Kleenheat

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

4 December 2020

Re: Wesfarmers Energy (Gas Sales) Limited submission on the proposed Dampier to Bunbury Natural Gas Pipeline Access Arrangement (2021-2025) and the Economic Regulation Authority's Position Paper

Dear Sir/Madam,

Wesfarmers Energy (Gas Sales) Limited ("WEGS") purchases and transports natural gas for the manufacture of LNG, LPG, and Ammonia; and, for the on-sale to commercial, industrial, small-to-medium-enterprise and residential customers in Western Australia. WEGS holds its transportation agreements with the group of companies that own and operate the DBNGP, now collectively called Australian Gas Infrastructure Group ("AGIG") and manages the supply and transportation optimisation for the following entities:

- CSBP Limited;
- Wesfarmers Gas Limited; and
- Kleenheat Gas Pty Ltd.

WEGS appreciates the opportunity to comment on the Economic Regulation Authority's ("ERA" or "Regulator") Position Paper of 20 November 2020 ("Position Paper") on Pipeline and Reference Services in the context of the Dampier to Bunbury Natural Gas Pipeline ("DBNGP") Access Arrangement for 2021-2025 ("AA5").

WEGS notes that in assessing the Final Plan, the ERA must apply the provisions of the National Gas Law ("NGL") and National Gas Rules ("NGR").

WEGS has structured this submission on six key areas in relation to the Position Paper:

1. ERA's proposed service classifications

2. Disparity in tariffs for access to pipeline capacity (and cost to user)
3. Predictability of the Peaker Service
4. Cost allocation to the Peaker Service
5. Inefficiency of the rebate mechanism
6. Definition of the Part Haul Service

1. ERA's proposed service classifications

a) The ERA has proposed that the Ullage Service be considered a non-reference rebateable service. WEGS supports this proposal for AA5 and believes the classification will need to be reviewed and most likely re-considered for AA6.

b) The ERA has proposed that the Pilbara Service be considered a non-reference non-rebateable service considering its size and certainty respectively. WEGS supports this proposal provided that, when applying Rules 93 and 95 of the NGR when making its Final Decision - in particular the total revenue and cost allocation process – the ERA allocates some costs to the provision of the Pilbara Service and that allocation is undertaken so that both capital and operating costs are allocated between reference services and the Pilbara Service proportionately. Given the assets that make up the DBNGP are required to provide the Pilbara Service and given the similarity of the Pilbara Service to the Part Haul and Back Haul Services, the allocation should include both capital and operating costs and not just incremental costs.

c) The ERA has proposed that the Spot Service remains a non-reference service due the fact this service does not meet the reference service factors. However, the ERA does not propose that the Spot Service should be considered a rebateable service. WEGS understands under Rule 93(3) that where there is ***substantial uncertainty*** for the demand of a service, the cost of delivering this service may be allocated to reference services but the revenues derived from this service shall be rebateable. WEGS believes there may be substantial uncertainty in the demand for the Spot Service for the following reasons:
   i) the service cannot be reserved by shippers,
   ii) the price of this service (being the higher of $1.20/GJ and the price cleared as a result of the daily auction) ranks this service as least preferred option – ahead of the shipper's over-run tolerance, and
   iii) the availability of the Spot Service is determined by the operator's daily configuration of the pipeline (not the pipeline's capacity).

   WEGS believes that Rule 93 (3) applies to the Spot Service offered by AGIG.

d) The ERA has proposed to classify the Peaker Service as a non-reference rebateable service due to:

i) The service not satisfying the service factors that would otherwise make it a reference service.
ii) The demand for and revenue from this service not being sufficiently certain to make it a non-reference non-rebateable service.

As further detailed below, WEGS believes instead that:

i) the demand for and revenue from this service is more predictable than claimed by AGIG,
ii) according to the National Gas Rules, the National Gas Objectives and the Revenue and Pricing Principles, this service cannot be considered as a rebateable service; and
iii) an appropriate allocation of total revenue and costs should be made to this service (and other non-reference non-rebateable services) in the process of setting tariffs for reference services.

2. Disparity in tariffs for access to pipeline capacity (and cost to user)

WEGS had highlighted in its previous submission that the classification of the Peaker Service as a rebateable non-reference service along with the pricing level of this service as WEGS understood it[1], caused an unfair disparity between the cost to access capacity for Peaker Service customers and for Reference T1 Service customers of approximately $0.40/GJ[2].

According to Rule 95 (1), "a tariff for a reference service provided by means of a transmission pipeline must be designed:

a) to generate from the provision of each reference service the portion of total revenue referable to that reference service; and
b) as far as is practicable consistently with paragraph (a), to generate from the user, to which the reference service is provided, the portion of total revenue referable to providing the reference service to the particular user or class of users".

WEGS believes that the allocation of total revenue and costs of the pipeline should be done in a way that the users' cost of accessing similar services is not dissimilar amongst each class of user. As currently proposed, the Reference Service class of users will be heavily subsidizing

[1] WEGS submission dated 4th November 2020, Issue 3, para. "Defining the Peaking Service".
[2] WEGS submission dated 4th November 2020, Issue 3, para. (c).

the class of users using the Peaker Service.

The National Gas Objective as stated in the National Gas Law (NGL) is: "to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas". An equivalent tariff for all users of the pipeline ensures the efficient operation of natural gas services for the long term interests of ***all*** consumers of natural gas.

AGIG and the Regulator's proposed treatment of the Peaker Service underscores the issue of cross-subsidisation by setting it as a rebateable service. The following section outlines why the Peaker Service should not be classified as a rebateable service.

3. Predictability of the Peaker Service

Under rule 93(4)(b), a non-reference service may be considered a rebateable service only if there is ***substantial uncertainty*** of its demand or revenue.

WEGS would suggest to make a distinction between the predictability of the ***demand*** for Peaker Service and the predictability of the ***usage*** of the Peaker Service. AGIG has made this distinction in its proposal only to conclude that the overall assessment of the revenues of this service is difficult.

WEGS believes that the demand for this service is likely to be well known by AGIG (or not substantially uncertain). The fact that it is a new service for AGIG does not of itself mean that demand is substantially uncertain. It is clear that AGIG has held negotiations with shippers that have resulted in the parties agreeing to or agreeing to move from a T1 Service and progress towards a Peaker Service contract as a replacement for the shippers' currently subscribed T1 capacity. In this sense, the ***demand*** for Peaker Service is most probably well understood.

However, due to the likely high commodity portion of this tariff (circa 80%[3]), the estimation of the ***usage*** strongly influences the estimation of the revenues derived by AGIG on this service. WEGS believes there is adequate information available to AGIG and to the ERA to enable them to conclude that there is not ***substantial uncertainty*** concerning the revenue to be earned from this service (in accordance with Rule 93(4)(b) of the NGR). The following sources of information demonstrate this point:

- **Whole of System Plan:** This initiative from Energy Policy WA has recently delivered

[3] As explained in WEGS' prior submission, dated 4th November, Issue 2, para. "Defining the Peaking Service".

detailed scenarios of the West Australian Electricity Market. One of the outputs of this initiative is a yearly summary of each power station's electricity production. Using this information, AGIG or the ERA may be able to determine the likely peaking (gas plant) requirements and infer the usage of the Peaker Service proposed by AGIG[4]. These scenarios show a fairly narrow forecast uncertainty until 2025.

- **Shippers' obligations to forecast demand:** Under clause 8.2 of the DBP shipper contract, AGIG has a right and shippers have a best endeavour obligation to provide "advance estimates (covering such periods and in such detail as the Operator may determine) in good faith of the Shipper's likely Nominations".
- **Information provided by shippers for negotiation purposes:** To conduct its negotiation with shippers, WEGS believes AGIG would have undertaken an analysis of the probable usage of this service by future customers to compare the value for AGIG of offering this service as opposed to other services that would otherwise be available to shippers (such as the T1 and the Spot services). WEGS encourages the ERA to make enquiries of AGIG about the level of analysis undertaken by AGIG in this regard and outlined in its business case prepared to seek approval for the shipper negotiations.
- **Other sources of information:** WEGS believes that the information above may be cross-checked with other benchmarks such as the detailed workings of the Electricity Statement of Opportunities and forecasts from ACIL Allen, obtained by AGIG to support their forecast of natural gas demand[5].

Given the above, it is not clear to WEGS how AGIG and the ERA could conclude pursuant to rule 93(4) that the Peaker Service is a rebateable service.

4. Cost allocation to this service

The Peaker Service is understood to be in all respects similar to the T1 Reference Service aside from the curtailment priority of this service. However, as WEGS has previously indicated in its submission, considering the level of spare full haul capacity available on the pipeline during the AA5 period, this single difference is not material in the assessment of the quality of this service[6].

This view is supported by the strong link between the firmness of access to gas transport for a

[4] Gas plant electricity generation (on an asset by asset basis) may allow to infer full load equivalent running hours, and (depending on each plant), making an assumption of these hours being generally run on a continuous strip of 2 to 4 hours, then deriving the average daily peak generation and the number of days per annum. This may then be converted to peak gas requirements using the heat rate assumptions proposed in the WOSP.

[5] DBP revised Final Plan Attachment 11.4 ACIL Allen Gas Demand Review (Public), 8th October 2020.

[6] WEGS' submission dated 4th November, Issue 2, para. "Contribution of the Peaking Service to pipeline costs".

power generator and the Capacity Credit Assignment process described in the WEM Rules[7]. That is, should a pipeline service not offer evidence of an "operationally firm" access to gas transport, this may cause unfavourable outcomes for the market participant in terms of capacity credit assignment - a significant source of revenues for electricity generators in the WEM. We encourage the ERA to make enquiries to the AEMO to satisfy itself the extent to which generators have described the operational firmness of Peaker Services.

WEGS would also encourage the ERA to look at the historical reliability of services provided on the pipeline over the period of the last access arrangement as, based on the information contained in the access arrangement documentation submitted by AGIG, there would appear to be very little likelihood that services such as the Peaker Service would be curtailed during AA5:

- Figure 3.2 of the access arrangement[8] indicates that the reliability of compressors has increased to almost 100% reliability during AA4,
- In section 11.5 of the access arrangement information, average full haul demand for T1 reference services during AA4 has ranged from between 610.6TJ/d to 621.6TJ/d based on the designed capacity of 845TJ/d.

AGIG indicates in its submission that the allocation of costs to this service is very difficult aside from direct incremental costs, such as fuel gas. WEGS strongly disagrees with this view and instead believes that, the Peaker and Reference T1 services being similar in nature, the allocation of costs to these services should be similar.

In fact, Rule 93(2) states that "costs are to be allocated between reference services and other services as follows:

a) Costs directly attributable to reference services are to be allocated to those services; and
b) costs directly attributable to non-reference services are to be allocated to those services;

[7] The Capacity Credit Assignment process is described in the WEM Rules (Rule 4.10.1(e)(v)): The market participant (seeking capacity credits) shall provide "details of primary and any alternative fuels including [...]details acceptable to AEMO together with supporting evidence of both firm and any non-firm fuel supplies and the factors that determine restrictions on fuel availability that could prevent the Facility operating at its full capacity for Peak Trading Intervals on Business Days". It is also described in AEMO's Market Procedure: Certification of Reserve Capacity (15 June 2020) which further explains that to "make a determination whether it reasonably expects that the Facility is likely to be available at the level of capacity determined [...] for Peak Trading Intervals on Business Days" (Section 5.3.1 of the procedure), "AEMO considers that a fuel supply or fuel transportation (including gas pipeline capacity) that has a Non-Firm component may indicate a restriction on fuel availability that could prevent the Facility operating at its full capacity for Peak Trading Intervals on Business Days" (Section 5.3.4 of the Procedure). And finally, under this same procedure: "Based on the outcome of assessments in sections 5.1 to 5.4 of this Procedure, but subject to any other relevant principles in clause 4.11.1 of the WEM rules, AEMO must assign a quantity of Certified Reserve Capacity" (Section 5.5.1).

[8] Five year plan for the Dampier to Bunbury Natural Gas Pipeline – 2021-2025 Draft Plan, January 2020.

and

c) other costs are to be allocated between reference and other services on a basis (which must be consistent with the revenue and pricing principles) determined by the AER".

WEGS argues (under Rule 93 (a)) that considering the intra-day peaking rights of the Peaker Service, certain costs such as fuel gas and specific maintenance arising from the subsequent wear and tear on rotating equipment shall be directly attributed to the Peaker Service.

WEGS also argues (under Rule 93 (c)) that, given the practical similarity of the Peaker Service and the reference services for the duration of AA5 (as outlined above), all other fixed and capital costs of the pipeline required to satisfy the capacity requirements of the Peaker Service shall be allocated proportionately to the anticipated (if not already subscribed) Peaker Service reservation quantity in a way consistent with the Revenue and Pricing Principles of Division 2 Section 24 of the National Gas Law, and in particular:

- "A service provider should be provided with a reasonable opportunity to recover at least the efficient costs the service provider incurs" (Division 2, Section 24, Para. (2)): in other words, AGIG should be given the opportunity to recover from Peaker Service customers the efficient cost of holding the capacity available to these customers on the pipeline and operating the pipeline in a manner that meets the intra-day peaks of their transportation requirements.
- "A service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides. The economic efficiency that should be promoted includes […]
  b) the efficient provision of pipeline services: and
  c) the efficient use of the pipeline" (Division 2, Section 24, Para. (3)).

The fact that there are costs of providing a Peaker Service similar to the costs of providing a Reference T1 service means the ERA should ensure, pursuant to Rule 95, that the total revenue referable to the reference services is determined so that costs of the reference services are only attributable to the reference tariff and not the costs of other services such as the Peaker Service.

In other words, the allocation of costs between reference and non-reference services should not have the effect of cross-subsidizing Reference T1 service customers and risking to cause an inefficient use of the pipeline by these users as a consequence.

If the ERA accepts this submission, it is suggested the allocation should be based on the proportion of capacity requirements that each service bears to the total capacity requirements across services (adjusted to Full Haul Equivalent). So, for example, if the total for Full Haul Equivalent services (reference and non-reference, non-rebateable services) is approximately 750TJ/d and the amount of Reference T1 Service forecast is approximately 600TJ/d, then the proportion of total revenue and costs to be allocated to the Reference T1 Service should be apportioned by the ratio of 600 on 750.

5. Inefficiency of the rebate mechanism

In the event that the above submissions are not accepted by the ERA and the Peaker Service is to remain a rebateable service, WEGS believes there are significant issues with the efficiency of the rebate mechanism. WEGS had indicated in its prior submission[9] that the rebate sharing mechanism proposed by AGIG does not properly reflect the cost of providing these services. Each of the Ullage and the Peaker Services are primarily available ***because*** the pipeline holds available capacity. Therefore, proposing a sharing mechanism to reflect that AGIG will require 30% of the revenues to cover only the related incremental fuel gas does not seem appropriate when considering that fuel gas only represents 6% of AGIG's proposed Reference Services.

6. Definition of Part Haul Service

As a final matter, WEGS notes that the Position Paper reproduces Table 6.2 of AGIG's initial proposal which details the pipeline services provided by means of the DBNGP. In that table, the second row describes a Part haul P1 reference service as a service "with outlet point upstream of CS9, regardless of the location of inlet point". This is an incorrect description of the Part Haul P1 reference service contained in both AGIG's initial proposal and its revised proposal filed in response to the Draft Decision. While the ERA subsequently (at paragraph 27 of the Position Paper) refers to the correct description of this reference service and its Draft Decision does not propose to change the description of this service, WEGS assumes that it is not the ERA's intention to change the description of the service in the Final Decision. If it is, WEGS submits that the ERA should call for submissions from stakeholders before issuing its Final Decision. If this is not the ERA's intention, WEGS submits that if the ERA intends to replicate Table 6.2 in the Final Decision, it notes the incorrect description of the Part Haul P1 reference service.

The comments above have been provided in good faith and reflect WEGS's broad view on the Final Plan proposed by AGIG for AA5. They are not intended to be used as expert technical

[9] WEGS' submission dated 4th November, Issue 2, para. "Inconsistency in AGIG's approach to rebating the revenues of its non-reference services".

advice; but to provide comments for consideration by the ERA in reviewing the Final Plan.

Should you wish to discuss any points raised in this submission please contact Vincent Blondeau on [redacted] or Hans Niklasson on [redacted].

Yours sincerely,

[redacted]

Mark Gadsby
General Manager
Wesfarmers Kleenheat Gas Pty Ltd