CHAMBER OF COMMERCE AND INDUSTRY OF WA SUBMISSION

17 August 2001

Mr Robert Pullella
Office of Gas Access Regulation
6th Floor
197 St Georges Tce
PERTH WA 6000

Dear Mr Pullella,

Draft Decision on Proposed Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline

The Chamber of Commerce and Industry of WA (CCI) is pleased to have the opportunity to provide the following submission on the Office of Gas Access Regulation's (OffGAR) Draft Decision on the Proposed Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline (DBNGP).

CCI believes that, in most markets, competition is the best driver for delivering products and services efficiently. However, in natural monopolies, there may be an incentive and capacity for the asset owner to charge higher prices than a competitive market would deliver, yielding an inferior outcome for the wider community. In such markets there is a need to regulate access and prices so as to replicate as near as possible the outcomes in a competitive market and in turn ensure that the optimum environment exists for economic development. This is the cornerstone of the various Australian access regimes, including the National Third Party Access Code for Natural Gas Pipeline Systems ("Code"), and the rationale for regulating the DBNGP's access arrangements and tariffs. How access issues (including prices) are regulated is a difficult issue to resolve, especially in growing markets which might comprise a mixture of new and established assets and potential and established customers.

In a recent submission to the Productivity Commission on its review of Part IIIA of the National Access Regime, CCI endorsed the broad pricing principles advocated by the Law Council, that access pricing regulations:

- must not create incentives to delay or accelerate investment in infrastructure;
- must reflect the level of risk associated with investment in infrastructure;
- should not create incentives for inefficient by-pass of natural monopolies; and
- should encourage efficient rate of use of facilities.

Many of the issues addressed in this review are relevant to the current consideration of access prices for the DBNGP.

The pipeline was purchased by Epic Energy as a 'going concern' with an established market and customer base, proven technology and a track record of performance. Clearly, the risks associated with the purchase of such an asset are lower than those associated with building a new asset from scratch in an untried market. The risk associated with incremental expansion of an established asset in an established market may be different from either new investment or the purchase of an established asset, and will depend on the size and creditworthiness of potential new customers. One CCI member observed that, if incremental investment is "rolled into" the capital base for the determination of prices, risk in the incremental investment may be no different to the risk inherent in the existing investment.

Epic Energy argues that, if the Regulator's draft decision becomes final, the prices it would be permitted to charge on its existing pipeline are too low to yield a reasonable rate of return on the investment in looping. So unless it is able to achieve a rate of return appropriate for the risk inherent in the total investment by charging higher prices to existing customers, new customers, or both, the investment will not be economically viable.

This latter concern is crucial. The DBNGP currently transports about 600 TJ of gas per day, which is close to its capacity. CCI accepts the premise of many of the submissions made to OffGAR in relation to the present deliberations that Epic Energy has exhausted the less costly options to increase the capacity of the pipeline and additional capacity can only effectively be delivered through looping of the pipeline, which would require a substantial capital outlay.

Perhaps the largest customer to be affected by the access regime, AlintaGas Limited, is in principle comfortable with a pricing model in which the efficient cost of incremental additions to the main pipeline are added in to the capital base for determining the reference tariff, which may on occasions lead to a small increase in the reference tariff. Such a model would provide Epic Energy with a reasonable return on its investment in most circumstances, and avoid any notion of there being "second class citizens" or "undue competitive advantage", whatever the Regulator may determine to be an appropriate Initial Capital Base for the DBNGP. AlintaGas argues that such a "roll-in" model would also address the concerns of prospective new clients discussed below.

Potential new customers argue that it is inequitable, inefficient and inappropriate for similar classes of customer with similar demand loads and patterns to be charged different amounts for supply. A differential pricing structure for new and established customers would distort or even prevent competition between existing and new operators. This would be a particular concern if, for example, potential new operators in electricity generation have to pay more for gas than the already dominant incumbent, Western Power, which is one of the major existing customers. Too high a margin under differential pricing would effectively preclude the development of a larger, more diverse and competitive resource market, with all the benefits of lower prices, a competitive energy market and the spin-offs in downstream processing and resource development these are expected to deliver.

It can further be argued that it is common practice for investors in new or expanded infrastructure to wait some years before making a profit; it is unreasonable to look to recover all costs from the outset, whether from new or existing customers. But it is also unreasonable to expect an investor to undertake such an investment, with all its attendant risk, in the knowledge that the best rate of return it can possibly hope for is the comparatively modest one permitted on its proven and established, and therefore much lower risk, pipeline asset.

OffGAR faces an extremely difficult task in balancing these conflicting but reasonable concerns, and it must do so in the knowledge that the stakes are very high – a wrong call in regulation now could have ramifications for the state's development for years to come.

This is particularly true because its decision will take effect as the policy and market environment look set to undergo major change. The need for access pricing to the DBNGP to be set at a level that does not adversely affect the future uptake of gas in the southwest of the state is assuming greater importance given reforms in other parts of WA's energy sector which look set to accelerate. Competition in electricity generation, in particular, could create opportunities for new gas powered generators to enter the WA electricity generation market. Furthermore, one of the key drivers for delivering lower electricity prices in WA will be to promote gas on coal competition. This was implicitly recognised in the Minister for Energy's recently announced power procurement policy for the WA electricity sector.

Aside from the contentious issue of price discrimination, the Code and the WA regulatory regime already incorporate some inherent disincentives for new facilities investment, namely, the requirement that investment in new facilities cannot be capitalised until the next access period and the regulatory uncertainty that surrounds the determination of access prices. Against this concern, it has been argued that a pipeline owner could ask for a review of access arrangements should circumstances change, and it is noted that OffGAR have indicated that in the determination of tariffs they would consider future capital enhancement expenditure.

Epic Energy cannot be compelled to expand the DBNGP unless it is "economically feasible" to do so, and so if expansion is in the state's interests, it must be induced by allowing Epic to make a reasonable return on any new investment.

The key challenge for OffGAR is to strike the right balance between the legitimate interests of the pipeline owners and current and potential users. CCI cannot propose a definitive solution to this quandary, but repeats its view that the ramifications of OffGAR's decision will be far reaching, affecting both the ongoing evolution of the state's energy market and its longer term industrial development.

Yours sincerely

LYNDON G ROWE
Chief Executive