PUBLIC SUBMISSION No. 1

DRAFT DECISION:
ALINTAGAS ACCESS ARRANGEMENT

Submitted to OffGAR 5 May 2000

INTRODUCTION

Empire Oil & Gas NL (Empire) makes this first public submission in response to the notice of 14 March 2000 published by the Office of Gas Access Regulation (OffGAR). This notice invited submissions by AlintaGas and other interested parties on OffGAR's Draft Decision on the proposed Access Arrangement submitted by AlintaGas for its Mid-West and South-West Gas Distribution Systems.

The intended purpose of this submission is to identify and discuss several key aspects of the Draft Decision on AlintaGas Access Arrangement for Mid-West and South-West Gas Distribution Systems (Access Arrangement) that will effect Empire.

Empire is actively involved in exploring for oil and gas in Western Australia. Empire is currently pursuing gas exploration and production opportunities within a number of gas fields in the Perth Basin that are strategically located close to AlintaGas South-West Distribution System. Significantly, both the Dampier to Bunbury Natural Gas Pipeline (DBNGP) and the Parmelia Pipeline run close to a number of Empire's Perth Basin gas fields.

SUMMARY

Empire believes various provisions within the Access Arrangement will have a significant financial impact on its expected future revenues. Empire considers that these provisions are denying it access to a gas market, which amounts to gas sales revenue of about $250 million (Source: AlintaGas Annual Report 1999 and Empire's estimate). In fact, these provisions will allow AlintaGas to maintain its monopoly and hold out Empire and other competitors for at least 5 years (i.e., Access Arrangement Period).

Empire has identified the following provisions in the Access Arrangement that it considers being anti-competitive:

1. Proposal for a more stringent Gas Quality Specification;
2. Reference Tariff A - Tariff Structure
    a) Reference Service A - basis for calculation of Interconnection Distance; and
    b) Reference Tariff A - Standing Charge - set at an excessive level

Empire is cognisant of these provisions in relation to the following legislation:

i) Gas Pipelines Access (WA) Act 1998 (GPAA);

ii) Trade Practices Act 1974 (TPA); and

iii) National Third Party Access Code for Natural Gas Pipeline Systems (Code).

Empire considers these provisions infringe parts of Schedule 1, Part 3, Clause 13 of the GPAA (Clause 13) and parts of s46 of the TPA.

Furthermore, Empire considers that OffGAR in issuing its draft determination in regard to these matters may have not fully discharged its duties under the Code. OffGAR's duties in reviewing any draft application include taking into account:

- the public interest, including the public interest in having competition in markets; and
- the interests of Prospective Users.

Each provision will be discussed separately in relation to the above legislation.

DISCUSSION

1. GAS QUALITY SPECIFICATION

Empire is opposed to OffGAR's decision to provisionally accept AlintaGas' proposed gas quality specification for gas entering and being transported through the AlintaGas Gas Distribution Systems.

Empire considers this provision to be anti-competitive and will not only just hinder Empire's ability to bring its gas to market via the AlintaGas Distribution System but will result in Empire seriously reconsidering any further investment in its gas fields.

The proposed gas quality specification is more stringent than the requirements laid down in the Gas Standards (Natural Gas) Regulations 1999 issued under the Gas Standards Act 1972.

Empire considers the proposed gas quality specification directly discriminates against gas from the Perth Basin and specifically gas from Empire's gas fields ever being transported by the Parmelia Pipeline into the AlintaGas Gas Distribution System. Empire considers that the Parmelia Pipeline offers considerable gas transportation cost advantages over the DBNGP.

AlintaGas' proposed gas quality specification incorporate the DBNGP gas quality specification, which is more narrowly defined over a wider range of gas components.

Empire understands that the Parmelia Pipeline gas quality specification meets the gas quality specification laid down in the Gas Standards (Natural Gas) Regulations 1999 issued under the Gas Standards Act 1972.

The decision by OffGAR to provisionally accept the more stringent gas quality specification can not be justified due to the following safety and anti-competitive reasons:

i) Safety

Empire understands that the gas flowing through the Parmelia Pipeline meets the gas quality specification under the Gas Standards (Natural Gas) Regulations 1999. These are based and refer to the Gas Standards Act 1972, which defined the gas specification for gas supplied to customers of the State Energy Commission of Western Australia for the period 1971 to 1984 prior to any gas production from the North West Shelf and transport via the DBNGP.

During this period, all natural gas supplied to the Perth region was produced in the Perth Basin and obviously complied with the Gas Standards Act 1972. This occurred without any safety issues or concerns in regard to gas quality.

In fact, the current Parmelia Pipeline's gas quality specification is more stringent than that laid down in Gas Standards Act 1972.

Gas located in Empire's Perth Basin Gingin Gas fields meets the Parmelia Pipeline gas quality specification.

ii) Anti-competitive

The GPAA legislates that AlintaGas must not engage in conduct for the express or inferred purpose of preventing or hindering the access of any person to a service provided by means of the AlintaGas Distribution System.

The gas quality specification proposed by AlintaGas and provisionally accepted by OffGAR would mean that current and future gas sourced from Perth Basin producers would require additional processing. For Empire this might mean production is not viable. At the very least it would have the effect of increasing rather than decreasing Empire's costs and therefore lessening competition between gas producers. Potential additional gas plant capital expenditure could amount to over $1 million and this may not even be sufficient to process the gas to a quality that meets AlintaGas' gas quality specification.

Empire considers that the proposed gas quality specification will hinder it accessing the AlintaGas Distribution System. Therefore, Empire believes that the proposed gas quality specification in the Access Arrangement infringes parts of Clause 13 that deals with preventing or hindering access.

Any barriers to entry to any market mitigate against competition, and the ability of end consumers of gas to exercise choice over gas supplier, retailer, or trader.

Furthermore, the TPA legislates that AlintaGas being a corporation that has a substantial degree of power in the market must not take advantage of that power for the purpose of preventing the entry of a person into that or any other market. Empire believes that the gas quality specification in the Access Arrangement infringes parts of s46 of the TPA.

Empire believes that OffGAR's decision to provisionally accept a more stringent gas quality specification is in direct conflict with the Operative Provisions Clause 2.1(c) of the Council of Australian Governments' Natural Gas Pipelines Access Agreement 1997 that the Western Australian Government agreed to. Clause 2.1(c) states that:

"The objective of this agreement is to establish a uniform national framework for third party access to natural gas pipelines that:
......
promotes a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders;"

Empire Proposal: OffGAR substitute the proposed gas quality specification with the gas quality specifications of the Gas Standards Act 1972.

2. REFERENCE TARIFF A - TARIFF STRUCTURE

Empire is opposed to OffGAR's decision to provisionally accept a tariff structure for Reference Service A that incorporates AlintaGas' definition of interconnection distance and a standing charge that has been set at an excessive and discriminatory level. Empire believes these components hinder competition and ensure that third parties do not compete on a level playing field. In fact, Empire can demonstrate that these provisions will allow AlintaGas to maintain its monopoly and hold out competitors for at least five years (i.e., Access Arrangement Period).

Empire notes that OffGAR has proposed that:

"Clause 21 of the Access Arrangement should be amended to provide a tariff structure for Reference Service A (or a succession of tariff structures for each year of the Access Arrangement Period) that accommodates a reasonable transition to the Reference Service A tariff from distribution tariffs that would have occurred for Users under the Gas Distribution Regulations 1996."

However, it should be noted that this only provides for a transition and so Users will eventually incur the proposed standing charge of $50,000 and therefore be much worse off than they would have been on the distribution tariffs that would have occurred under the current Gas Distribution Regulations 1996.

Empire argues that the tariff structure for Reference Service A is anti-competitive and discriminates against third parties due to:

a) the basis for calculation of interconnection distance; and

b) the imposition of a standing charge that is set at an excessive level.

Each issue will be discussed separately below.

a) Basis for Calculation of Interconnection Distance

The basis for calculation of the interconnection distance is defined in Chapter 10 of the Access Arrangement and is as follows:

".... a distance measured along the straight line which represents the shortest distance between the delivery point and the nearest pipeline or storage system from which gas is (or would be if an Interconnection Contract were entered into and necessary physical gate points and associated facilities were constructed) supplied into the AlintaGas Network;"

This means that Reference Tariff A is to be calculated on the basis of the straight line distance from a User's delivery point to either the Parmelia Pipeline or the DBNGP, whichever is closest.

OffGAR and AlintaGas justify this approach as quoted from the AlintaGas Access Arrangement Information (section 2.2.1) on the basis that:

"Use of distance to the nearest transmission pipeline as the measure of distance in the demand charge of Reference Tariff A is intended to mitigate the risk of inefficient by-pass of the AlintaGas Network."

Although the intent of the language is clear, the effect of the language, if taken literally, will be anti-competitive to Parmelia Pipeline and the gas it transports in favour of the DBNGP.

A pricing mechanism that has the intentional or unintentional effect of holding out competitors is clearly anti-competitive. The TPA legislates that AlintaGas being a corporation that has a substantial degree of power in the market must not take advantage of that power for the purpose of deterring or preventing any person (eg. Empire) from engaging in competitive conduct in that or any other market.

Empire considers that the basis for calculating the interconnection distance as proposed in the Access Arrangement will have the effect of preventing Empire and other parties engaging in competitive conduct. In fact, this provision will allow AlintaGas to maintain its monopoly and hold out competitors for at least five years (i.e., Access Arrangement Period).

Therefore, Empire believes that this provision infringes parts of s46 of the TPA.

Furthermore, Empire considers that this provision does not meet the principles outlined in Section 8 of the Code. The Code indicates that a Reference Tariff should be designed to:

- replicate the outcome of a competitive market; and
- not distort investment decisions in pipeline transportation systems or any upstream/downstream industries.

Empire Proposal: OffGAR amend the definition for interconnection distance to:

"interconnection distance means a distance measured along the straight line which represents the shortest distance between the delivery point and the nearest pipeline or storage system that supplies gas to that delivery point from which a User takes gas."

b) Reference Tariff A - Standing Charge

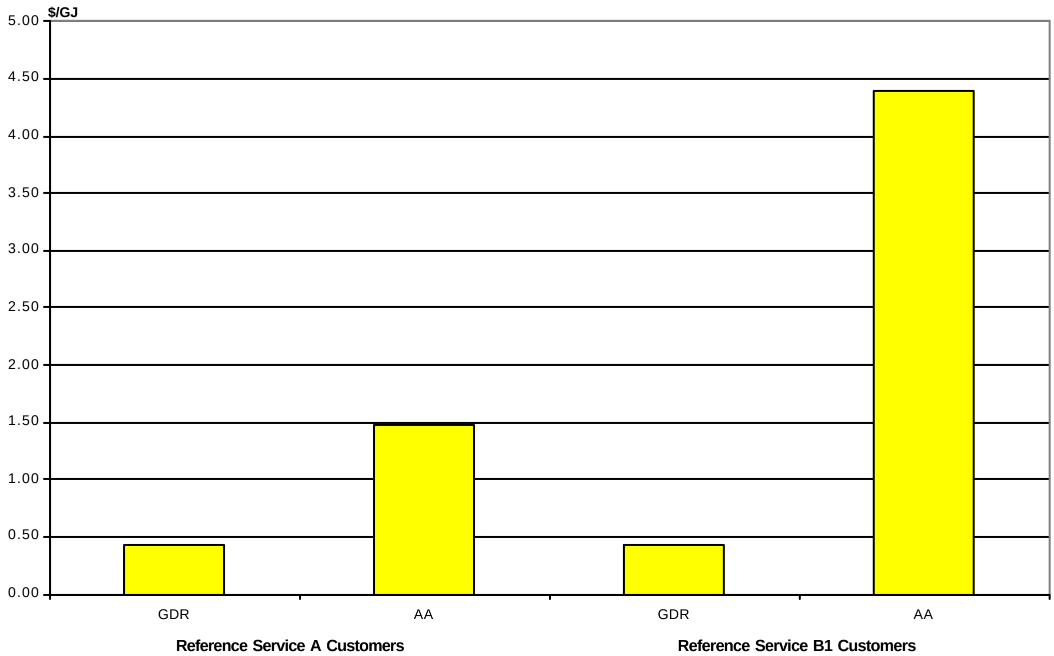
Empire considers that the standing charge of $50,000 for Reference Service A has been specifically set at a high level by AlintaGas to ensure that third parties such as Empire will find it difficult to capture any AlintaGas' customers if they have to supply gas via the AlintaGas Gas Distribution System.

This provision protects the AlintaGas Trading Business, who can use the diversity of its customer base to maintain supply to customers under competitive threat, i.e., it can use its residential market to cross subsidise its industrial market. In fact, this provision will allow AlintaGas to maintain its monopoly and hold out competitors for at least five years (i.e., Access Arrangement Period).

The impact of the proposed standing charge results in the tariffs for Reference Service A proposed in the Access Arrangement generally being substantially higher than those currently prevailing under the Gas Distribution Regulations.

Chart 1 shows that the tariffs for Reference Service A and B1 proposed in the AlintaGas Access Arrangement are generally substantially higher than those currently prevailing under the Gas Distribution Regulations.

Chart 1: Comparison: Gas Distribution Regulations and Access Arrangement Reference Service A and B1 Tariffs



The imposition of a $50,000 per year standing charge constitutes a substantial barrier to entry for Empire. For Empire to secure gas supply to a 100 terajoules per year customer who became contestable on 1 January 2000, just under half of the transport tariff paid by that AlintaGas competitor would be paid to AlintaGas to simply gain access to the market.

One of the stated objectives of the National Third Party Access Code for Natural Gas Pipeline Systems (the Code) is the promotion of a competitive market for natural gas in which customers may choose suppliers, including producers, retailers and traders.

Any barriers to entry to any market mitigate against competition, and the ability of end consumers of gas to exercise choice over gas supplier, retailer, or trader. The fixed charge incorporated in Reference Tariff A constitutes a substantial barrier to entry for competitors of AlintaGas.

Therefore, it may be seen that the tariff structure applicable to Reference Service A as currently proposed does not comply with the intent of the Code.

Whether it is intended, or unintended this provision hinders competition and therefore infringes Clause 13 of the GPAA. Furthermore, Empire considers that the standing charge will have the effect of preventing Empire and other parties engaging in competitive conduct. Therefore, Empire believes that this provision infringes parts of s46 of the TPA.

Overall Empire's contention is that the Standing Charge is either designed to block, or has the effect of blocking, access for third party producers, retailers and traders to the AlintaGas market.

Empire Proposal: OffGAR mandates that AlintaGas withdraws the currently proposed tariff structure for Reference Service A and puts in its place a structure which is fair and reasonable, and is in accordance with the intent of the Code.