

**EPIC DBNGP SYSTEM
PROPOSED ACCESS ARRANGEMENT**

**PUBLIC SUBMISSION BY CMS
March 2000**

CMS wishes to make the following comments regarding the Proposed Access Arrangement for the Dampier to Bunbury Gas Pipeline System dated the 15 December 1999.

1.0 Defined Services

The Reference Service offered is Firm Service which can be either forward or back haul. The Access Arrangement also identifies a number of other Non-Reference Services, included in which are pre-existing contracts as well as such things as odourisation, park and loan, pressure and temperature control and commingling services.

Comments: The Firm Forward haul Reference Service proposed by Epic appears to be consistent with the current "standard" T1 service available under the Gas Transmission Regulations 1994 (GTR). Epic have however imposed very aggressive capacity management penalties which include restrictions on Delivery Point capacity balancing. This is likely to be a significant issue for existing Users who have diversified offtake requirements.

It is our understanding that some of these, for historical reasons associated with previous vertical integration in the former SECWA, have also enjoyed a somewhat privileged form of T1 service which allows them to effectively manage on a daily basis the capacity commitments upon which they are charged. While the "standard" User under a GTR contract sees the Maximum Daily Quantity (MDQ) as a "take-or-pay" arrangement with overrun penalties implicit in the GTR surcharges, it is our belief that historically the Gas and Power Utilities may have effectively seen their MDQ as being a Daily Nomination quantity with no overrun penalties applied. CMS requests the Regulator to investigate whether in fact such a disparity exists and to consider in his analysis of the proposed Access Arrangement the inequity of grandfathering such contracts, particularly in light of future privatisation proposals.

CMS is also of the view that the Firm Reference Service is not adequately defined in respect of the availability being offered to new and existing Shippers. References in the Access Arrangement to curtailment limits are not entirely clear and as no period is specified, it is not possible to ascertain what degree of availability is really meant by "firm".

2.0 Tariff

2.1 Tariff Structure

Epic have proposed a 10 zone model with the zone boundaries defined as being 1km south of each compressor station. Zone 1 is split into two parts (1a and 1b) to capture the North West Shelf gas gathering area between Dampier and CS2. No provision is

made in the Proposed Access Arrangement for receipt points in any zone other than Zone 1.

The charge structure consists of five elements;

% of Full Haul		
1.	6.5%	Gas Receipt Charge (based on MDQ and independent of distance)
2.	76.8%	Pipeline Capacity Charge (based on MDQ and zoned)
3.	12.2%	Compression Capacity Charge (based on MDQ and number of compressors encompassed between receipt & delivery points)
4.	4.5%	Compressor Fuel Charge (based on throughput)
5.	<.1%	Delivery Point Charge (fixed charge for shared use)

It is noteworthy that the tariff is substantially (95%) based on reservation.

Comments: CMS notes that the Access Arrangement makes no provision for Producers to enter the DBNGP at any zone other than Zone-1. In addition, it would appear that the Gas Receipt Charge (which is effectively an access charge) would specifically restrict competition by preventing development of services involving part haul on the DBNGP. As leading proponent of gas storage services as well as the development of a second pipeline to deliver gas into the Mid and South-West of the State, we see this omission as further evidence of the fact that greater real market driven competition in gas transmission is needed in Western Australia to encourage regional development and facilitate true Open Access.

It is also significant that the reservation component of the full haul tariff has been effectively increased to something like 95%, up from around 75% previously. The fixed cost component of tariff in common practise is generally around 75% to 80% of the total. The effect of the increase in the fixed component of the tariff would appear to be that Epic is transferring the risks associated with capital recovery onto its customers.

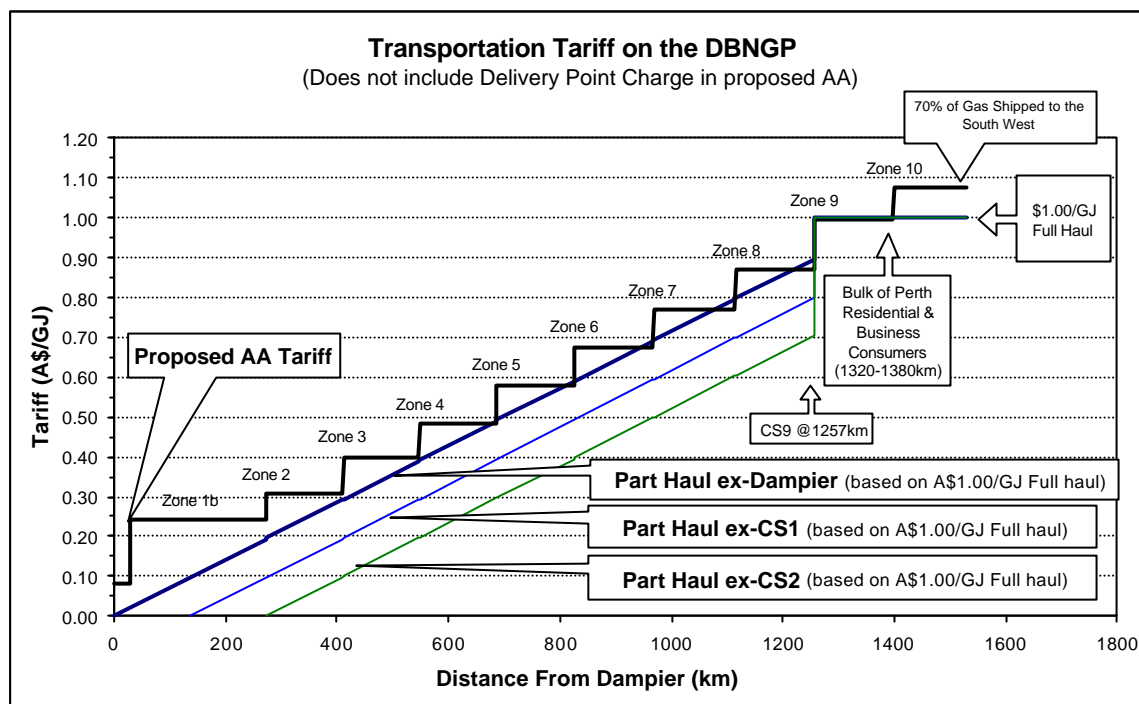
This increase in the reservation component is contributed to by the Compressor Capacity Charge (which is fixed regardless of the actual compression which might be employed) as well as the Delivery Point Charge which is also fixed. It is not clear to CMS how the fixed charge components were derived and we would question whether they may in any case be redundant, depending upon the extent of capital recovery contributions to date, and represent "double dipping" on the part of Epic.

2.2 Tariff Charges

With a capital base equivalent to the purchase cost, Epic claim that tariffs of A\$1.41/GJ to Kwinana Junction and A\$1.62/GJ to delivery points further south can be justified. However the Access Arrangement proposes that A\$1.00/GJ and A\$1.08/GJ, respectively, will be applied in order to honour a commitment which Epic claims to have given (although it is not specified to whom) at the time of acquiring the DBNGP.

Epic have specified 37 delivery (ie. outlet) points along the DBNGP, each having a specified daily charge ranging between A\$117 and A\$759 per day.

A comparison of the impact on tariffs of the proposed Access Arrangement compared with the existing DBNGP tariff structure (based on the promised A\$1.00/GJ full haul tariff) is given below.



Comments: Superficially there appears to be neither a benefit nor a detrimental impact on tariffs to the metropolitan distribution network (residential and business customers) which for the most part means the Alintagas customer base. However the magnitude of the proposed surcharges (for imbalances etc) at \$15/GJ appears to indicate that Epic have viewed this as a source of significant additional revenue rather than a legitimate and necessary mechanism for efficient capacity management by a prudent pipeline operator.

In addition, the bulk (70%) of gas shipped south on the DBNGP goes to Kwinana and further south, that is it is delivered in Zone 10. The tariff for this Zone has increased by 8% relative to the metro area.

The above graph illustrates the reality of Epic's claim to be reducing tariffs. It also indicates the magnitude of tariff increases to be expected by those shippers who would otherwise be facing a part haul tariff for gas received at CS1 or CS2 (or anywhere else outside of the proposed Zone 1). The impact is adverse and substantial.

CMS is of the view that the zone model as proposed by Epic has been deliberately structured so as to attempt to eliminate part haul competition and further entrench the monopolistic advantage of the DBNGP. It is clear what the consequences of such a strategy will be if the Regulator condones it. CMS is currently investing in the development and ultimate growth of the gas market in Western Australia. Gas customers are already enjoying price benefits as a

result of the competition which CMS has brought into the market. We would contrast this demonstrable intent with that reflected in the proposed DBNGP Access Arrangement and request the Regulator to consider in his deliberations the broader issues surrounding the apparent objective of merely reducing existing gas transportation tariffs by regulation.

CMS would argue that Epic's ambit approach to complying with Open Access regulation is a clear indication of the need for real (rather than artificially imposed) competitive motivation in the Western Australian gas transmission market, and highlights the immediate need for a second pipeline from the North West.

3.0 WACC

Epic have included an expansive report by their UK based "expert regulatory consultant", The Brattle Group, on the calculation of WACC which arrives at a pre-tax real WACC of 8.6%.

Comments: CMS would submit that the WACC is, as a matter of principle and in the context of existing regulatory precedent, too low and acts as an impediment to State development generally and development of a second pipeline from the North West specifically. We are obliged to restate the fact that comparisons of rates of returns permissible in Victoria (and specifically comparisons of transmission lines to distribution networks) are neither valid nor relevant in the context of the Western Australian market.

This comment is made with some authority. CMS is currently evaluating in all earnestness the viability of building a second gas pipeline with which it would hope to increase both the size and competitiveness of the gas market in Western Australia. The development of the massive offshore Gorgon Gas Field is aligned to the success of this happening. While the upstream hydrocarbon industry might appear to be relatively safe from the sovereign risks associated with heavy handed regulation of revenue (for the time being – we would refer the reader to various comments made by the ACCC), it is also acutely aware that the supply of gas from Producer to Consumer is a chain. A chain which is built upon significant expenditures and which depends upon the continued technical and economic integrity of each of its links. And such hugely capital intensive developments require a certain degree of confidence in the growth of downstream demand. Squashing expectations of being able to achieve commercially realistic returns on investments is hardly conducive to promoting such confidence.

There is definitely scope for improving the Australian regulatory process in so far as the application of assessments of WACC is concerned. Notwithstanding the foregoing comment regarding inappropriate comparisons, Regulator's across the country have yet to come to an understanding of the distinctions between older, established assets (in the sense that the market is established) and new or greenfields infrastructure developments. The recognition of the role which commercial, technical and (more recently) regulatory risk plays in the assessment of viable rates of return is sadly lacking in

both past regulatory decisions as well as the public (and all too academic) debate. Even from an academic perspective, when revenues are clamped, regulatory risk cannot be offset by higher required rates of return as would be the expected response for other increased commercial risks. CMS would hope that the independence of Western Australia's Regulator might allow the scope to break this economically repressive trend.

4.0 Capital Base

Initial Capital Base

Epic have claimed the full purchase price of the DBNGP including acquisition costs (A\$M 2,449.49), plus intervening capital expenditure to 31 December 1999 (less depreciation) to arrive at an ICB of A\$M 2,570.34. Neither DORC nor DAC have been considered and the Access Arrangement makes the claim that "the competitive bidding process [...] removed the DBNGP from within the indicative bounds of Section 8.11 of the Code" (Access Arrangement Information, section 3.1).

Comments: CMS is of the view that it might be worthwhile to consider Epic's apparently optimistic ICB proposal in context.

In establishing the purchase price which it was prepared to bid for the DBNGP, Epic was faced with a known tariff expectation (publicised by the State Minister for Energy and Resource Development) which, in accordance with standard valuation methodology, would have been combined with assumptions about required rates of return, risk acceptance and load and market growth potential. If Epic chose to be more aggressive than its rivals in these assumptions, then that may be considered a reasonable commercial prerogative. However, in the context of regulatory compliance, Epic's requirement to claim such a high capital base is a direct reflection upon the regulatory adoption of unrealistic rates of return (as a consequence of basing outcomes on erroneous assumptions and slavishly following inappropriate precedents) as well as the 'cherry picking' of parameters by Regulators to achieve their own preconceived outcomes.

In a regulatory environment which permits only such unattractively low rates of return, Epic have little choice but to claim the ICB which they have in order to attempt to sustain the tariff outcomes which have been preordained for them (notably without the benefit of any quantitative economic rationale) and upon which, presumably, their purchase of the DBNGP was justified. In accepting this valuation of the DBNGP, the Western Australian Government implicitly accepted this as the basis upon which future tariffs would be determined. Clearly, the current expectation of regulatory outcomes does little to promote economic efficiency, either directly by mandatory imposition or by the stimulation of competition and development.

Carry Forward of Capital Base

Epic have declared that a commitment which they have given to achieve January 2000 target tariffs of A\$1.00/GJ to Perth-Kwinana and A\$1.08/GJ to delivery points further south will be honoured. As a consequence, the Access Arrangement Information claims that revenue will be insufficient to provide a full return on Capital. Epic proposes that the capital recovery shortfall be carried forward into the residual capital base (in a similar manner to AGL's Central West Proposal).

Comments: In the present environment of regulated revenues, the capital base carry forward mechanism which Epic has proposed may have some justification. However there remains a question of distinction in the application and intent of such a mechanism. CMS would argue that it may well be appropriate to apply it to a new development in order to ensure efficient pre-investment and equitable return on investment once employed.

The fundamental issue for CMS is the relationship between the principle espoused in the Code that the asset owner is entitled to earn a stream of revenue that recovers the [efficient] costs of delivering the Reference Service over the expected life of the assets, and the latitude given to Regulators by the Code to quarantine capital as 'speculative investment'. Such treatment can be used to facilitate regulatory compliance while permitting commercially derived and fair tariffs to be put in place prior to full asset utilisation being achieved but can also be misused by Regulators to reverse engineer predetermined and arbitrary tariff targets. In this context, we would urge the Regulator to consider the wider impact in his determination for the DBNGP.

Future Capital

Section 3 of the Access Arrangement Information provides an inordinate level of detail for the future capital expenditure projected.

Comments: The level of detail which Epic have provided in regard to future capital costs appears designed to obfuscate the inclusion of costs which may not be specific to the operation of the DBNGP. CMS would question whether investment in the Customer Reporting System (for example) might not be a cost which should be shared across Epic's interstate operations.

7.0 Load

Capacity and Load Assumptions

According to the Access Arrangement Information, capacity has been based on current contract commitments with no additional market growth forecast. Capacity and flow and hence load factor are detailed below.

	2000	2001	2002	2003	2004	1998 avg
AVERAGE DAILY FLOW TJ/d						
zone	avg. flow TJ/d	avg. flow TJ/d	avg. flow TJ/d	avg. flow TJ/d	avg. flow TJ/d	avg. flow TJ/d
1a	26.0	25.1	25.3	25.3	25.3	42.0
1b	0	0	0	0	0	0.0
2	0	0	0	0	0	0.0
3	0	0	0	0	0	0.0
4	1.5	1.5	1.5	1.5	1.5	1.1
4a	0	0	0	0	0	0.0
5	0	0	0	0	0	0.0
6	0	0	0	0	0	0.0
7	17.6	19.6	19.8	18.1	16.8	25.2
8	0	0	0	0	0	0.0
9	76.0	77.4	78.4	79.4	80.4	86.8
10	411.7	416.6	417.0	428.0	434.0	393.0
TOTAL	532.8	540.2	542.0	552.3	558.0	548.1

	CAPACITY FORECAST TJ/d					
	capacity TJ/d	capacity TJ/d	capacity TJ/d	capacity TJ/d	capacity TJ/d	max. flow TJ/d
1a	48.0	48.0	48.0	48.0	48.0	53.5
1b	0	0	0	0	0	0.0
2	0	0	0	0	0	0.0
3	0	0	0	0	0	0.0
4	1.5	1.5	1.5	1.5	1.5	1.3
4a	0	0	0	0	0	0.0
5	0	0	0	0	0	0.0
6	0	0	0	0	0	0.0
7	18.6	18.6	18.6	16.8	15.6	41.2
8	0	0	0	0	0	0.0
9	57.0	57.0	57.0	57.0	57.0	140.5
10	469.7	467.9	469.8	479.0	485.9	461.5
TOTAL	594.8	593.0	594.9	602.3	608.0	698.1

	LOAD FACTOR					
	load factor	load factor	load factor	load factor	load factor	load factor
1a	0.54	0.52	0.53	0.53	0.53	0.80
1b						
2						
3						
4	1.00	1.00	1.00	1.00	1.00	0.83
4a						
5						
6						
7	0.95	1.05	1.06	1.08	1.08	0.63
8						
9	1.33	1.36	1.38	1.39	1.41	0.62
10	0.88	0.89	0.89	0.89	0.89	0.85
AVERAGE	0.90	0.91	0.91	0.92	0.92	0.77

Comments: The average net load factors we calculate are between 90% and 92% however there seem to be a number of inconsistencies between individual zones which do not seem rational (see table).

10.0 Trading Policy

Epic state their intention to establish and run a Secondary Market for trading spare capacity. They specify that there will be two categories of sellers (Epic and Shippers who hold 'Eligible Capacity') and three categories of buyers (Epic, Shippers who hold 'Eligible Capacity' or a pre-existing transportation contract under a previous regime, and 'Approved Third Parties') in the market.

Comments: The most critical issue is that the Secondary Market mechanism proposed by Epic should not fall under the DBNGP Access Arrangement. It is a non-reference service anyway, but more importantly, it should be something which is available to wider application and participation. Its inclusion by Epic appears to be an attempt to entrench a monopolistic position. Certainly Epic's own surcharge arrangements (especially the Nominations Surcharge) provide a strong incentive for Shippers to use the Market for fiscal relief.

Notwithstanding the above, there are a number of specific issues relating to the Secondary Market Rules as described in the Epic documentation. The wording of the text is both inadequate in detail and incomplete in substance. It is not clear just who is empowered to post for sale capacity which is contracted but un-nominated. Definitions are generally vague or omitted (eg. the definitions of a "Stand-in-the-market" bid, and the term "Converted Amount", respectively). The descriptions of process are at best unclear but also appear in some cases to be unworkable (eg. the timing and determination process of a sale for a Stand-in-the-market bid as described under Section 4.7(a)(I)&(ii)).

The question remains as to why the Secondary Market mechanism has been specifically included in the DBNGP Access Arrangement at all. Our view is that it should stand apart.

11.0 General Terms & Conditions

Gas Specification

While Epic has stated that it may accept out of specification gas, the gas specifications in the proposed Access Arrangement are the same as the currently prevailing (December 1999) DBNGP specifications. A surcharge of A\$ 15 / GJ applies to unauthorised out of specification gas.

Comments: The "Broadest Specification" is not referenced in Epic's Access Arrangements and should be explicitly included so as not to inhibit market entrants. We would note however that this specification is only broader in certain regards and is in fact still more restrictive than both the Parmelia and the Australian standard in other regards.

An additional consideration is that the Broadest Specification is currently defined in legislative text which is enmeshed with other legislative documents (the Gas Corporations Act, Gas Transmission Regulations, etc). If these documents are to be superceded then it is not clear to CMS where and to what extent the broader gas specification will be embodied.

Receipt and Delivery Points

The proposed Access Arrangement does not specify a minimum delivery pressure.

Comments: Minimum delivery pressures should be defined. Open Access requires not just commercial certainty – process considerations require Users to also have technical certainty.

Notional Delivery Points

In Section 11.5 of the Terms & Conditions relating to Multiple Transmission Systems, Epic specifies that, “Where gas is delivered to a distribution system (to which the DBNGP is connected) by a gas transmission system other than the DBNGP, the quantities of gas measured at a Notional Delivery Point will need to take into account arrangements between Epic Energy, that other gas transmission system and the operator of that distribution network”.

Comments: This clause is itself vague but it would appear that the intent is to maintain Epic’s monopolistic access into the Alintagas Distribution Network. CMS would argue that the clause should be removed on the basis that the connection of alternate suppliers to a distribution network are of necessity physically separate and should be contractually independent.

Metering

The Correction Period for meter errors as specified in the proposed Access Arrangement, shall not exceed half of the time elapsed since the last Meter Verification (Terms & Conditions, Section 12.6).

Comments: It is not clear to CMS why the Correction Period should be constrained to half the period and why it should not apply for the full period since the last Accuracy Verification Test.

Indexation of Tariffs

Epic have specified that the full Reference Service tariff is to be indexed at 67% of CPI.

Comments: As a matter of principle, CMS wishes to restate its opposition to the indiscriminate application of CPI-X as a supposed “efficiency incentive mechanism”. Nonetheless, in specific regard to the operation of the DBNGP which has yet to demonstrate the efficiencies normally associated with competitive private sector operation, the application of CPI-X may be appropriate. However, CMS would note that whereas

under the GTR's only the commodity portion of the tariff was subject to indexation, Epic are now proposing to index the full cost of transportation.