ALINTAGAS'S FOURTH SUBMISSION TO THE REGULATOR ON EPIC ENERGY'S DBNGP ACCESS ARRANGEMENT

ISSUES RELATED TO ADDITIONAL SUBMISSIONS

Submission dated 19 May 2000

1. OVERVIEW

AlintaGas's first submission addressed the need for Epic Energy to provide depreciated actual cost (**"DAC"**) and depreciated optimised replacement cost (**"DORC"**) valuations of the Dampier to Bunbury Natural Gas Pipeline (**"DBNGP"**).

In its second submission, AlintaGas addressed the need for the Regulator to require Epic Energy to provide a Reference Service equivalent to the T1 service that Epic Energy currently provides to users[1].

AlintaGas's third submission addressed, among other things, the initial Capital Base and the rate of return proposed by Epic Energy.

This fourth submission addresses issues raised in two submissions released recently by the Regulator. The submissions are:

(i) "Proposed Access Arrangement submission under the National Access Code", public version dated 28 February 2000, by Epic Energy (the "**Epic Energy Submission**"); and

(ii) "Proposed Regulatory Model for the Dampier to Bunbury Natural Gas Pipeline", dated October 1999, prepared for Epic Energy by Paul Carpenter and Carlos Lapuerta of the Brattle Group (the "**Brattle Submission**").

The main issues addressed in this fourth submission are:

- Epic Energy's assertion that it has a "regulatory compact", which AlintaGas submits does not, and never did, exist;
- AlintaGas submits that at the time of Epic Energy's bid for the DBNGP, Epic Energy was aware it would be required to prepare an Access Arrangement complying with the National Access Code and have that Access Arrangement approved by an independent regulator;
- Epic Energy's proposed deferred recovery account, which AlintaGas submits is inappropriate and is incapable of being approved by the Regulator, is not a concept accepted by regulatory authorities for established pipelines; and
- AlintaGas submits that the tariff and initial Capital Base proposed by Epic Energy are excessive and will impose an unacceptable burden on users during the current Access Arrangement period and in subsequent Access Arrangement periods.

[1] For consistency with the National Access Code, in this Submission AlintaGas uses the term "users" to refer to those previously referred to by the *Gas Transmission Regulations 1994* and *Dampier to Bunbury Pipeline Regulations 1998* as "shippers".

2. THERE WAS AND IS NO REGULATORY COMPACT

A recurring theme in the Epic Energy Submission and in Epic Energy's proposed Access Arrangement is that there was some form of "regulatory compact" between Epic Energy and either or both of AlintaGas and the State, under which:

(a) Epic Energy "committed" to headline tariffs of $1.00 per GJ to Kwinana Junction and $1.08 per GJ beyond; and

(b) either or both of AlintaGas and the State agreed to accept such tariffs and to permit Epic Energy to use its purchase price for the DBNGP as the initial regulatory capital base.

There was and is no such compact or related agreement. Specifically:

(i) AlintaGas did not agree to accept headline tariffs of $1.00 per GJ and $1.08 per GJ or any other headline tariffs; and

(ii) AlintaGas did not agree to allow Epic Energy to use the DBNGP purchase price as the initial Capital Base in determining tariffs under the National Access Code, or any other Capital Base.

AlintaGas is also aware that the State made no such agreements and had no such understandings with Epic Energy.

AlintaGas wishes to confirm that the DBNGP sale was achieved by a contract between various Epic Energy entities (as buyer) and AlintaGas (as seller). Although the State, as owner of AlintaGas, was naturally closely interested in the sale, some statements in the Epic Energy Submission risk misleading the Regulator by suggesting that AlintaGas effectively had no part in the transaction. That was not the case.

2.1 The concept of a "regulatory compact"

On page 14 of the Epic Energy Submission, Epic Energy claims that:

> "US regulatory thinking has, since 1976, used the more specific, if less legally accurate term, "regulatory contract". This term has not been used in Australia. Australian regulatory debates still appear to be conducted within the confined framework of normative analysis as positive economic theory."

Epic Energy implies that the type of "regulatory compact" that it claims to have in place with the State is an accepted concept in the United States. This does not accord with AlintaGas's understanding of the term "regulatory compact".

AlintaGas has been advised that the concept of a regulatory compact, as it applies in the United States, is one in which the public and a utility have rights and obligations towards each other.

The utility has an obligation to provide a service and to develop its assets in a way that guarantees reliability whilst providing a low-cost service in the future. The utility has a right to recover all the costs of providing that service, including a fair return on its investment.

The public has a right to obtain a service on demand and at a fair price. The public has an obligation to have procedures in place by which the utility's cost of service can be analysed and to have rates set that enables the utility to recover its fair cost of service.

More simply put, the "regulatory compact" provides a utility with an opportunity to recover its costs of providing a service in return for operating as a monopoly with the attendant obligations to provide a service at a fair price.

Regulation of monopoly gas assets in the United States is focused on providing for the recovery of the original capital cost of the assets and does not allow for an increase in the initial Capital Base by incorporating the purchase premium following the acquisition of an existing asset.

AlintaGas has been advised that in the United States, a regulator is generally only permitted to deviate from the application of accepted regulatory principles if the regulator is presented with some form of "negotiated settlement". In such a situation, the negotiated settlement must be clearly supported and agreed by all parties which may be affected. The "regulatory compact" suggested by Epic Energy clearly does not satisfy such requirements.

AlintaGas suggests that a "regulatory compact", as envisaged within United States' jurisdictions, is simply the process embodied by application of the National Access Code. AlintaGas submits that the Regulator should ignore any inference by Epic Energy that a "regulatory compact", as Epic Energy utilises the term, is accepted practice in the United States. In any event the practice in the United States is irrelevant in the context of the National Access Code, which Epic Energy knew was to be applied to the DBNGP at the time Epic Energy purchased the DBNGP, as will be demonstrated in this Submission.

2.2 Epic Energy's particular "regulatory compact"

In Epic Energy's proposed Access Arrangement Information, Epic Energy states, at clause 2.1(a):

> "The *form and level of the Reference Tariff for Firm Service was determined in the process through which Epic Energy acquired the DBNGP* … [which was] … a multistage competitive bidding process structured and executed by the Government of Western Australia ("State") to achieve a number of public policy outcomes. *Those outcomes included the State securing a high purchase price for the DBNGP whilst delivering lower transmission tariffs to shippers.*
>
> Epic Energy's successful bid for the DBNGP of $2.407 billion was considered by the State superior to any other bid and *was consistent with the State's proposed price path for transmission tariffs*." (italics added)

Further, at clause 2.5, Epic Energy states:

> "… Epic Energy gave a *commitment* to lowering gas transmission tariffs to $1.00 /GJ to Kwinana Junction, and $1.08 /GJ for gas transportation to delivery points downstream of Kwinana Junction.
>
> These were the tariffs the Government of Western Australia *sought as outcomes* of the pipeline sale process.
>
> …

> To satisfy its *commitment* to the Government of Western Australia at the time of the sale of the DBNGP, Epic Energy has made pro rata adjustments to the tariffs determined from its forecast total cost of providing services using the pipeline." (italics added)

The passages state or imply a number of things, which AlintaGas wishes to refute, as discussed below.

2.2.1 Neither AlintaGas nor the State has agreed to Epic Energy's tariff proposals

The passages state or imply that there were commitments given by Epic Energy to the State or AlintaGas or both of them, regarding the tariff path to apply after the DBNGP sale. The expressed or implied corollary to this is that this supposed undertaking by Epic Energy was part of the value obtained by AlintaGas or the State as a result of the DBNGP sale, and hence was reflected in Epic Energy's purchase price. Epic Energy seeks, presumably, to imply that the State and AlintaGas have thus somehow agreed in advance that Epic Energy may use its purchase price as the initial Capital Base in determining tariffs under section 8 of the National Access Code.

AlintaGas is unaware of any agreement between Epic Energy and either (or both of) the State or AlintaGas regarding future tariff paths or regarding the value of the capital base Epic Energy would use for tariff setting under the National Access Code.

AlintaGas has indicated in its second submission the extent of Epic Energy's representations to AlintaGas during the DBNGP sale, in relation to future tariff paths. Those representations did not amount to an undertaking by Epic Energy to charge certain tariffs, or to an agreement by AlintaGas to accept such tariffs or to accept a Capital Base derived from the purchase price.

Epic Energy states in the Epic Energy Submission that:

> "Epic Energy *gave … warranties* concerning its proposed gas transmission tariffs and future tariff path." (italics added)

Epic Energy appears to acknowledge that it has provided a warranty that it is prepared to implement the rates detailed in Schedule 39 for the services provided for in the Schedule. In fact, this overstates the warranty given by Epic Energy, which was merely that those were the tariffs it then proposed to implement, and further that it could make an acceptable return at those tariffs. However, what is quite certain is that neither the State nor AlintaGas gave any undertaking to accept the tariffs as proposed. In fact, there could be no such undertaking given by the State or AlintaGas since the determination of tariffs under the National Access Code is outside the State's or AlintaGas's control.

AlintaGas requests the Regulator to entirely disregard Epic Energy's express or implied statements to the effect that:

- there is a prior "regulatory compact"; or
- there were any undertakings given by any of Epic Energy, AlintaGas or the State in relation to tariff paths and the initial Capital Base other than the representations by Epic Energy dealt with in AlintaGas's second submission.

2.2.2 The Regulator cannot be bound by any "regulatory compact"

Clearly, a "regulatory compact" between Epic Energy and the State would usurp the regulatory process. AlintaGas submits that even if there was some form of regulatory compact between Epic Energy and the State, which AlintaGas understands there is not, the Regulator's independence means that it is not, and should not be, bound by any such compact.

2.2.3 Epic Energy was aware it could not agree future tariffs with the State

The passage quoted above from clause 2.1(a) of Epic Energy's proposed Access Arrangement Information refers to "the State's proposed price path". At the time of the DBNGP sale, the State expressed certain expectations regarding future tariffs in the DBNGP. However, as is made clear in the next section, by the time final bids were made for the purchase of the DBNGP all interested parties, including Epic Energy, knew that tariffs would be determined under an independent regulatory process, not by, or through an agreement with, the State.

AlintaGas submits that it would be misleading for Epic Energy to imply that it framed its bid in an environment where it felt able to agree future tariff paths with the State.

2.3 Schedule 39 and the "regulatory compact"

AlintaGas annexed Schedule 39 to the DBNGP Asset Sale Agreement as part of its second submission for two purposes:

(1) To show that in March 1998, and knowing its proposed purchase price, Epic Energy considered that it could recover prudently incurred costs, including a reasonable rate of return on its DBNGP investment over the full term of the asset's economic life, at headline tariffs of $1.00 /GJ to Kwinana Junction.

(2) To demonstrate that Epic Energy proposed at that stage to provide a T1-equivalent Reference Service, and that the proposed tariffs related to such a service.

The first objective was the reason AlintaGas required Schedule 39 to be included in the Asset Sale Agreement in the first place. That is, AlintaGas wished to be able to rebut arguments by Epic Energy at a later date that Epic Energy required higher tariffs to achieve a reasonable return.

Schedule 39 indicates that in 1998 Epic Energy was of the view that a tariff of $1.00 /GJ for delivery to Kwinana Junction for the T1-equivalent service was sustainable at the purchase price of $2.407 billion.

In this context, the introduction to Schedule 39 is also significant for what it does not say. In the introduction, Epic Energy stated that its proposed tariffs and tariff path "have been structured to be in compliance with the State of Western Australia's draft Transitional and Long Term Access Regimes and the National Access Code". One would expect this passage (which was prepared by Epic Energy) to refer to any "regulatory compact" with the State which gave Epic Energy a guarantee that the proposed tariffs could be implemented. It does not, and for good reason. Quite simply, there was and is no such guarantee.

Schedule 39 was not a contractual agreement between Epic Energy and AlintaGas that Epic Energy must charge $1.00 /GJ for the T1-equivalent reference service. Nor was Schedule 39 an acceptance by AlintaGas of a tariff of $1.00 /GJ to Kwinana Junction and $1.08 /GJ downstream of Kwinana Junction for the T1-equivalent Reference Service, or of any other tariff. In accordance with the terms of the DBNGP Asset Sale Agreement, AlintaGas is not bound by anything in Schedule 39. Schedule 39 was a contractual representation by Epic Energy to AlintaGas of its then proposed tariff rates and path, and the fact that it felt that those rates and path (for a T1-equivalent Reference Service) would be profitable. Schedule 39 is in no way evidence of a "regulatory compact".

AlintaGas was and is in no way bound to accept the tariffs and tariff path in Schedule 39; it was and is at liberty to seek lower and different tariffs, if such tariffs are consistent with the National Access Code. This fact was clearly communicated to Epic Energy at the time of the DBNGP sale.

2.4 Discussion

When Epic Energy submitted its bid for the DBNGP, Epic Energy was aware that its proposed Reference Services, initial Capital Base and associated tariffs would be subject to the scrutiny and approval of an independent regulator. It was also aware that an independent valuer had estimated the initial Capital Base for the DBNGP assets, determined in accordance with National Access Code principles, to be $1,124 million. Epic Energy also knew that it was expected to provide a T1-equivalent Reference Service as part of its proposed DBNGP Access Arrangement.

That Epic Energy chose to bid $2.407 billion for the DBNGP is a matter of record. It did so in full knowledge of the existence of the National Access Code and the requirements that this would impose on it in being able to earn an appropriate return on its investment. For Epic Energy to now claim that it had some form of mandate to do otherwise in the form of a "regulatory compact" is, in AlintaGas's opinion, disingenuous. AlintaGas submits that the Regulator should ignore Epic Energy's claims that it has a "regulatory compact".

3. EPIC ENERGY WAS FULLY AWARE OF THE NATIONAL ACCESS CODE WHEN THE DBNGP WAS SOLD

AlintaGas submits that, for the reasons set out below, all parties to the DBNGP sale were fully aware that the National Access Code would govern tariff setting for the DBNGP from (it was then thought) 1 January 2000. There can thus be no suggestion that the Regulator in applying National Access Code principles to the setting of tariffs for the DBNGP constitutes any form of "sovereign risk" or breach of faith by the State or, for that matter, AlintaGas.

3.1 National Access Code was widely publicised

An exposure draft of the National Access Code was released on 12 July 1996. The development process for the National Access Code before and after that release included significant involvement by, amongst others, relevant industry stakeholders. The *Natural Gas Pipelines Access Agreement* was signed on 7 November 1997, four months before bids for the DBNGP were finalised. Schedule A to the National Access Code listed the DBNGP as a Covered Pipeline.

3.2 Epic Energy expressly referred to the National Access Code

On page 7 of the Epic Energy Submission, Epic Energy quotes the Minister for Energy, at the time the Minister announced the issue of the DBNGP sale Information Memorandum, as follows:

> "From the year 2000, *the State is planning to adopt the National Access Code* and tariffs could fall to around $1 /GJ." (italics added)

In Schedule 39 to the Asset Sale Agreement, Epic Energy stated:

> "Epic's proposed tariff rates and path have been structured to be in compliance with the State of Western Australia's draft Transitional and Long Term Access Regimes *and the National Access Code* ("NAC")."
>
> …
>
> From 1 January 2000 onward, Epic will submit to scheduled regulatory reviews where access principles and reference tariff paths *will be approved by the regulator under an effective access regime that complies with the NAC.*
>
> …
>
> Epic's proposed tariff path from 1 January 2000 onwards is *based on the underlying principles embodied in the National Access Code*." (italics added)

Clearly there was and is no doubt that Epic Energy was aware of the requirements of the National Access Code and that that Code would apply in Western Australia from (it was then thought) 1 January 2000 when it submitted its bid for the DBNGP.

3.3 Bidding documentation

Well prior to the final bids being made for the purchase of the DBNGP, the Gas Pipeline Sale Steering Committee ("**GPSSC**") provided a considerable amount of information to prospective bidders, including Epic Energy (the "**Information**"). The Information was

provided in the course of the DBNGP sale and was used by prospective bidders, including Epic Energy, as a basis for submitting indicative bids.

The Information is relevant because it forms part of the basis upon which Epic Energy submitted its bid.

AlintaGas submits that the Information, which Epic Energy had well before it submitted its final bid for the purchase of the DBNGP, makes it quite clear that the successful bidder would have to submit its tariffs and service policies to the scrutiny and approval of an independent regulator. More specifically, AlintaGas submits that the Information would have indicated to Epic Energy that:

- the State had committed to adopting an Access Code from 1 January 2000 containing a fully negotiation-based and independently-regulated access and pricing regime for the DBNGP fully consistent with the then draft National Access Code;

- it was proposed that the Access Code would define a general regulatory framework within which specific access and pricing arrangements for the DBNGP would need to be developed by the purchaser of the DBNGP in the form of an Access Arrangement containing, among other things, reference tariffs;

- its DBNGP Access Arrangement would be required to include details relating to a "Reference Tariff" for each Reference Service;

- the Reference Tariff would have to comply with the reference tariff principles of the National Access Code;

- a central feature of the National Access Code was the position of an independent Regulator;

- Access Arrangements developed under the Access Code would need to be approved by the independent Regulator under the Access Code;

- the detailed task of setting a Reference Tariff would be undertaken by Epic Energy as the Service Provider, subject to the independent Regulator's scrutiny and approval of the whole Access Arrangement; and

- the Access Arrangement would be subject to approval by the Regulator after a public consultation process, after which the Regulator could require the Service Provider to amend the Access Arrangement, and could, if necessary, draft those amendments itself if the Service Provider does not draft them to the Regulator's satisfaction.

In summary, there can be no doubt that when Epic Energy submitted its bid for the DBNGP, it did so in full knowledge that from (it was then expected) 1 January 2000, tariffs for the DBNGP would be set either under the National Access Code, or under an equivalent access regime containing all key elements of the National Access Code. (The uncertainty as to which code would apply was simply a matter of timing, and the need to be absolutely precise in the context of a major asset sale. There was no uncertainty as to the practical effect of the planned access regime, however it was to be implemented.)

3.4 Use of reference material

AlintaGas submits that the Regulator should be extremely careful with Epic Energy's selection of reference material that supposedly supports its submissions.

The Price Waterhouse Report of August 1997 referred to in the Epic Energy Submission needs to be read and understood in its entirety before any reliance can be placed on any part of it. Additionally, even the full Price Waterhouse Report should be considered having regard to the context in which it was made available to prospective bidders. The report was part of the material that formed the basis of Chapter 9 of the Information Memorandum issued by the GPSSC on behalf of the State in August 1997, which Information Memorandum is referred to in Epic Energy's third submission to the Regulator.

AlintaGas submits that the Regulator should consider the whole of Chapter 9 of the Information Memorandum, before placing any reliance upon material referred to selectively by Epic Energy from the Price Waterhouse Report or the Information Memorandum.

4. DEFERRED RECOVERY ACCOUNT

AlintaGas submits that the Regulator should disallow Epic Energy's proposed use of a deferred recovery account.

The Brattle Submission suggests on page 20 that, with Epic Energy's proposals, Epic Energy's shareholders will earn a return that will at most be a "fair return". However, AlintaGas submits that the return cannot be considered a fair return when it is based upon an unreasonable capital cost. The inference is that it is fair for a Buyer to achieve a return on an asset at the expense of users no matter what the Buyer pays for the facility. AlintaGas submits that this should not be the case. In fact one of the key underlying principles of the National Access Code is that Service Providers are not free to select the Capital Base of the relevant pipelines, by purchase price or otherwise, but that the Capital Base must be determined in accordance with a balanced valuation methodology. The interests of users should also be taken into account, with Epic Energy being allowed to earn a fair return based on a fair valuation for the DBNGP. AlintaGas submits that under the National Access Code a fair upper value for the DBNGP is the DORC valuation of the DBNGP.

The deferred recovery account proposed by Epic Energy is a direct result of its attempt to have an initial Capital Base that is substantially greater than the DBNGP's DORC valuation. Any perceived need for a deferred recovery account would disappear if the initial Capital Base were equal to or less than the DORC valuation.

In applying the deferred recovery concept to the DBNGP, Epic Energy is attempting to defer cost recovery on a fully loaded pipeline in which the capital base is set at the price Epic Energy chose to pay for the DBNGP. This price incorporates a considerable premium above the depreciated replacement value of the DBNGP. AlintaGas submits that the use of a deferred recovery concept in the way proposed by Epic Energy is unacceptable and not in accordance with the National Access Code.

Table 3.3 of Epic Energy's proposed Access Arrangement Information shows that a deferred recovery account would increase each year until it was valued at $741.69 million at the end of the Access Arrangement period. AlintaGas submits that the large and increasing balance of the deferred recovery account is an indication that Epic Energy's proposed initial Capital Base of $2.45 billion is not sustainable under Epic Energy's tariff regime, despite such a tariff regime imposing considerably higher costs on users compared to existing tariffs.

The Brattle Submission infers that the deferred recovery methodology it proposes for the DBNGP is an accepted methodology that has been applied in Australia and the United States. AlintaGas submits that this inference is misleading.

The concept of deferred recovery is acceptable when it is applied to a new pipeline as a way of normalising the tariff structure whilst gas demand on the pipeline increases. This was the situation in the examples referred to in the Brattle Submission.

None of the examples quoted in the Brattle Submission can be legitimately compared to the DBNGP. The examples in the Brattle Submission are situations in which there is an unloaded or lightly loaded pipeline that defers its cost recovery with the use of a normalised tariff whilst pipeline demand increases. The pipelines are valued at the capital cost of constructing the pipelines.

For example, consider the Brattle Submission's reference to a pipeline owned by the SunShine Interstate Transmission Company ("**SITCO**") in the United States. The pipeline was a new pipeline in respect of which FERC required SITCO to calculate its tariffs based upon the pipeline's capability rather than its contracted capacity. SITCO's pipeline was connecting to an intrastate pipeline that, at least for the first four years, did not have sufficient delivery capability to receive the full quantity of gas that the SITCO pipeline could deliver. FERC found that deferred recovery is a way for SITCO's users to share a portion of the risk of pipeline under-utilisation whilst demand on the pipeline builds up.

5. INITIAL CAPITAL BASE AND TARIFFS

5.1 Initial Capital Base expected to be about $1.1 billion

AlintaGas is aware that prior to Epic Energy submitting its bid for the DBNGP, Epic Energy knew the principles under which a pipeline operator would be expected to determine Reference Service tariffs, with specific reference to the setting of the initial Capital Base for the DBNGP. Specifically, prior to making its bid, Epic Energy was aware that:

- under the then draft National Access Code the pipeline operator would have to calculate Reference Tariffs in accordance with detailed principles relating to matters including asset valuation, apportionment of costs, depreciation and incentive mechanisms;

- the Regulator would have considerable discretion in determining whether to approve a Reference Tariff or a Reference Tariff Policy;

- Reference Tariff levels for transmission services to be provided by the DBNGP following the Transition Period were to be based upon Access Code principles that provided for a reasonable rate of return on the capital base of the pipeline's various assets;

- the GPSSC had, for its own purposes, commissioned an independent indicative valuation for the DBNGP Assets, consistent with National Access Code principles, for the purpose of considering possible future tariff paths for the services provided by the DBNGP;

- the independent indicative valuation suggested that a supportable capital base for the DBNGP Assets, being a DORC valuation consistent with the National Access Code principles, was in the order of $1,124 million as at 31 December 1997; and

- determination of a DORC valuation may be undertaken in different ways, which could give different values to the estimate of $1,124 million.

5.2 Epic Energy should be able to include prudent discounts

AlintaGas submits that in approving a reference tariff, the Regulator should permit Epic Energy to incorporate the contractual discount that it provides for the delivery of gas to the Wesfarmers LPG ("**WLPG**") plant in accordance with section 8.43 of the National Access Code. The discount was incorporated as part of the Gas Transmission Regulations 1994, Epic Energy included it in Schedule 39 of the Asset Sale Agreement as a discount to be incorporated in the reference tariff, and it was a grandfathered obligation at the time Epic Energy purchased the DBNGP.

The WLPG plant extracts propane and butane from the stream of natural gas flowing in the DBNGP at Kwinana Junction. There are sound economic reasons for the discount, given that the energy content of propane and butane is considerably greater than the energy content of an equivalent volume of natural gas. The Energy Implementation Group incorporated the discount when determining the tariffs to apply to the DBNGP. The tariffs also included the WLPG discount when they were re-determined in 1997 for implementation from 1 January

1998. The Gas Transmission Consultation Committee was consulted on this proposed tariff re-determination and raised no objections to the continued application of the WLPG discount.

AlintaGas included an estimate in its third submission of an appropriate 100% load factor full-haul firm tariff for the DBNGP. AlintaGas submitted that the tariff should be between $0.79 per GJ and $0.84 per GJ. This estimate included an allowance for Epic Energy to recover the discount associated with the delivery of gas to the WLPG plant.

5.3 An appropriate tariff is less than $1.00 per GJ

Whilst Epic Energy is promoting its Firm Service as having a "headline" tariff of $1.00 per GJ, AlintaGas submits that this does not reflect the costs that will be incurred by users of the DBNGP. There are a number of significant other costs that impose a considerable additional burden on users. Two examples are the $1.08 per GJ charge for users downstream of Kwinana Junction and a Delivery Point Charge imposed on all users. As AlintaGas indicated in its third submission, application of Epic Energy's proposals could double AlintaGas's costs. If Epic Energy's proposed penalty charges were excluded, AlintaGas anticipates that its costs would still increase by almost 25% if it were to adopt Epic Energy's proposed Access Arrangement.

AlintaGas would consider a tariff of $1.00 per GJ or lower to be acceptable, provided it is based on an initial Capital Base that is no higher than an independent DORC valuation for the DBNGP and on a reasonable rate of return. The "headline" tariff would then be much more of a realistic indication of the costs that a user might incur.

In the Epic Energy Submission, Epic Energy quotes from the August 1997 report to the GPSSC by Price Waterhouse, which provided an independent DORC valuation for the DBNGP of $1,124 million. Epic Energy says, on page 8, that Price Waterhouse concluded:

> "… a gas transmission tariff of around $1/GJ commencing at 1 January 2000 was a reasonable and supportable tariff for "firm full haul transmission capacity" under the Draft Code. The analysis suggested that the tariff could lie anywhere within the broad range of $0.71/GJ to $1.12/GJ for firm, full haul transmission capacity and that *values between $0.88/GJ to $0.98/GJ* could be argued." (italics added)

To the best of AlintaGas's knowledge, tariffs at the lower end of the range in the tariffs determined by Price Waterhouse were subject to high levels of CPI escalation during the Access Arrangement period. Similarly, tariffs at the higher end of the range were subject to low levels of CPI escalation. Since Epic Energy proposes reference tariffs that escalate at 67% of CPI, AlintaGas submits that comparable tariffs, if Epic Energy is to be consistent with the Price Waterhouse conclusions it quotes, should be at the lower end of the range of tariffs determined by Price Waterhouse.

To the best of AlintaGas's knowledge, the tariffs determined by Price Waterhouse were based on a T1 equivalent service. As such, a uniform pricing structure would apply in the Price Waterhouse models for delivery of all gas downstream of compressor station 9. This contrasts with Epic Energy's proposals, where it is seeking to apply a tariff of $1.08 per GJ in Zone 10, which is the zone in which the majority of DBNGP gas demand occurs.

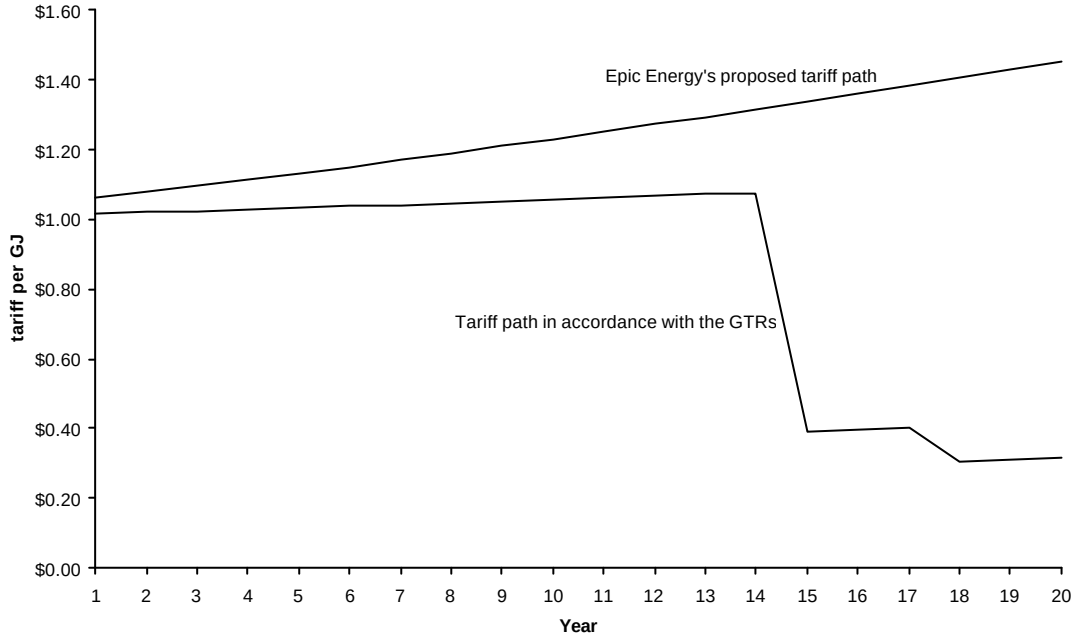
5.4 Long term tariff expectations

AlintaGas has attempted to estimate tariffs on the DBNGP in accordance with the pricing provisions of the Gas Transmission Regulations 1994 ("**GTRs**"). AlintaGas's tariff estimate

provides an indicative guide with which to compare the tariffs that might be expected over a 20 year period under Epic Energy's proposed DBNGP Access Arrangement.

AlintaGas submits that the DBNGP tariff as determined in accordance with the GTRs complies with the National Access Code. Tariffs have previously been determined in accordance with the GTRs on two occasions. On the first occasion in 1994 the Energy Implementation Group determined the tariffs in accordance with the pricing provisions of the GTRs (the "**GTR Methodology**"). These tariffs applied from 1 January 1995 until 31 December 1997. On the second occasion, in 1997, tariffs were re-determined using the GTR Methodology under the supervision and approval of the Gas Transmission Consultation Committee. Tariffs using this methodology were due for re-determination in 2000, for application from 1 January 2001.

The graph below shows the expected full-haul 100% load factor tariff over a 20 year period as proposed by Epic Energy and the tariff as estimated by AlintaGas in accordance with the GTRs.



In the GTR Methodology, assets have been depreciated over a relatively short 20-year period. The bulk of the assets have already been depreciated for 6 years, leaving only 14 years before the assets will be fully depreciated. As a result, the tariff will be higher for the next 14 years than it would be if the assets were depreciated over their economic life. It does mean that tariffs will reduce significantly once the assets have been fully depreciated, rewarding users with significantly lower costs. Despite this high initial rate of capital recovery because of the relatively short depreciation period, the tariff determined using the GTR Methodology is still significantly lower than Epic Energy's proposed tariff.

A steady increase can be expected in Epic Energy's proposed tariff due to the CPI escalation of both its capital and commodity tariff components. In contrast, the capital component of the tariff determined in accordance with the GTR Methodology is not escalated, resulting in very little increase in the nominal tariff.

AlintaGas suggests that the complete impact on users of Epic Energy's proposals is not fully captured by the above graph since no allowance is made for the effect of load factor, penalty charges, delivery inflexibility and Epic Energy's proposed deferred recovery account. The deferred recovery account is particularly insidious. It will result in an inexorable rise in the DBNGP Capital Base. This will ensure that tariff reductions that users would have reasonably expected to occur as the DBNGP is expanded at a low marginal capital cost will not materialise. Instead, the cost benefits of expansion will be retained by Epic Energy as it attempts to recover an increasing Capital Base that is supporting the amount it chose to pay for the DBNGP.

The contrast between the long term tariff path that can be expected under Epic Energy's proposed DBNGP Access Arrangement and the reasonable expectations of users, as encompassed by a tariff path determined in accordance with the GTR Methodology, is clear. AlintaGas submits that Epic Energy's proposed DBNGP Access Arrangement would impose significant and unreasonable increases in costs on users. This is in contrast to a more reasonable expectation of users, namely a declining tariff path as the benefits from DBNGP expansions at lower marginal capital costs materialise.

5.5 Relevance of the firm service terms and conditions

Clause 2.1 of Epic Energy's Access Arrangement Information states:

> "The "tariffs" were widely referred to by the State during the sale process of the DBNGP. The "tariffs" were not, however, a complete specification of the tariffs for Firm Service. Epic Energy has therefore developed its proposed Reference Tariff and Access Arrangement recognising the commitments it made to the State at the time it purchased the DBNGP. At the same time it has looked to refine and improve the structure where appropriate."

The above passage confuses the situation by suggesting that there was doubt as to what (reference) service was contemplated in Schedule 39. There was, and is, no such doubt. First, to AlintaGas's knowledge, all discussions at the time of the DBNGP sale were based either explicitly or implicitly on the T1 service, simply because that was the only service provided to third party users at the time. Second, as Epic Energy indicates in its third submission to the Regulator, Epic Energy was aware prior to submitting its bid for the DBNGP that the successful bidder would be expected to provide a T1-equivalent Reference Service. Third, in Schedule 39 to the Asset sale Agreement Epic Energy explicitly proposed to offer a T1-equivalent Reference Service and made it clear that its then tariff proposals were developed in the context of such a service.

Epic Energy proposes to take advantage of what it claims was doubt regarding the terms and conditions to apply to its proposed Reference Service, by putting forward a proposed Firm Service which has been stripped of many elements of the T1 service. AlintaGas submits first that there was no such doubt, and second that the proposed Firm Service is so different from the T1 service that it cannot be considered a T1-equivalent service.

The large-scale calculations required by section 8 of the National Access Code produce tariff outcomes that are largely independent of the detailed terms and conditions of the service being offered. However, this does not mean that a Service Provider is free to offer, as Epic Energy is attempting, substantially degraded services in place of the balanced service it was previously providing.

6. CONCLUSIONS

There are a number of core issues that AlintaGas has submitted to the Regulator in its four submissions concerning Epic Energy's proposed DBNGP Access Arrangement. In summary, these include:

1. The initial Capital Base should be equal to or less than a DORC valuation, which is in the vicinity of $1.0 billion.

2. The proposed Firm Service is not an appropriate Reference Service; which could result in AlintaGas's DBNGP gas transport costs doubling.

3. A T1-equivalent Reference Service should be included within the DBNGP Access Arrangement.

4. The DBNGP is exposed to relatively little risk and as such the rate of return should be less than that used in other jurisdictions.

5. Epic Energy did not have, and does not have, any form of "regulatory compact" with AlintaGas or the State. Even if it did, in purporting to enter into any such regulatory compact the parties would be undermining the Regulator's independence, so the notion of a regulatory compact should be disregarded.

6. At the time it bid for the DBNGP, Epic Energy was fully aware that it would have to submit an Access Arrangement that complies with the National Access Code and which would have to be approved by an independent Regulator.

7. A deferred recovery account, as proposed by Epic Energy, is inappropriate. It is being proposed as a way to recover a purchase premium over and above the realistic value of the DBNGP to the detriment of users. A deferred recovery account is an acceptable concept for new pipelines that are building up demand from a low base, but it is not appropriate to apply the concept to an existing pipeline that has little, if any, uncontracted capacity.

8. Epic Energy's proposed DBNGP Access Arrangement will impose significant and unacceptable additional costs in an environment where it is reasonable for users to expect a declining tariff path as the benefits from expanding the DBNGP at low marginal capital costs materialise.