DAMPIER TO BUNBURY NATURAL GAS PIPELINE
PROPOSED REVISED ACCESS ARRANGEMENT

SUBMISSION # 27

RESPONSE TO DRAFT DECISION AMENDMENTS

PUBLIC VERSION

MAY 2005

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1. EXECUTIVE SUMMARY

1.1. This is one of a series of submissions being made by Operator in response to the Draft Decision ("Draft Decision") released by the Regulator on 11 May 2005 in connection with the proposed revised Access Arrangement submitted by Operator in January 2005. These submissions deal with the following topics:

(a) **[deleted – confidential]**

(b) A response to the Draft Decision Amendments (Submission#27)

(c) Gas Quality Specification issues (Submission#28)

(d) Further explanation and justification of the forecast non capital costs for the Access Arrangement Period (Submission#29)

1.2. It should be noted that Operator's responses contained in this submission and the others listed above have been done on the following primary bases:

(a) the need to preserve the sanctity of existing contractual rights of parties to pre-existing contracts

(b) to outline aspects of the Regulator's reasons which Operator considers reflect a clear incorrect application of the Code.

1.3. In preparing this submission, Operator has not been able to respond fully to all of the amendments, due to the constrained response period and the significance of some of the amendments.

1.4. **[deleted – confidential]**

1.5. **[deleted – confidential]**.

1.6. Section 2 of this submission deals with the non tariff amendments. Section 3 contains Operator's initial and partial response to some of the tariff related amendments. **[deleted – confidential]**.

2. RESPONSE TO DRAFT DECISION NON TARIFF AMENDMENTS

This section of the Submission sets out Operator's response to each of the non tariff amendments in the Draft Decision.

2.1 Amendment: 1 – T1 Reference Service

2.1.1 Draft Decision Amendment

The Services Policy of the Proposed Access Arrangement should be amended to remove the Tf Service and to include a Reference Service that is of the nature of the "T1 Service" to which the Standard Shipper Contract relates. The minimum contract term for this Service should be 2 years when it is made available to a Prospective User through the utilisation of Spare Capacity and 15 years when it is made available to a Prospective User through the utilisation of Developable Capacity.

2.1.2 Operator's Response

Operator submits that there are three reasons why it can not incorporate this amendment in any amended proposed revised Access Arrangement that it might lodge in response to a decision of the Regulator.

[deleted – confidential]:

(a) the fact that, because of a combination of the curtailment arrangements in the existing shipper contracts and the terms and conditions that attach to the Firm Service as set out in the Original Access Arrangement, there is no Spare Capacity in the DBNGP that could be made available to shippers seeking any Service in the nature of Firm Service or T1 Service capacity at delivery points downstream of Compressor Station 7 based on the current configuration of the pipeline;

(b) the fact that it would not be in the legitimate business interests of the Service Provider to fund an expansion of the capacity of the pipeline or to extend the geographical range of the pipeline based on the proposed Reference Tariff for the Reference Service;

(c) **[deleted – confidential]**

(d) the need for the proposed access arrangement to have regard to pre-existing contractual obligations owed to Shippers and others;

(e) the desire to have the proposed Reference Service reflect the practicalities of the operation of the DBNGP and the legitimate business needs of Operator; and

(f) compliance with the Code.

[deleted – confidential].

[deleted – confidential]

T1 Service does not satisfy Code criteria for a reference service

In light of the first reason, the Operator also submits that there are two other reasons for why it can not incorporate a revised Access Arrangement which incorporates amendment 1. The first of

these is that Operator considers that the inclusion of a T1 Service in the Access Arrangement as a Reference Service does not satisfy the criteria of the Code for a reference service.

As outlined below in respect of Amendments 5 and 6, the fact that the T1 capacity of the pipeline is fully contracted for the duration of the access arrangement period, and existing users have rights under their existing contracts to obtain additional capacity and options to extend the durations of their contracts, there is no basis for referring to these contracted volumes as forming part of the "market".

Minimum term is unreasonable

The remaining reason (and the third reason overall) is that the proposed minimum term used to describe the reference service is unreasonable in that:

(a) the reasoning for the minimum term places too much weight on certain public interest elements and insufficient weight on Operator's legitimate business interests; and

(b) the Regulator does not take sufficient account of the minimum contract term under the Standard Shipper Contract (***SSC***).

In considering whether or not to approve the proposed revised Access Arrangement, including whether to require amendments as a condition to approval and the nature of those amendments, the Regulator's decision making is to be guided by section 2.24 of the Code ("the section 2.24 factors").

The Draft Decision considers the minimum term of the required T1 Reference Service (and for that matter the Part Haul and Back Haul proposed reference services) in the context of the Services Policy, on the basis that it is "necessary that the description of the Service include the minimum term of contract".

Operator submits the following in support of the view that the minimum two year term does not adequately take account of the factors listed in section 2.24 and is unreasonable.

Firstly the Regulator's Draft Decision places too much weight on the public interest in encouraging full retail contestability in Western Australian gas markets and insufficient weight on the legitimate business interests of the Service Provider. As has been previously outlined in submissions prior to the draft decision, the full haul capacity of the pipeline is fully contracted on the basis of SSC terms and conditions containing a minimum term of 15 years. These contracts underpin the financial viability of the pipeline and its proposed expansion. The only foreseeable basis upon which spare full haul capacity may become available and be accessed under the Access Arrangement would be if one of those contracts were to be terminated as a result of shipper default or insolvency. It would in those circumstances be unreasonable to require the Service Provider to accept replacement contracts having a minimum term of only two years. The Operator should not be prejudiced from achieving an outcome that was based on a reasonable commercial assessment when it purchased the pipeline. The minimum term amendment would, in circumstances where an existing contract is terminated, expose Operator to this risk.

Secondly, the Draft Decision does not take sufficient account of the minimum term applicable under the SSC. The Regulator has adopted the terms and conditions of the SSC, except in relation to gas quality, tariff and duration of the contract. In doing so, the Regulator comments that "...there has to be no general claim that the terms and conditions set out in the Standard Shipper Contract are unreasonable, except in relation to gas quality. The Authority therefore considers that, with the exception of terms and conditions relating to gas quality (addressed further below),

the terms and conditions for the T1 Service as set out in the Standard Shipper Contract appear, prima facie, to be reasonable within the meaning of section 3.6 of the Code." The minimum term applicable under the SSC is 15 years and, on that basis, it is reasonable that if the service is to be included in as a reference service, it should be for a minimum term of substantially longer minimum term than two years.

[deleted – confidential]

[deleted – confidential]

[deleted – confidential]

2.2 Amendment: 2

2.2.1 Amendment

The Proposed Access Arrangement should be amended so that the definition of Spot Transaction Terms and Conditions explicitly provides for these terms and conditions to be negotiated with Users and Prospective Users, with resort to arbitration in the event of a dispute over terms and conditions.

2.2.2 Operator's Response

Operator understands that the prime reason for including this amendment is to ensure that the arbitrator has the ability to arbitrate in respect of a dispute concerning access to this service. It is not necessarily concerned with the ability of the Operator to unilaterally change the terms and conditions.

The Regulator's proposal would provide prospective shippers with recourse to the arbitrator in circumstances where the terms and conditions are expressed to be negotiable.

Due to the nature of the proposed Spot Market, the Spot Market will not operate effectively if different shippers have different terms and conditions.

There needs to be a set of common terms between Operator and the Spot Market participants.

This principle is consistent with the approach of the Standard Shipper Contract which outlines certain key principles and which can only be varied by agreement between the parties. Otherwise, it allows for the Operator to unilaterally set rules to apply to the operation of the market.

Operator proposes therefore that to otherwise address the reasons for the amendment, that the provisions of the Spot Capacity in the Standard Shipper Contract be incorporated in the access arrangement.

2.3 Amendment: 3

2.3.1 Amendment

The Services Policy of the Proposed Access Arrangement should be amended to indicate that Non-Reference Services that are in the nature of gas transmission Services will be made available subject to availability of Capacity, and other Non-Reference Services will be made available subject to operational availability.

2.3.2 Operator's Response

The Regulator has sought to differentiate the term "operational availability" from "availability of Capacity" in relation to gas transmission services.

Operator has a practical concern about not having the protection of an "operational availability" standard.

The issue of the distinction between Capacity and operational availability is a real one. Capacity is a theoretical term. It is determined by reference to fixing values for key assumptions such as gas quality, compressor unit availability and reliability, air temperature, MAOP of the pipeline etc. More importantly, if the Standard Shipper Contracts are to be used as the basis for establishing the terms and conditions for the reference service, then the Capacity is only going to be able to be changed in accordance with the provisions of the Standard Shipper Contract – this will essentially mean only after the pipeline is reconfigured. However, if the actual values of the key assumptions change but not as a result of the reconfiguration of the pipeline, then the Capacity of the pipeline will not be able to be reset.

Operational availability on the other hand, requires a practical assessment to be undertaken based on actual situations. For example, if there is a maintenance program that needs to be undertaken over a period but which was not assumed when determining the Capacity of the pipeline, Operator may be forced to make available a gas transmission service even though it is not operationally available.

For this reason, the amendment is unreasonable

Operator notes that following a review of the proposed access arrangement, section 6.2(a) of the access arrangement will need to use the terms "availability of Capacity" and "operational availability".

2.4 Amendment: 4

2.4.1 Amendment

The Services Policy of the Proposed Access Arrangement should be amended to include descriptions of all Non-Reference Services.

2.4.2 Operator's Response

Operator notes that these services are described in the access arrangement information document. Nonetheless, Operator will, subject to the outcome of the final decision to be released by the Regulator, incorporate this amendment in any revised access arrangement it files.

2.5 Amendment: 5 & 6

2.5.1 Amendment

Amendment 5

The Services Policy and Reference Tariff Policy of the Proposed Access Arrangement should be amended as necessary to include a Part Haul Service as a Reference Service. The Part Haul Service should be in the nature of the T1 Service to which the Standard Shipper Contract relates and should have a minimum contract term of 2 years when it is made available to a Prospective

User through the utilisation of Spare Capacity and 15 years when it is made available to a Prospective User through the utilisation of Developable Capacity.

Amendment 6

The Services Policy and Reference Tariff Policy of the Proposed Access Arrangement should be amended as necessary to include a Back Haul Service as a Reference Service. The Back Haul Service should be in the nature of the T1 Service to which the Standard Shipper Contract relates and should have a minimum contract term of 2 years when it is made available to a Prospective User through the utilisation of Spare Capacity and 15 years when it is made available to a Prospective User through the utilisation of Developable Capacity.

2.5.2 Operator's Response

There are several reasons why Operator will not incorporate these amendments in any amended revised access arrangement.

Not services likely to be sought by a significant part of the market

[deleted – confidential]

It is noted that the Regulator's power to require the inclusion of additional Reference Services in the proposed Access Arrangement is contained in section 3.3 of the Code. Section 3.3 provides

An Access Arrangement must include a Reference Tariff for:

(a) at least one Service that is likely to be sought by a significant part of the market; and

(b) each Service that is likely to be sought by a significant part of the market and for which the Relevant Regulator considers a Reference Tariff should be included.

The effect of paragraph (b) is that, in order to require the inclusion of a Service as a Reference Service, the Regulator must be satisfied that the Service "is likely to be sought by a significant part of the market". The Regulator concludes that this condition is satisfied in relation to both the Part Haul Service and the Back Haul Service in the Draft Decision.

[deleted – confidential]

In relation to Part Haul, the Regulator comments (at paragraph 93) that "DBNGPT has forecast quantities of gas delivery by Part Haul of about 41 TJ/day for the Access Arrangement Period". The Regulator then concludes in (paragraph 94) that it "is satisfied that a Part Haul Service is sought by a significant part of the market". In relation to Back Haul, the Regulator comments (at paragraph 98) that "DBNGPT has forecast quantities of gas delivery by Back Haul of up to 112 TJ/day for the Access Arrangement Period, which the Authority considers comprises a significant part of the market".

The approach taken by the Regulator raises the question whether, in assessing the likelihood of a Service being sought by a significant part of the market, regard should be had to the volume of contracted capacity or only to the likelihood of future access requests being received for uncontracted capacity during the Access Arrangement Period.

Operator submits that capacity which is contracted for the full term of the Access Arrangement Period should be disregarded in the assessment. The words used in section 3.3(b) of the Code are "...each Service that is likely to be sought by a significant part of the market". This language suggests a simple factual enquiry as to whether the relevant Service is or is not likely to be the subject of access requests from or in respect of a significant part of the market during the relevant

period. If capacity is already contracted for the full term of the Access Arrangement Period, then it cannot be said that the Service is likely to be sought in respect of that capacity. In order for the test to be satisfied, it would be necessary to demonstrate a likely requirement for further capacity either by those existing users or by other new users.

[deleted – confidential]

[deleted – confidential]

Minimum term

Operator submits that the proposed amendment is unreasonable in relation to the proposed minimum term, for the same reasons as outlined in connection with the Draft Decision Amendment 1 above.

2.6 Amendment: 13

2.6.1 Amendment

The Proposed Access Arrangement should be amended to include terms and conditions for the T1 Service (as a Reference Service) that are substantially the same as the terms and conditions set out in the Standard Shipper Contract, save as otherwise required by this Draft Decision.

2.6.2 Operator's Response

Operator is still preparing its response to this amendment and will provide it in a separate submission shortly. Although, it should be noted that because of Operator's response to amendment 1, it will not incorporate this amendment in any revised access arrangement it files.

2.7 Amendment: 14

2.7.1 Amendment

The Proposed Access Arrangement should be amended to include terms and conditions for the Part Haul Service and Back Haul Service (as Reference Services) that, to the extent applicable for these Services, are substantially the same as the terms and conditions set out in the Standard Shipper Contract, save as otherwise required by this Draft Decision.

2.7.2 Operator's Response

Operator is still preparing its response to this amendment and will provide it in a separate submission shortly.

2.8 Amendment: 15

2.8.1 Amendment

The Proposed Access Arrangement should be amended so that the terms and conditions for Reference Services include an Operating Specification for gas quality as follows and to apply from the time that the Proposed Access Arrangement comes into effect.

Component		Receipt Points and Delivery Points
Maximum carbon dioxide (mol %)		4.0
Maximum inert gases (mol %)		7.0
Minimum higher heating value (MJ/m^3)		37.0
Maximum higher heating value (MJ/m^3)		42.3
Minimum Wobbe Index		46.5
Maximum Wobbe Index		51.0
Maximum total sulphur (mg/m^3)	Unodorised	10
	Odorised	20
Maximum Hydrogen Sulphide (mg/m^3)		2
Maximum Oxygen (mol %)		0.2
Maximum Water (mg/m^3)		48
Hydrocarbon dewpoint over the pressure range 2.5 to 8.72 MPa absolute		Below 0 °C
Maximum radioactive components (Bq/m^3)		600
Minimum extractable LPGs (t/TJ)		0

2.8.2 Operator's Response

Operator's response to this amendment is to be the subject of a separate submission from Operator (submission 28).

2.9 Amendment: 16

2.9.1 Amendment

The Proposed Access Arrangement should be amended to include a Capacity Management Policy that indicates that the DBNGP is to be managed as a Contract Carriage Pipeline.

2.9.2 Operator's Response

Operator will, subject to the outcome of the final decision to be released by the Regulator, incorporate this amendment in any revised access arrangement it files.

2.10 Amendment: 17

2.10.1 Amendment

The Proposed Access Arrangement should be amended to include, as part of the Trading Policy, provisions that are substantially the same as provisions of clauses 14.1 – 14.9, 25.3 and 25.4 of the Standard Shipper Contract and these provisions should apply as a policy for the pipeline and for Services generally and not be limited in application to Reference Services.

2.10.2 Operator's Response

Operator will, subject to the outcome of the final decision to be released by the Regulator, incorporate this amendment in any revised access arrangement it files.

2.11 Amendment: 18

2.11.1 Amendment

Sub-clause 5.4(f) of the Proposed Access Arrangement should be amended so that the time limits for negotiation of terms or satisfaction of conditions set out in sub-clause 5.4(f) of the Proposed Access Arrangement should be expressly contingent upon both parties negotiating terms and conditions in good faith, and the timing suspended in the event that a dispute over terms and conditions of access is referred for arbitration under section 6 of the Code.

2.11.2 Operator's Response

Amending clause 5.4(f) of the Proposed Access Arrangement so that the time limits on negotiation are contingent on the parties negotiating terms and conditions in good faith has the potential to substantially detract from the benefits sought to be obtained from the time limits. Operator therefore considers this amendment to be unreasonable.

However, amending clause 5.4(f) of the Proposed Access Arrangement so that the time limits are suspended in the event that a dispute over terms and conditions of access is referred for arbitration under section 6 of the Code seems to be a reasonable change.

The principal purpose of including a time limit on negotiations in the Queuing Policy was to ensure, as far as possible, that the queue at any point in time included only genuine access requests which had a reasonable prospect of maturing into an access contract. This is in the interests both of Operator and of prospective users, given that a prior access request that remains in the queue for an extended period creates uncertainty about the Operator's ability to deal with later requests. While the requirement that, for the time limit to apply, the parties must be negotiating in good faith appears reasonable in principle, the difficulty is that the concept of good faith in a negotiation is relatively vague. As a result, it can be expected that prospective users will assert that the Service Provider is not negotiating in good faith and that any purported removal of an access request from the queue is invalid. This will result in uncertainty (for Operator and other prospective users) about the status of the queue.

A preferable approach would be to require the parties to resort to the arbitration process if they are unable to reach agreement within the proposed time limits and the prospective user wishes to

maintain its place in the queue. This provides a high degree of certainty about the status of the queue for all parties, as well as an effective remedy if either party is not negotiating in good faith.

2.12 Amendment: 19

2.12.1 Amendment

Clause 12.1 of the Proposed Access Arrangement should be amended so that the Revisions Submission Date is 1 April 2010.

2.12.2 Operator's Response

Operator notes that during this process, the Regulator has consistently attempted to rely on its statutory obligations to assess an access arrangement within the required 6 month period, as a basis for not extending aspects of the approvals process.

In an age of user pays and where significant costs have been passed on to Operator under the funding regime, Operator would be keen to ensure that any extended period for assessment does not lead to additional charges. Accordingly, it would be agreeable to the proposal if the Regulator were agreeable to some form of incentive mechanism which minimises costs.

2.13 Amendment: 20

2.13.1 Amendment

Section 2.7 of the Proposed Access Arrangement, relating to revision of the Proposed Access Arrangement pursuant to a decision by the Gas Review Board, should be deleted.

2.13.2 Operator's Response

Operator will, subject to the outcome of the final decision to be released by the Regulator, incorporate this amendment in any revised access arrangement it files.

2.14 Amendment: 21

2.14.1 Amendment

Clauses 4.1 and 4.2 of the Proposed Access Arrangement should be amended to make it clear that the revisions to the Access Arrangement will have effect on the later of the date of approval of the revisions by the Authority or 1 July 2005.

2.14.2 Operator's Response

Operator will, subject to the outcome of the final decision to be released by the Regulator, incorporate this amendment in any revised access arrangement it files.

2.15 Amendment: 22

2.15.1 Amendment

The Proposed Access Arrangement should be amended to remove clauses 5.1 to 5.3.

2.15.2 Operator's Response

The Regulator appears to have proceeded on the assumption that these clauses did not form part of the Operator's queuing policy. This is incorrect.

The queuing policy is required to determine the priority that a prospective user has, against other suers, to obtain access to Spare and Developable Capacity where the provision of the service sought by the prospective user may impede the ability of the Service Provider to provide a service that is sought or which may be sought by another Prospective User. Clauses 5.1 to 5.3 were part of such a policy.

To remove it from the access arrangement will potentially lead to confusion with shippers.

It should be noted that if this amendment were to be included in the access arrangement, the following changes will need to be made to the proposed Queuing Policy:

"Access Request" will need to be re-defined (perhaps by reference to section 5.4 of the Code);

Clauses 5.4(d) and (e) will need to be amended, and consideration will need to be had as to the grounds (if any) upon which a request can be evaluated before being placed in the queue. Similar considerations will apply to the operation of clause 5.4(j), although it does not expressly cross-refer to clause 5.2;

Clause 5.4(k) will need to be amended by the removal of the cross-reference to clause 5.2(f), and consideration will need to be had as to whether there will be a process set out for amending access requests; and

The definitions for "Prescribed Fee", "Spot Market Rules" and "Spot Transaction Terms and Conditions" in clause 13 of the Proposed Access Arrangement will need to be deleted as they were only used in clauses 5.1 to 5.3. In this regard, however, we refer to our comments in respect of Amendment No. 2 above.

There appear to be two approaches to this issue: DBNGPT could either amend clause 5.4 or could include aspects of the process currently set out in clauses 5.1 to 5.3 in the Information Package. However, the issues raised by Western Power in relation to clauses 5.1 to 5.3 (in particular, those with which the Regulator appears to concur) would still need to be considered in respect of either approach.

3. INITIAL RESPONSE TO TARIFF-RELATED AMENDMENTS FROM DRAFT DECISION

3.1. This section of the Submission sets out Operator's initial response to some of the tariff related amendments to the draft Decision. It should be noted that:

(a) A further submission will be provided in respect of all of the tariff related amendments by 2 June 2005;

(b) Some of the information in this submission may be superseded as a result of the Operator's analysis of the impact of the proposed change to the gas quality specification.

3.2 Amendment: 7

3.2.1 Amendment

The proposed Access Arrangement should be amended to include in the Reference Tariff Policy a redundant capital mechanism that provides for the disposal value of any compression assets made redundant during the next Access Arrangement Period to be removed from the value of the Capital Base at the commencement of the ensuing Access Arrangement Period.

3.2.2 Operator's Response

On the basis of information provided by a user, the Regulator has determined that the Reference Tariff Policy of the DBNGP Access Arrangement be amended to include a redundant capital mechanism which would permit the disposal value of any compression assets made redundant during the next Access Arrangement Period to be removed from the Capital Base at the commencement of the following Access Arrangement Period.

According to paragraph 189 of the Draft Decision, such a mechanism is necessary given the potentially significant disposal value of compressor assets to be disposed of during the next Access Arrangement Period.

Operator notes that the capital redundancy provisions of the Code have the effect of:

1. removing from the Capital Base the value of assets which cease to contribute to the provision of service;
2. share costs associated with the decline in the level of service provision between the Service Provider and Users; and
3. permit the return of the value of the assets in question to the Capital Base if, at some later time, they once more contribute to the provision of service.

The redundant capital provisions – sections 8.27 to 8.29 – have the effect only of removing from the Capital Base an amount for redundant capital equal to the value ascribed to those assets in the Capital Base at the time they become redundant. They do not contemplate the disposal of redundant assets. Indeed, they deal explicitly with the possibility that redundant capital may be returned to the Capital Base at a later date. In consequence, a service provider cannot impose on users an additional cost where assets made redundant are disposed of at a loss.

There is, moreover, an obvious symmetry in the operation of the redundant capital provisions. A service provider cannot impose on users the cost of disposal at a loss. Nor must any profit be

taken into account in determining the total revenue and reference tariff in the event that disposal is at a profit to the service provider.

Accordingly, the Regulator's rationale for requiring Amendment 7 does not have any basis in the Code.

Nor does it have relevance in the specific circumstances of the DBNGP.

The only compressors on the DBNGP which might be made redundant and disposed of in the planned expansion of pipeline capacity are five GE LM500 4 MW compressor units. These units were installed during the 1980s. They are now about two-thirds of the way through their economic lives. Furthermore, their drivers are light-weight gas turbines originally designed for aviation applications. They are not of a type now used on gas transmission pipelines, and are expected to have little or no disposal value.

More importantly though, as part of its expansion program, Operator is intending to install more powerful (10 MW) compressor units at each of the compressor stations at which it has an LM500 unit. The LM 500 units are not, however, to be removed from service. They are to be retained in fully operational state to maintain the reliability of the transportation service provided by the DBNGP and to ensure that Operator is able to maintain contracted capacity.

With capacity expansion forecast to occur throughout the next Access Arrangement Period, and with retention of the LM500 units to maintain system reliability, there is no requirement for an amendment to the Access Arrangement to include a redundant capital mechanism to deal with the disposal of compression assets.

Even if the redundancy of compression assets were in prospect – and it is not – a redundant capital mechanism could do no more than remove the written down value of redundant assets from the Capital Base. It could not, as Amendment 7 seems to require, take into account the disposal value of compressors removed from the Capital Base.

Operator therefore, does not intend on complying with Amendment 7. Through the explanation provided in this submission, Operator has sought to otherwise address the reasons for the Amendment.

3.3 Amendment: 8

3.3.1 Amendment

Amendment 8 of the Draft Decision requires a number of very specific changes to the costs used in determining the reference tariff for the next Access Arrangement Period, and consequential changes to the reference tariff proposed by Operator.

The reference tariff is to reflect:

1. a Capital Base at 1 January 2005 of $1,619.77 million;
2. new facilities investment totaling $909.06 million for the period 2005 to 2010;
3. a pre-tax real rate of return of 7.24%;
4. depreciation totaling $329.91 million; and
5. non capital costs amounting, in total to, $419.53 million.

(All values are expressed as real values at December 2004.)

3.3.2 Operator's Response

Operator's initial response to each of these requirements is addressed in the following paragraphs of this submission.

1. Capital base at 1 January 2005 of $1,619.77 million

Operator has two principal concerns with the Regulator's requirement that the Capital Base be set at $1,619.77 million at 1 January 2005. These are:

1. the Regulator's conclusion, at paragraph 135 of the Draft Decision, in respect of the depreciation applied to determine the Capital Base at 1 January 2005, is only partially correct;
2. the Regulator's approach to determining the Capital Base at 1 January 2005 is not compliant with the Code because it does not roll in to the Capital Base the actual new facilities investment during the period 2000 to 2004.

Regulator's conclusion in respect of depreciation is only partially correct

Paragraph 135 of the Draft Decision indicates that there are two discrepancies with the requirements of the Code in respect of the way in which Operator has sought to determine depreciation for the purpose of determining the Capital Base at 1 January 2005. These are:

1. in determining the depreciation of the initial Capital Base for the period 2000 to 2004, Operator has used remaining asset lives for compression and metering assets which were different from those used in the calculation of the (current) reference tariff; and
2. Operator has calculated depreciation of new facilities investment in the period 2000 to 2004 on the basis of actual new facilities investment, rather than applying the value of depreciation calculated on the basis of forecast new facilities investment for the period and taken into account in the determination of the reference tariff.

When the initial Capital Base of the DBNGP was established, compression assets were disaggregated into the assets at each of the 10 compressor stations on the pipeline, and metering assets were disaggregated by some 40 individual meter station. This disaggregation made depreciation calculations somewhat tedious, and Operator sought to simplify the depreciation calculations required for roll forward of the Capital Base, and for the determination of the reference tariff for the next access arrangement period, by applying a single weighted average asset life to the aggregate asset value for compression assets, and to the aggregate asset value for metering assets.

Operator now acknowledges that this procedure has the effect of changing the remaining asset lives from those established in the Final Decision leading to the DBNGP Access Arrangement. To maintain consistency, and eliminate error, operator has reverted to calculating depreciation of the initial Capital Base by individual compressor station, and by individual meter station, using the remaining asset lives established in with the Final Decision.

Operator has then calculated depreciation for the period 2000 to 2004 on the basis of actual new facilities investment.

Operator can find no basis in the Code for the approach taken by the Regulator, in which the value of depreciation is calculated on the basis of forecast new facilities investment for the period 2000 to 2004, and taken into account in the determination of the reference tariff. Nor can Operator find reasoning supporting the Regulator's approach, either in terms of Code requirements, or otherwise, in the Draft Decision.

Regulator has not rolled in actual new facilities investment

At paragraph 126 of the Draft Decision, the Authority advises that it does not consider that all of the costs relating to the Stage 3A expansion should be rolled in to the Capital Base.

The costs in question were costs incurred during the period 2000 to 2004.

The Authority has argued that, in the Draft and Final Decisions on the Access Arrangement proposed in December 1999, the view was taken that forecast new facilities investment associated with the Stage 3A expansion of the DBNGP should be incorporated into the initial Capital Base, and should not be considered as forecast capital costs in 2000.

The Authority's treatment of the Stage 3A costs is:

1. inconsistent with the requirements of the Code; and
2. inconsistent with the way in which the Regulator sought to establish the initial Capital Base for the DBNGP.

The Code provides no basis for the treatment of Stage 3A costs incurred after 2000 as part of an initial Capital Base established at 1 January 2000.

The Stage 3A costs in question had not, as at 1 January 2000, been incurred, and could not, therefore, be considered in establishing a value of the pipeline based on costs.

The Stage 3A costs are clearly new facilities investment in accordance with section 8.15 of the Code. They must be treated as such, irrespective of any belief by the Regulator that they may have, in some way, been taken into account in an initial Capital Base established at a date prior to the time at which the costs were incurred.

In paragraph 510 of the Final Decision on the Access Arrangement proposed in December 1999, the Regulator advises that, for the purpose of establishing the initial Capital Base, a significant consideration is a value consistent with a full-haul tariff of $1.00/GJ at 31 December 1999, given weight by actions of government during and after the 1997-98 pipeline sale process.

The Regulator notes at paragraph 513 that, in order to undertake the calculation of an Initial Capital Base value from this notional revenue it is necessary to assign values to the other cost-of-service parameters for new facilities investment, rate of return and non capital costs. The values assigned were those the Regulator considered should be adopted for the Access Arrangement to conform to the requirements of the Code. Using these values and a straight-line depreciation of the Capital Base according to asset lives as indicated in paragraph 343 of the Final Decision, and apportioning of the value of the Initial Capital Base across asset classes is in the same proportions as for Epic Energy's proposed initial Capital Base, the Regulator estimated that a value of the initial Capital Base consistent with the notional revenue and these other cost parameters would be in the order of $1,525 million.

The details of the calculations made by the Regulator were not made available to Operator.

Presumably, where it was appropriate to do so, the Regulator correctly applied the Code in making these calculations. The magnitude and timing of capital expenditure forecast for the period 2000 to 2004 would have been correctly taken into account in deriving a value of $1,525 million at 31 December 1999 from the notional revenue at a full-haul tariff of $1.00/GJ in the manner described in the Final Decision.

A value of $1,550 million was finally established as the initial Capital Base for the DBNGP, taking into account the circumstances of Epic Energy's purchase of the pipeline, the merits of a value close to DORC, and the interests of Users (paragraph 514 of the Final Decision).

Although other factors were taken into account, paragraphs 510 to 514 of the Final Decision indicate the importance of the derivation of the value of $1,525 million in the Regulator's thinking leading to establishment of the initial Capital Base.

Paragraph 514 indicates that the initial Capital Base of $1,550 million, as at 31 December 1999, includes the value of capital costs associated with Stage 3A. Consistent with the requirements of the Code, this must mean – and Operator has understood it to mean – that new facilities investment associated with Stage 3A during the period 2000 to 2004 was properly taken into account in arriving at the initial Capital Base. That is, in establishing the value of $1,550 million, the Regulator correctly recognized that new facilities investment of some $20 million was required for completion of Stage 3A during the period 2000 to 2004. That investment was necessary to allow transportation of the gas volumes forecast for the period 2000 to 2004, and was a necessary assumption in Regulator's method of establishing asset value from the notional revenue stream based on a full-haul tariff of $1.00/GJ.

The actual costs of the final work on Stage 3A – construction and commissioning of compressors at CS2 and CS7, and final work on CS10 – are clearly actual new facilities investment. The costs had not been incurred by 31 December 1999, the date at which the initial Capital Base was established. They were incurred during the period 2000 to 2004, the first access arrangement period for the DBNGP. Accordingly, the owners of the pipeline should not be arbitrarily deprived of the full value of the Stage 3A investment, and the actual costs during the period 2000 to 2004 should now be rolled in to the Capital Base.

Capital base at 1 January 2005

The combined effects of the depreciation of compression and metering assets over the remaining lives established by the Final Decision leading to the (current) Access Arrangement, correct recognition of the actual new facilities investment during the period 2000 to 2004, and depreciation of that actual new facilities investment during the period are shown in the following table.

Roll forward of the Capital Base (real $ million, 31-Dec-2004)

	2000	2001	2002	2003	2004
Capital base					
Pipeline	1,491.14	1,465.33	1,438.00	1,410.69	1,383.32
Compression	249.80	257.83	246.48	233.62	220.37
Metering	20.49	20.58	20.63	20.46	19.89
Other (depreciable)	56.26	58.61	56.55	53.60	50.59
Other (non depreciable)	12.09	12.09	12.09	12.09	12.09
	1,829.77	1,814.44	1,773.75	1,730.47	1,686.25
New facilities investment					
Pipeline	1.55	0.03	0.07	0.00	0.62
Compression	20.78	1.44	0.09	-0.12	0.18
Metering	0.64	0.58	0.38	-0.03	1.67
Other (depreciable)	5.69	1.48	0.79	0.94	0.90
Other (non depreciable)	0.00	0.00	0.00	0.00	0.00
	28.65	3.54	1.32	0.79	3.38
Depreciation					
Pipeline	27.36	27.37	27.37	27.38	27.38
Compression	12.74	12.78	12.95	13.13	13.20
Metering	0.54	0.54	0.54	0.54	0.54
Other (depreciable)	3.34	3.54	3.74	3.96	4.15
	43.98	44.23	44.60	45.01	45.27
End of year asset value					
Pipeline	1,465.33	1,438.00	1,410.69	1,383.32	1,356.56
Compression	257.83	246.48	233.62	220.37	207.36
Metering	20.58	20.63	20.46	19.89	21.02
Other (depreciable)	58.61	56.55	53.60	50.59	47.34
Other (non depreciable)	12.09	12.09	12.09	12.09	12.09
	1,814.44	1,773.75	1,730.47	1,686.25	1,644.36

2. New facilities investment 2005-2010

Operator's new facilities investment for the period 2005 to 2010 has been revised:

1. to include the capital program approved by Operator's board of directors for the major expansion of pipeline capacity to be undertaken during the next access arrangement period; and
2. to correct for the discrepancy in stay-in-business new facilities investment noted by the Regulator in paragraph 166 of the Draft Decision.

The expansion capital program for 2005 to 2010, the initial stage of which has now been approved by Operator's board, is the subject of a separate submission to the Regulator.

In paragraph 166 of the Draft Decision, the Regulator noted that the total stay-in-business new facilities investment, determined by summing the planned expenditures for the individual items listed in Tables 2a and 2b of Annexure 2 of the Amended Proposed Revised Access Arrangement Information, was less that the total expenditure shown at the bottom of Table 2b. The difference, over the period from 2005 to 2010, was about $1.76 million.

Operator has reviewed the individual items of stay-in-business new facilities investment listed in Tables 2a and 2b of Annexure 2 and has found:

1. expenditure on IT infrastructure has been understated in 2005 and 2006 by amounts of $0.105 million and $0.108 million, respectively.
2. a line item – Security Upgrades – has been omitted entirely from Table 2b and from the justification which follows

The understatement of expenditures on IT infrastructure appears to have been the result of errors in totaling planned expenditures on application systems upgrades in 2005 and 2006.

The omission of Security Upgrades is a more significant matter. Operator's facilities are either in remote locations or, in the case of facilities in the South West (in particular, meter stations), are away from built-up areas and generally "out-of-sight". Operator has now experienced "break-ins" at a number of meter station sites, which have resulted in either or both of damage to facilities and removal of computers and electronic equipment.

This is a major concern, not only because equipment has been damaged or stolen. Individuals removing or damaging equipment:

1. place themselves in considerable personal danger; and
2. may inadvertently cause disruption to gas supplies.

Furthermore, although all facilities are fenced and locked, the break-ins indicate that determined individuals can access what were regarded as reasonably secure facilities when they were built during the 1980s. This is an important issue both for Operator, and the wider community, with recent recognition that infrastructure facilities are potential targets for terrorist activity.

Operator has therefore included in the stay-in-business component of its new facilities investment for the period 2005 to 2010 the following amounts for the upgrading of security at its facilities:

Stay-in-business CAPEX (nominal, $ million)

	2005	2006	2007	2008	2009	2010
Security upgrades	0.526	0.270	0.221	0.057	0.000	0.477

The total amount to be spent ($1.551 million) represents expenditure of approximately $50,000 on security at each of some 30 sites downstream of CS9.

The investment is, in the Operator's view investment that would be undertaken by a prudent pipeline operator. It is necessary to maintain the safety, integrity and Contracted Capacity of the Services, and therefore meets the requirements of section 8.16(a)(ii)(C) of the Code.

Operator submits that the Regulator now accept correction of the errors in forecast new facilities investment in IT infrastructure, and allow the planned expenditures on the omitted line item, Security Upgrades, which should have been included as a third entry under Buildings and Grounds in Table 2b of Annexure 2 of the Amended Proposed Revised Access Arrangement Information.

If these changes are adopted, the total forecast Stay-in-Business CAPEX should be as shown in Table 2b of Annexure 2.

3. Pre-tax real rate of return

Operator notes that the Regulator has accepted the proposed rate of return submitted by it although does not accept the values of some of the inputs in the CAPM formula used by Operator. While Operator does not agree with the Regulator's reasoning for disagreeing with the values of some of these inputs, given that the proposed rate of return has been accepted, Operator does not intend making submissions in respect of the Regulator's reasons.

This lack of response should therefore not be taken as acquiescence by Operator to the Regulator's reasons.

4. Depreciation

As noted in the discussion of the Capital Base above, the use of weighted average lives for compression and metering assets existing at 1 January 2000 results in incorrect depreciation estimates for the period 2000 to 2004, and Operator has reverted to calculating depreciation of the initial Capital Base by individual compressor station, and by individual meter station, using the remaining asset lives established in with the Final Decision. To generate the correct depreciation estimates for the period 2005 to 2010, the individual remaining asset lives must again be applied. To use the weighted average lives, as the Regulator appears to have done, has the effect of changing the asset lives, going forward, in the way the Regulator objected to in respect of Operator's calculation of depreciation for the period 2000 to 2004.

In consequence, the requirement of Amendment 8, that determination of the reference tariff for the next access arrangement period reflect depreciation totaling $329.91 million is inappropriate. The depreciation used in the determination of the reference tariff for the next access arrangement period should now reflect:

1. the roll forward of the Capital Base, as discussed above, resulting in a Capital Base at 1 January 2005 of $1,644.36 million (real, 31-Dec-2004);
2. the remaining asset lives for the individual compression and metering assets comprising the initial Capital Base;
3. the forecast of new facilities investment for the period 2005 to 2010, the initial stage of which has now been approved by Operator's board; and
4. correction of some minor errors in the Regulator's depreciation calculations.

Operator's estimate of depreciation for the period 2005 to 2010 which reflects these changes is shown in the following table.

Roll forward of the Capital Base during access arrangement period (real $ million, 31-Dec-2004)

	2005	2006	2007	2008	2009	2010
Capital base						
Pipeline	1,356.56	1,329.66	1,302.26	1,526.37	1,767.07	1,813.82
Compression	207.36	193.74	245.79	344.99	365.35	344.39
Metering	21.02	20.41	19.80	19.19	18.58	17.97
Other (depreciable)	47.34	56.50	65.67	67.90	71.25	75.05
Other (non depreciable)	12.09	12.09	12.09	12.09	12.09	12.09
	1,644.36	1,612.40	1,645.61	1,970.53	2,234.34	2,263.31
New facilities investment						
Pipeline	0.50	0.00	251.51	271.70	81.62	143.26
Compression	0.00	65.66	115.00	40.00	0.00	0.00
Metering	0.00	0.00	0.00	0.00	0.00	0.00
Other (depreciable)	12.81	13.25	6.74	8.10	8.81	7.93
Other (non depreciable)	0.00	0.00	0.00	0.00	0.00	0.00
	13.31	78.90	373.25	319.80	90.44	151.19
Depreciation						
Pipeline	27.39	27.40	27.40	30.99	34.88	36.04
Compression	13.61	13.61	15.80	19.63	20.97	20.97
Metering	0.61	0.61	0.61	0.61	0.61	0.61
Other (depreciable)	3.65	4.08	4.52	4.74	5.01	5.31
	45.27	45.70	48.33	55.98	61.47	62.93
End of year asset value						
Pipeline	1,329.66	1,302.26	1,526.37	1,767.07	1,813.82	1,921.04
Compression	193.74	245.79	344.99	365.35	344.39	323.42
Metering	20.41	19.80	19.19	18.58	17.97	17.35
Other (depreciable)	56.50	65.67	67.90	71.25	75.05	77.67
Other (non depreciable)	12.09	12.09	12.09	12.09	12.09	12.09
	1,612.40	1,645.61	1,970.53	2,234.34	2,263.31	2,351.57

5. Non capital costs

This will be the subject of a separate submission to be provided shortly

3.4 Amendment: 11

3.4.1 Amendment

Amendment 11 requires that the Reference Tariff Policy of the Access Arrangement be amended, by modification of clause 7.3 of the Proposed Access Arrangement, to distinguish between:

1. determination of the Capital Base at the commencement of the each access arrangement period, by reference to the actual new facilities investment that meets the requirements of section 8.16 of the Code; and

2. estimation of the Capital Base in the forthcoming access arrangement period, taking into account forecast new facilities investment, for the purpose of determining the reference tariff in accordance with section 8.20 of the Code.

3.4.2 Operator's Response

Operator proposes the following amendment to clause 7.3:

7.3 Calculation of Capital Base

(i) The Initial Capital Base at 1 January 2000 was $1,550.00 million.

(ii) For each year after 2000, and until 1 January 2005, the Capital Base for the DBNGP at the beginning of the year was:

(A) the Capital Base at the beginning of the immediately preceding year; plus

(B) actual New Facilities Investment during the preceding year; less

(C) depreciation for the preceding year.

(iii) The calculation of the Capital Base was undertaken in real terms with all values expressed at 31 December 2004 prices.

(iv) The Reference Tariff for the Access Arrangement Period is determined on the basis of New Facilities Investment that is forecast to occur within the Access Arrangement Period.

3.5 Amendment: 12

3.5.1 Amendment

Amendment 12 requires Operator to delete sections 7.13(a)(ii) and 7.6(d) from the Proposed Access Arrangement.

3.5.2 Operator's Response

Operator included a number of fixed principles in section 7.13 of the Proposed Revised Access Arrangement which it submitted to the Regulator on 21 January 2005. One of these fixed principles sought to provide Operator with some certainty as to the rate of return to be used in future reference tariff determinations.

Section 7.13(a)(ii) of the Proposed Revised Access Arrangement set, as a fixed principle, the method of determination of the rate of return as set out in sections 7.5 and 7.6 of the Access Arrangement, and the elements used in the determination as set out in section 7.6(d) of the Access Arrangement.

Amendment 12 requires Operator to delete sections 7.13(a)(ii) and 7.6(d) from the Proposed Access Arrangement.

This is unreasonable for reasons clearly recognised by the Regulator in its arguments supporting Amendment 12.

At paragraph 371 of the Draft Decision, the Regulator states that it is satisfied that "*both the methodology used by DBNGPT in determining the Rate of Return, and the CAPM parameters proposed by DBNGPT as Fixed Principles, meet the definition of Structural Elements*". That is, Operator's methods and capital asset pricing model parameters meet the primary test of the Code for their being fixed principles.

The Regulator has, however, reasoned that, although Operator's methods and parameters meet the test of the Code, and making them fixed principles would provide Operator with certainty in future access arrangement periods, this would be contrary to the interests of users and prospective users.

The Regulator argues that rate of return values approved by regulators under the Code (and other similar regulatory regimes) are currently a matter of substantial debate. As the Regulator notes in paragraph 372 of the Draft Decision, while approved access arrangements have embodied rates of return in excess of values that may be justified by strict adherence to evidence from capital markets, it is possible that future considerations of methodologies for determining rates of return will allow a refinement of regulatory practice.

Clearly, the Regulator anticipates "refinement of regulatory practice" will lead to lower rates of return.

It is not at all clear that this will be the case.

The substantial debate over rate of return has been initiated, not by regulators, but by infrastructure service providers concerned that regulatory rates of return are too low, and do not provide adequate incentives for new investment.

In this respect, Operator takes issue with the Regulator's statement that approved access arrangements have embodied rates of return in excess of values that may be justified by strict adherence to evidence from capital markets. No direct capital market evidence has been provided by the Regulator, or by regulators in other jurisdictions, which supports the Regulator's contention. Indeed, it is doubtful that such evidence could be provided. The Regulator has, like others, simply relied on the Capital Asset Pricing Model – a conceptually inadequate model of limited empirical validity – and on limited empirical evidence supporting parameter values (in particular, supporting the value of imputation credits) to provide a measure of rate of return.

Operator acknowledges that the Capital Asset Pricing Model is widely used, and it has used the model in establishing its proposed rate of return. Operator and others using the model (especially those concerned with the valuation of assets) are, however, well aware of its limitations.

Operator would remind the Regulator of the debate which took place over access to the Dalrymple Bay coal handling facilities in Queensland, in particular as it related to rate of return.

There is, at the present time, at least as great a likelihood of rates of return on regulated infrastructure assets rising in the future as asset pricing methods are refined, and better evidence is brought forward, as there is of rates of return falling for the same reasons.

Operator maintains that its requirement for future certainty protects its own position and, in the medium term, protects users and prospective users against the likelihood of increases in the rate of return as methods are refined and further evidence is brought forward.

In these circumstances, Amendment 12 is inappropriate. Sections 7.6(d) and 7.13(a)(ii) of the Proposed Access Arrangement should be retained.

4. DELETED - CONFIDENTIAL

[deleted – confidential]