

Economic Regulation Authority
Level 4, Albert Facey House
469 Wellington Street
Perth
Western Australia 6000

02 June 2015

**Re: Wesfarmers Chemicals, Energy & Fertilisers submission on the proposed
Dampier to Bunbury Natural Gas Pipeline Access Arrangement (2016-2020).**

Dear Sir/Madam,


Wesfarmers Chemicals, Energy and Fertilisers ("WESCEF") is a division of Wesfarmers Limited. Its subsidiaries, CSBP Limited, Wesfarmers Kleenheat Gas Pty Ltd and CSBP Limited's majority owned subsidiary Australian Gold Reagents Pty Ltd, purchase and transport some 70 TJ per day of natural gas for the manufacture of ammonia, LNG, LPG and sodium cyanide, and for the on-sale to commercial, industrial, small-to-medium-enterprise and residential customers in WA. WESCEF holds its transportation agreements with DBNGP (WA) Transmission Pty Ltd ("DBP") through the following entities:

- CSBP Limited;
- Wesfarmers Gas Limited; and
- Wesfarmers Energy (Gas Sales) Limited.

WESCEF appreciates the opportunity to comment on the proposed Dampier to Bunbury Natural Gas Pipeline ("DBNGP") 2016-2020 Access Arrangement ("AA4").

WESCEF is concerned with the high rate of return that DBP is seeking, leading to high tariffs for all its customers over the AA4 period. As a general comment, WESCEF is concerned with a number of amendments and new provisions proposed by DBP which appear to be endeavouring to:

- significantly increase return to DBP while simultaneously transferring risk onto customers through tariff adjustments and reduced service offering; and
- enable DBP to pass additional charges onto customers without such charges



going through a proper regulatory process by fettering the discretion of the Regulator.


While WESCEF understands that DBP needs to achieve adequate returns, it should be commensurate with the asset's level of risk and an appropriate regulatory process should be followed in relation to all tariff adjustments and new charges.

WESCEF is also concerned that there are changes to the terms and conditions which appear to be contrary to the interests of the customers.

WESCEF's key concerns in relation to the proposed revisions to the Access Arrangement are as follows:

Rate of Return on the Regulatory Asset Base: The nominal WACC of 8.36% proposed by DBP is high in comparison to other recent regulatory decisions (eg. ATCO draft decision of 14 October 2014 ("ATCO Draft Decision") of 5.94% nominal WACC). In regards to the cost of debt, WESCEF does not support the inclusion of a new issue premium as it is inconsistent with the ERA Rate of Return Guidelines and is not commonly included in the calculation of cost of debt. WESCEF notes DBP has also included a hedging swap allowance in the debt raising cost, which is inconsistent with DBP's proposed use of 10 year risk free rate. This allowance should not be included in the debt raising cost. WESCEF also notes that whilst DBP broadly used the same models as the ERA in its ATCO Draft Decision to estimate the debt risk premium ("DRP"), it has simply used the highest estimate of DRP from the four models rather than the average as adopted by the ERA in its ATCO Draft Decision. WESCEF believes a more appropriate approach would be to apply the average of the model estimates.

In regards to the cost of equity, WESCEF does not believe that DBP's approach of including non-energy stocks in the sampling estimate is appropriate. The sampling estimate should reflect the risk profile of the asset. Given the nature of DBP's asset WESCEF believes the sampling methodology should be consistent with the Rate of Return Guidelines as this approach would more closely reflect the risk and return profile of the asset. Also, WESCEF does not support the use of the Black CAPM as it is contrary to the most widely used and supported SL CAPM model as recommended in the ERA Rate of Return Guidelines. WESCEF is surprised that DBP is proposing using a model other than SL CAPM as all information provided by DBP to WESCEF in the last 12 months during shipper contract renegotiations used the SL CAPM model. WESCEF suggests that the ERA requests DBP to advise the reason for the change in the use of model in the last 12 months.




Operating Expenditure: WESCEF is concerned at the significant increase in operating expenditure when compared with the actual operating expenditure of the previous Access Arrangement ("AA3"). A significant portion of the increase in operating expenditure is driven by system use gas cost which is more than three times higher than the actual average expenditure in AA3. This appears to be contrary to recent movements in the domestic gas market. WESCEF suggests that the ERA investigates the basis for the significant difference in system use gas costs between DBP's forecast and the actual expenditure in the current Access Arrangement.

Revenue Cap Adjustment: WESCEF believes the proposed annual revenue cap adjustment of the reference tariffs is unacceptable as it transfers volume risk to the shippers. This risk transfer is not consistent with the level of return DBP is seeking and will introduce volatility in tariff prices. WESCEF assumes that the reason that DBP is proposing CPI escalation of the Initial Total Revenue, rather than the Reference Tariffs (as under the current Access Arrangement) is due to the proposed revenue cap adjustment. WESCEF submits that the revenue cap adjustment be rejected, and that the CPI escalation should remain as escalation of the Reference Tariffs, rather than the Initial Total Revenue.


WESCEF is concerned with the following proposed revisions to the Access Arrangement.

- a) DBP's proposed amendments to the definition of Part Haul Service in the Access Arrangement would have the result that a service would only be a Part Haul Service where the Outlet Point is located upstream of CS9. WESCEF submits that the proposed amendment should not be approved and that the previous definition of Part Haul Service be maintained. In WESCEF's view, there is no justification for a shipper to be required to pay a full haul tariff when it wishes to obtain a forward haul service to transfer gas only part of the way down the DBNGP. The calculation of part haul tariffs already take into account the distance the gas is transported (the "Distance Factor"). Submissions made historically, and now, make it clear that existing and potential shippers believe that there is a likelihood of demand for such a service, including for the transfer of gas from upstream of MLV31 to the Mondarra Gas Storage Facility ("MGSF") and the transfer of gas from the MGSF to customers with contracted capacity at outlet points downstream of CS9.
- b) Section 7.3(a) of the proposed revised Access Arrangement states that the Operator can elect for an extension or enhancement to not become part of the Covered Pipeline. WESCEF submits that clarity on timing (eg. no later than 30 business days before the consent to operate the extension or



enhancement is granted) of the election should be addressed to provide certainty as to whether an extension or enhancement will be part of the Covered Pipeline within an appropriate timeframe.

- c) WESCEF will leave it for the Regulator to comment on the reasonableness of the timeframes proposed by DBP in its proposed revisions to Section 7.3 of the Access Arrangement relating to expansions (as set out in Section 7.3(b)).
- d) DBP's proposed amendments to Section 11.4 (d) of the Access Arrangement have the effect that the Regulator can only object on certain specified grounds to a tariff variation, compared to the previous wording which required the Regulator to approve the tariff variation and did not contain any fetters on the matters that can be considered by the Regulator. WESCEF believes the amendment places an unreasonable fetter on the Regulator and therefore submits that the proposed amendment should not be approved.
- e) DBP has proposed an amendment in Section 11.4 of the Access Arrangement in relation to the notice period for a change in tariffs from 30 to 20 Business Days. Any changes in tariffs can potentially have a significant impact on DBP's customers. There does not appear to be a reasonable basis to reduce the notice period. WESCEF submits that the notice period should be reinstated to 30 Business Days.
- f) WESCEF does not agree with DBP's proposed deletion of the words "could not be predicted prior to the" in Section 11.5(a)(iii) of the Access Arrangement. This should not be a mechanism for DBP to recover amounts not included by the DBP by oversight or as a result of a strategic decision to avoid the regulated process, particularly when DBP is also proposing to significantly fetter the Regulator's ability to reject a variation under DBP's proposed amendments (see proposed amendments to Section 11.5(d) (and new Section 11.5(e) which WESCEF submits should not be approved).
- g) As noted above, WESCEF submits that the DBP's proposed amendments to Section 11.5(d) and new Section 11.5(e) which have the effect that the Regulator can only object to a New Cost Pass Through Variation on specified grounds (compared to the previous wording which required Regulator approval) should not be approved. It appears to WESCEF that this part of an effort by DBP to pass through to shippers additional charges that have not been through a proper regulated process (and an attempt by DBP to fetter the discretion of the Regulator in relation to new charges and tax changes which, in WESCEF's view, is entirely inappropriate in the context of a regulated asset).
- h) DBP's proposed amendments to Section 14 change the date DBP is required to submit a revised Access Arrangement from three years after the commencement of the Current Access Arrangement to four years after the




commencement of the Current Access Arrangement. WESCEF submits that the revised Access Arrangement should be submitted three years after the commencement of the Current Access Arrangement to provide all relevant parties sufficient time for review and evaluation. Past experience has indicated that the review process can take considerably longer than 12 months and WESCEF cannot see any justification for a later submission date.

- i) DBP's proposed amendments to Section 10 give the effect that the Speculative Capital Expenditure Account ("SCEA") will increase annually at the return of equity implicit in the reference tariff. NGR 84(2) provides that the SCEA increases annually at a rate determined at the AER's discretion, which may, but need not be, the rate of return implicit in the reference tariff. The effect of Section 10.2 and 10.3 is contrary to NGR 84(2) as it removes the Regulator's discretion to set the rate of return for the SCEA. Furthermore, the rate of return proposed by the DBP is the return on equity which would be higher than the rate of return implicit in the reference tariff which is based on the WACC. There is no justification for the SCEA to achieve a greater return than the asset base. WESCEF submits that the proposed amendments should not be approved and that the rate for the SCEA should reflect the risks of the investment.
- j) As a minor comment, Section 6.2(b) includes the words "Subject to any [Pre-existing Contractual Right], but the term "Pre-existing Contractual Right" does not appear to be defined. WESCEF requests that DBP provide a proposed definition and that interested parties be provided an opportunity to comment on the proposed definition.


WESCEF is concerned with the following proposed amendments to the terms and conditions of the T1 and P1 Reference Services.

- a) DBP's proposed amendments to Clause 9.9 require the imbalance to be cashed out at the end of the month rather than at the end of the Capacity End Date. This would significantly reduce the flexibility of the shipper's gas usage and WESCEF is of the view that the current provisions in relation to imbalances (including rights of the Operator in the case of the shipper exceeding its Accumulated Balance Limit) provide sufficient incentive on shippers to stay in balance. In WESCEF's view, the amendments proposed by DBP to clause 9.9 are unbalanced and unnecessary and should not be approved.
- b) DBP's proposed amendments to the definition of "Part Haul" should not be accepted for the reasons set out earlier in this submission.
- c) DBP's proposed amendments to Clause 10.3 and 10.5 provide the Operator with more discretion on issuing a notice requiring the shipper to reduce its




take of gas in the event of exceeding the hourly peaking limit and require the shipper to comply immediately rather than using best endeavours to comply. It also removes the requirement that the Operator issue similar notices to all other shippers. WESCEF understands the importance of the hourly peaking limit however this needs to be balanced with providing shippers with sufficient flexibility and notice with no discrimination between shippers. WESCEF submits the proposed amendments to Clauses 10.3 and 10.5 should not be approved.

- d) DBP's proposed inclusion of Planned Maintenance in the definition of Major Works in Clause 1.1 excludes Planned Maintenance from the calculation of the probability of supply under Clause 3.2. WESCEF believes this is detrimental to the shippers as it may result in a lower actual probability of supply as curtailments for Planned Maintenance are excluded from the calculation. WESCEF submits that the amendments relating to Planned Maintenance should not be approved.
- e) In relation to DBP's proposed amendments to the definition of New Costs, please see WESCEF's comments in paragraph (f) above in relation to the proposed amendments to the Access Arrangement.
- f) In relation to DBP's proposed removal of Clause 3.2(a)(i), which states that access to gas can only be curtailed in circumstances specified in clause 17.2, WESCEF is concerned that this is amending the certainty of the T1 and P1 services in the interests of DBP and adverse to the interests of shippers. WESCEF submits that this clause should not be deleted.
- g) In relation to DBP's proposed amendments to Clauses 5.3(e) and 5.3(g), in WESCEF's view the proposed amendments are contrary to the interest of shippers seeking access on the terms of the Standard Shipper Contract and are not reasonable or justified (WESCEF cannot see any reason why DBP should be entitled to act other than as a reasonable and prudent person in these circumstances). WESCEF submits that these amendments should not be approved.
- h) In relation to DBP's proposed amendments to Clauses 6.5(d)(iii), 17.9(c)(iii) and 9.5(a) to remove the priority of Spot Transactions and relevance of spot capacity when calculating the accumulated imbalance limit, in WESCEF's view the proposed amendments change the nature of Spot Transactions in a manner adverse to the interests of a shipper utilising Spot Capacity. The exclusion of Spot Transactions in the calculating the imbalance limit reduces the shipper's flexibility. WESCEF submits that these amendments should not be approved.
- i) In relation to DBP's proposed amendments to clause 9.5, these remove the obligation on the Operator to issue similar notices to all other shippers with a



negative or positive (as the case requires) Accumulated Imbalance, remove the provisions giving the shipper protection if it is using best endeavours to reduce its imbalance and remove the concept of an Outer Imbalance Limit. In WESCEF's view, these amendments are contrary to the interests of shippers, removing flexibility and reasonable protections. WESCEF submits that these amendments should not be approved.

- j) In relation to DBP's proposed amendments to Clause 11.2(a) which remove the qualifications on the Operator to issue Unavailability Notices in respect to overrun gas and the requirement that the Operator issue similar notices to all other shippers taking overrun gas, while WESCEF understands the importance of managing the taking of overrun gas, this needs to be balanced with providing shippers with sufficient flexibility and notice and not discriminating between shippers. WESCEF submits the proposed amendments to Clauses 11.2(a) should not be approved.
- k) In relation to DBP's proposed amendments to Clause 17.4 to remove the refund of the Capacity Reservation Charge to the extent that the curtailment falls within the T1 permissible curtailment limit, WESCEF is of the view that this amendment is unreasonable, clearly in the interests of DBP and contrary to the interests of shippers and is an attempt to change the nature of the Reference Services. WESCEF submits that the curtailment limit should not diminish the shippers' entitlement to a refund in the event of a curtailment and that this proposed amendment should not be approved.
- l) In WESCEF's view DBP's proposed removal of Clause 25.5(f) is not reasonable as it removes the certainty that was previously provided to shippers that the DBNGP won't be disposed of leaving the Operator with no ability to meet its contractual obligations under the shipper contract. WESCEF submits that Clause 25.5(f) should be reinstated in its original form.
- m) WESCEF notes that DBP has proposed that the Non-Discrimination clause (previously clause 45) be deleted. WESCEF submits that this clause should be reinstated to ensure fairness between all shippers.
- n) In relation to the proposed amendments to clause 6.16, in WESCEF's view the reference to clause 6.11 should be changed to clause 6.9.
- o) The term "CPI Changes" is used in clause 20.5, but does not appear to be defined. WESCEF requests that DBP provide a proposed definition and that interested parties be provided an opportunity to comment on the proposed definition.



It is important to note that the comments above have been provided in good faith and reflect WESCEF's broad view on the proposed DBNGP AA4. They are not intended to be used as expert technical advice; but to provide comments for consideration by the ERA in reviewing the proposal.

Should you wish to discuss any points raised in this submission please contact Ric Colgan at ric.colgan@csbp.com.au or Gerard Chan at gchan@wescef.com.au.

Yours sincerely,

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Wesfarmers Chemicals, Energy and Fertilisers