must be consistent with the revenue and pricing principles) determined or approved by the AER.*
- 3.6 Rule 95(2) governs the allocation of total revenue to reference services. Contrary to the ERA’s assertion in paragraph 956 of the Draft Decision, Rule 95(2) has no bearing on the issue of the allocation of costs to the components of the tariff for a particular reference service. That allocation of costs to tariff components is governed by Rule 95(3).
- 3.7 In DBP’s tariff determination for the Original AA Proposal, all of the total revenue has been attributed to reference service provision, and is allocated to all users of the reference

service via the capacity reservation and commodity components of the reference tariff. That is, all costs are considered directly attributable to provision of the reference service and are allocated to the relevant class of users, being the class comprising all pipeline users.

- 3.8 DBP has, then, complied with the applicable requirements of the NGL and the NGR in a way which is consistent with the applicable criteria prescribed by the NGL and the NGR. Under Rule 95, the ERA's discretion is limited and, in these circumstances, the ERA cannot re-allocate field expenses and reactive maintenance costs so that they can be recovered via the commodity tariff.
- 3.9 Even if the ERA were to have been able to re-allocate these costs, there is no justification for doing so.
- 3.10 Field expenses include:
- (a) recurrent field service costs: the costs of programmed maintenance of the pipeline itself, compressor stations, and metering facilities, and the costs of other maintenance-related activities including logistics, maintenance planning, and the maintenance of communications systems and buildings; and
 - (b) non-recurrent field service costs: the costs of major overhauls of items of plant other than compressor units, and of other major maintenance activities, which vary from year to year in accordance with manufacturers' specifications and utilization.¹
- 3.11 The maintenance activities which are classified as field service activities are not carried out in response to the volume of gas flowing through the DBNGP during a particular period of time, and do not vary as throughput varies from one year to the next. Field service activities are carried out in accordance with pre-specified schedules which may be based on equipment manufacturers' recommendations, or on experience (either DBP's experience, or the experience of other pipeline operators). The costs of these activities are, then, unrelated to volume.
- 3.12 Requirements for reactive maintenance are unpredictable, and affect the availability of pipeline capacity directly (for example, because a compressor unit cannot operate) or indirectly (for example, because a hazardous condition is created). The unpredictable nature of reactive maintenance means that it is unrelated to gas flow. It is not carried out in response to the volume of gas flowing through the DBNGP during a particular period of time, and does not vary as throughput varies from one year to the next.
- 3.13 Both field service activities and reactive maintenance are activities required to keep the DBNGP in a condition where all contracted capacity is available for use by shippers. A larger pipeline system, with larger contracted capacity, has a larger number of components, requiring more extensive field service activity. With a larger number of components, there will also be a larger number of unplanned component failures, which requires a higher level of reactive maintenance.
- 3.14 This was recognized by the ERA in 2005 when, in its Final Decision on the proposed first revisions to the DBNGP Access Arrangement, it approved:
- (a) a change to the current tariff structure;

¹ See Economic Regulation Authority, *Final Decision on Proposed Revisions to the Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline*, November 2005, paragraph 358.

- (b) the current allocation of fuel gas costs to the commodity tariff for recovery over pipeline throughput; and
- (c) the current allocation of all other costs to the capacity reservation tariff for recovery over the contracted capacity of the pipeline.

3.15 In paragraph 943 of the Draft Decision the ERA stated:

Under this draft decision, the Authority is requiring that the commodity charge of reference tariffs be at a level approximately equal to the incremental cost of a unit of gas throughput (refer to paragraph 956, below). The Authority considers that the commodity charge is a reasonable approximation of the incremental cost of service provision for non-reference services.

3.16 Recognising that DBP's reference tariff was a two-part tariff, the ERA advised, in paragraphs 385 and 386 of its November 2005 Final Decision on the first proposed revisions to the Access Arrangement that:

. . . by establishing the Commodity Charge to recover only the cost of fuel gas, the Authority takes the view that this charge establishes the "marginal price" for gas transmission at a value approximately equal to the marginal cost.

386. *On this basis, the Authority considers that the cost allocation proposed by DBP is broadly consistent with economic efficiency in the levels of the tariffs for the Full Haul, Part Haul and Back Haul Reference Services.*

3.17 Since 2005 the capacity of the DBNGP has been significantly expanded, but there has been no fundamental change in the physical operation of the pipeline. Setting the commodity tariff to recover only fuel gas costs continues to establish the marginal price at a value approximately equal to the marginal cost, and to lead to a tariff broadly consistent with economic efficiency.

3.18 To change the cost allocation as the ERA indicated it has done in paragraph 956 of the Draft Decision is neither in accordance with the requirements of the NGL and the NGR, nor is it consistent with the ERA's own stated requirement for economic efficiency.

4. TARIFF VARIATION METHOD – NEW TAXES & NEW COSTS

Response to Amendment 14

4.1 Required amendment 14 in the Draft Decision provides the following:

The proposed revised access arrangement should be amended so that the variation of reference tariffs by way of a Tax Changes Variation:

- is limited to costs of tax changes that satisfy the criteria governing operating expenditure set out in rule 91 of the NGR; and
- is subject to the Authority's approval of the variation

4.2 There are several aspects of the ERA's amendment that require a response.

4.3 Firstly, it is wrong to limit DBP's ability to only pass through Tax Changes which satisfy the criteria in Rule 91 of the NGR. Any Tax Change is mandated on DBP by law. DBP has no control over whether the change or the quantum of the change is prudent or efficient. DBP will therefore be exposed to not being able to recover an aspect of a tax change that is inefficient or imprudent. An example of this currently under debate is the proposal for a carbon tax. There are many views being expressed by stakeholders as to the prudence or efficiency of this tax. To the extent that the carbon tax becomes law, any change to the rate of the tax over time will be at risk of not being prudent or efficient. And so, DBP will be exposed to the risk of not being able to pass it through.

4.4 Furthermore, it is a well accepted principle that in a competitive environment, all taxes are passed through to the end customer. There should be no modification of that principle in this instance.

4.5 Secondly, it is inappropriate for the ERA to impose a requirement that the variation as a result of a tax change be approved by the ERA before it is passed through to shippers. This is so because of the following reasons:

- (a) Shippers under the SSCs have already agreed to a mechanism for passing through the effect of new tax changes without the involvement of an unrelated third party. There is nothing to suggest that this mechanism doesn't work. Accordingly, given the shippers have accepted this, there is no reason to now include it in the access arrangement.
- (b) There is no time limit imposed on the ERA to approve the variation – this would mean that DBP could be exposed to a loss of significant revenue if the ERA were to unnecessarily deliberate as there is no ability that DBP is aware of that would enable it to claw back the revenue retrospectively.

4.6 If there is going to be any involvement of the ERA in any application of this tariff variation mechanism, DBP considers that it should be limited to exercising its oversight powers. This will still ensure consistency with the Act. If the ERA is going to insist on approving it, then DBP insists that a time limit be applied to make a decision.

4.7 In addition, DBP submits that if there is going to be an approval process, DBP should be allowed to also pass through the costs of the approvals process as these are not presently included in DBP's forecast operating expenditure.

Response to Amendment 15

- 4.8 Required Amendment 15 provides for the removal of the tariff to be varied by way of the new cost pass through variation mechanism that was included in the Original AA Proposal.
- 4.9 The reasoning given by the ERA for this amendment (paragraph 974 of the Draft Decision) is that it was not consistent with Rule 97 which limits a cost pass through only in respect of a defined event and the proposed mechanism extended to cover other events which were not defined events.
- 4.10 On that basis, DBP's Amended AA Proposal has amended (see clause 11.4 of the access arrangement) the new cost pass through variation mechanism to apply only to new costs that are in respect of the following defined events:
- (a) A Change in Law
 - (b) The additional costs not included in the forecast operating expenditure in the Amended AA Proposal which arise from any new or amendment to any agreement that is entered into for the supply of system use gas to meet DBP's obligations under an access contract for the reference service which new agreement or amendment of an existing agreement has the effect of increasing the price of system use gas;
 - (c) Additional costs not included in the forecast operating expenditure in the Amended AA Proposal which arise from a change in the type or level of the fees payable to the Land Access Minister under any Access Right relating to the DBNGP and granted under the Dampier to Bunbury Pipeline Act 1998.
- 4.11 Accordingly, DBP submits that the change to clause 11.4 of the access arrangement should be accepted by the ERA

5. CONFIDENTIALITY

