DAMPIER TO BUNBURY NATURAL GAS PIPELINE

PROPOSED ACCESS ARRANGEMENT UNDER THE NATIONAL ACCESS CODE

FURTHER INFORMATION IN RESPONSE TO THE DRAFT DECISION

Response DD 3: Capacity of the DBNGP

5 October, 2001

Epic Energy (WA) Transmission Pty Ltd
ACN 081 609 190
Level 7
239 Adelaide Terrace
PERTH WA 6000
CONTACT: Anthony Cribb
TELEPHONE: 9492 3803

1. Introduction

1.1 On 21 June 2001, the Western Australian Independent Gas Access Regulator ("Regulator") released his draft decision in relation to the proposed access arrangement for the Dampier to Bunbury Natural Gas Pipeline (the "DBNGP") filed by Epic Energy. In accordance with the provisions of the National Gas Access Code ("Code"), the Regulator has called for public submissions in response to the draft decision.

1.2 This submission forms part of a number of submissions to be made to the Regulator by Epic Energy. The submissions focus on different aspects of the draft decision and various consequences of the draft decision and challenges whether these aspects and consequences are consistent with the requirements and principles of the Code that the Regulator must take into account when deciding whether to approve an access arrangement.

1.3 On 28 August 2001 the Supreme Court of Western Australia issued an Order Nisi (matter no CIV 2166 0f 2001) in respect to the draft decision. The orders were made on application of Epic Energy. The grounds contained in such application, inter alia, go to the application of the Code in considering the approval of a proposed access arrangement. The matters covered by the Order Nisi have not yet been considered by the Full Court and as a result it has not yet been finally determined whether the draft decision should stand nor whether the Regulator is required to take a different approach in applying the Code in his consideration of the proposed Access Arrangement for the DBNGP. The submissions are being made with that background and may therefore need to be adjusted or supplemented once the Full Court's decision is known. The submissions are made on a "without prejudice" basis to those proceedings. Epic Energy advises the Regulator that it will be likely that it will need to make further submissions once the outcome of those proceedings are known. Although Epic Energy is progressing the proceedings expeditiously, the timing of the outcome of these proceedings is a matter outside of Epic Energy's control.

2. Background

2.1 The draft decision on the DBNGP differed substantially from the proposed Access Arrangement filed by Epic Energy. One key area of variation is the Services Policy and the services to be offered. The Regulator has not accepted the proposed Reference Service as filed and, inter alia, instead has directed that the Firm Service proposed by Epic Energy as a Reference Service be combined with the non-reference Seasonal Service. The Reference Service amended as proposed by the Regulator, coupled with the tariffs flowing from the Draft Decision and the impact that has on Epic Energy if implemented, has a direct impact on the capacity available for the Reference Service.

2.2 It is important to note that the proposed Access Arrangement as filed by Epic Energy was put forward on the basis of the "regulatory compact" argument[1]. The proposed Access Arrangement as filed sought to closely replicate Schedule 39 of the DBNGP Asset Sale Agreement, a copy of which Epic Energy understands the Regulator has acquired. The tariff and tariff path were developed based on an average day capacity approach[2]. At the time of submitting its bid Epic Energy believed there was an appropriate risk and reward associated with the package set out in Schedule 39 to adopt the risk associated with the higher average day capacity in moving away from the lower risk tranche capacity approach. This is expanded on more in Section 3 of this Submission.

2.3 In the Draft Decision the Regulator has rejected the existence of the "regulatory compact"[3] and has rejected the tariff and tariff path associated with that. As a result, and as indicated in submissions to the Regulator[4], the proposed Access Arrangement must be looked at in a completely different light given that connection disappears. If the Regulator believes a "regulatory compact" does not exist then the fundamental assumptions underlying the Access Arrangement filed by Epic Energy are no longer appropriate. One of these is the use of average

[1] For a detailed description and discussion of the "regulatory compact" see DBNGP Access Arrangement Information, 15 December, 1999; Submission 1, 28 February 2000; Submission 3, 17 March 2000; DBNGP Revised Access Arrangement Information 28 July 2000; Additional Paper 4, 8 September 2000; Additional Paper 5, 25 October 2000.

[2] Average Day Capacity is explained or referred to in; DBNGP Access Arrangement Information 15 December 1999, Section 6; Revised Access Arrangement Information 28 July 2000, Section 6; Response 7 "Derivation of Average Day Capacity" 3 October 2000, Response 11 "Probability of Supply of Firm Service" 22 February 2001.

[3] "Epic Energy submitted that the manner in which the sale was conducted gave rise to the understanding of a regulatory compact between it and the Government on the price that may be charged for transmission of gas on the pipeline. While a number of references to transmission tariffs for the DBNGP were made at the time of the sale of the pipeline and subsequently, the Regulator has not been able to verify a regulatory compact". – OffGAR Notice "DRAFT DECISION – DAMPIER TO BUNBURY NATURAL GAS PIPELINE: 21 June 2001.

[4] DBNGP Access Arrangement Information 15 December 1999, Section 10; Response 7 "Derivation of Average Day Capacity" 3 October 2000 para 3.2, Response 11 "Probability of Supply of Firm Service" 22 February 2001 para 3.10.

day capacity as the capacity for the service. As the Regulator has surmised at page B.293 of the Draft Decision:

*"Notwithstanding the continuance of existing contracts, Epic Energy might, after approval of the Access Arrangement, be obliged to offer to vary the price for services under existing contracts to the Reference Tariff for the Firm Service. Whether or not this obligation exists depends in part on whether the Firm Service is considered to be equivalent to the existing T1 Service and/or T2 Service. A decision on this matter is outside of the jurisdiction of the Regulator. However, the Regulator notes that the Firm Service when amended in accordance with the requirements of this Draft Decision, and when offered in combination with the Non-Reference Services set out in Epic Energy's proposed Services Policy**, is similar to the T1 Service**."* (emphasis added)

Hence it is more appropriate to revert back to the tranche method of calculation of capacity as has been the case since 1995 with the system of third party access regulation introduced and prescribed by the State government.

2.4 Epic Energy has therefore modelled the capacity that would be available if it were to implement the Draft Decision. The conclusion is that there is a substantial reduction in available capacity to properly reflect the risk profile Epic Energy is prepared to undertake in implementing the Draft Decision.

2.5 Naturally if the Regulator should change to adopting the "regulatory compact" and the proposed Reference Tariffs filed, then it would be appropriate to continue with the average day capacity approach.

3. Average Day Concept

3.1 The Average Day concept derives from Schedule 39 of the Asset Sale Agreement for the sale of the DBNGP. Previously, when the pipeline was owned by the State, capacity[5] was provided in accordance with the terms and conditions of the Access Manual approved under the *Dampier to Bunbury Pipeline Act 1998*[6]. This in turn was largely based on the *Gas Transmission Regulations 1994, as they were in force immediately prior to their repeal.* The Average Day concept, as filed in the proposed Access Arrangement, is a fundamental part of what became known as the "Regulatory Compact", defined by Epic Energy as:

"…a label used by Epic Energy to describe the common understandings and expectations which developed during the process in which it bid for, and purchased, the DBNGP. These common expectations and understandings now give rise to the justification for the proposed Access Arrangement filed by Epic Energy with the Regulator…Epic Energy has not, and does not, suggest that the regulatory compact equates to an agreement or guarantee by the State that Epic Energy would be able to charge the tariffs set out in Schedule 39 of the DBNGP Asset Sale Agreement."[7]

3.2 Schedule 39 reflected the inextricable link between capacity quantum and the tariff and tariff path for the DBNGP and the derivation of Epic Energy's purchase price for the DBNGP. These played a significant role in Epic Energy fulfilling its commitments to the WA government made at the time of sale which formed part of the "regulatory compact". These commitments included:

- *"a payment by Epic Energy of a purchase price of $2.407 billion;*
- *a reduction in gas transmission tariffs to those outlined in Schedule 39;*
- *the future expansion of the DBNGP requiring capital expenditure of up to $875 million based on forecasts made by the Government at the time of sale;*
- *the relocation of Epic Energy's head office to Perth.*

The "commitments" include on the State's behalf:

an acceptance that the tariffs proposed in Schedule 39 were the appropriate tariffs".[8]

3.5 The proposed Access Arrangement and "Regulatory Compact" advocates an operating regime yielding a particular pipeline capacity in accordance with an appropriate risk profile. The Draft Decision does not offer sufficient reward for the

[5] The T1, T2 & T3 capacity.
[6] see clause 3(1) of Schedule 1 of the *Dampier to Bunbury Pipeline Act 1997*.
[7] Epic Energy Additional Paper 4: Regulatory Compact, 8 September 2000.
[8] Ibid.

requisite risk expected to be borne by Epic Energy, nor does it accept the other salient features of the “regulatory compact”.

4. The Capacity of the DBNGP

4.1 A key change in the Access Arrangement proposed by Epic Energy from previous access regimes was a marked increase in capacity available as "Firm Service" on a daily basis. This increase was largely achieved by adopting a riskier profile on availability of compressors, largely enabled by a proactive maintenance programme, supported in part by the proposed Reference Tariff and tariff path. The Regulator acknowledged in the Draft Decision that "…the Service Provider appears to be assuming a greater risk (in providing a Firm Service) than would be the case under the T1 Service"[9].

4.2 Attachment 1 illustrates the "Impact of Unit Availability on Tranche and Average Capacities" and demonstrates the relationship between compressor unit availability and pipeline capacity, depending on the type of service offered. This graph shows that as compressor unit availability increases, the capacity of a pipeline increases, in some circumstances exponentially. Whereas Average Day capacity can be seen to progress linearly and T1 capacity is largely flat until above 98% availability, T2 capacity is somewhat unpredictable. It should be noted that under the access regime extant before Epic Energy purchased the DBNGP, compressor unit availability was taken as being significantly less than 98% and fell somewhere between 90-95%, depending on the compressor.

4.3 In the proposed access arrangement, Epic Energy assessed that a compressor unit availability of approximately 98% for the Solar Mars and 96% for the LM 500/PGT10 units deriving an annual average daily capacity of 630Tj was possible, with 605Tj available on the lowest day of the lowest month. This availability would have been achieved through a suitable level of operations expenditure and shifting maintenance schedules to periods of lower demand. Given the fixed nature of the Reference Tariff and tariff path resulting from the "regulatory compact" there was an incentive built in for the Service Provider to operate the pipeline efficiently in order to achieve those availabilities. The capacity also took into account the current prescribed and contracted gas specification of 5.5% inerts, in accordance with the DBNGP Access Manual. The capacity available under the Average Day concept is illustrated at Attachment 2.

4.4 Epic Energy's financial viability is dealt with in a separate submission[10]. However, what is well known is that under the tariff regime proposed by the Regulator in the Draft Decision, with indicative tariffs around 0.75c in Zone 9 and 0.85c in Zone 10, the availability of financial resources to the company is severely constricted. In meeting the debt servicing requirements, assuming that Epic Energy could even avoid an Event of Default under its financial obligations and can refinance the debt, there will simply be insufficient funds to meet the Non Capital Costs forecast during the Access Arrangement period[11]. There is a clear relationship between the amount of money available for operations expense (a

[9] DBNGP Draft Decision dated 21June 2001, Part B p.31.
[10] Epic Energy Confidential Submission DD1: Financial Viability filed on 20 September 2001
[11] Ibid. Table; "Revisions to forecast Non-Capital Costs "Part B p189.

non capital cost) and the availability of compressors. Given the financial distress suffered in the event of the Draft Decision being implemented, not only does this work to drive down capacity itself, but under the Draft Decision, no incentive exists to accept the risks of altering maintenance practice as envisaged under the Average Day concept.

4.5 Under the Access Arrangement proposed by the Regulator, compressor availability would likely be reduced, at best, to 96% for the Solar Mars units and it would likely remain constant at 96% for the LM 500/PGT10 units, although this remains well above the availability achieved by the State when it owned the pipeline. Additionally, the Regulator has decreed that from 2005 the broadest specification of gas prescribed in the *Dampier to Bunbury Regulations 1998*[12], despite their repeal with the approval of the Access Arrangement, should be adopted in the Access Terms and Conditions. This means that the quality of the gas carried in the DBNGP would be substantially worse than that prescribed in the proposed Access Arrangement proposed by Epic Energy and therefore more pipeline capacity is required to carry an equitable heating value. Given that the volume of the gas able to be transported is unchanged but the quality produces a lower energy value, the capacity of the pipeline in energy terms, TJ/day, reduces. In coupling the broadest gas specification with a compressor unit availability of 96%, an annual average daily capacity (T2 cutoff) would be derived of just under 490Tj, with the lowest day of the lowest month (T2 cutoff) being 473Tj. This impact is illustrated at Attachment 3.

[12] 6.5% inerts.

5. Projected Impact of the Draft Decision if Implemented

5.1 The current contracted combined T1 and T2 capacity for the DBNGP is marginally under 550Tj per day. Were the Draft Decision to be implemented, capacity may not be available in 2005 for current contract holders who have an option to extend their present contracts at the "statutory price" – that of course may reflect in the determination of the "statutory price" for those shippers. Instead, the capacity shortfall would most likely only be available at an appropriate tariff for incremental expansion, taking account of the prevailing risk, or as is more likely given the financial stress of Epic Energy, if a capital contribution is made by the party requiring such capacity[13].

5.2 The practical impact of the Regulator's intention, as illustrated by the Draft Decision, might be compared to removing a pipeline of equivalent capacity somewhat larger than the Goldfields Gas Pipeline. This line of thought appears to be not only at odds with the rationale for founding a single Regulator specifically for Western Australia, but against the objectives of the National Access Code, including those promoting a competitive market for natural gas and facilitating pipeline development. Additionally, the Draft Decision projected outcome does not sit well with section 8 of the Code in that it does not offer "…a market-based incentive to improve efficiency" and in particular with section 8.1(d), as it appears to be distorting investment decisions on the pipeline and both upstream and downstream. If the Regulator's Draft Decision were implemented it would severely constrain future economic development in the State and have a negative impact on present energy availability and current economic activity. That loss of energy would have to be made up by alternative fuels. The realistic alternative to natural gas in WA is coal and thus the Regulator has worked not only against the interests of the Service Provider, but those of the User and the public in making energy more expensive and further, by increasing carbon emissions.

5.3 It is difficult to understand how stated government policy to disaggregate Western Power and to move to full retail contestability in the gas distribution sector can be implemented in such circumstances. In the first instance the impact of the Draft Decision, if implemented, is to halt expansion of the DBNGP and secondly, it serves to reduce existing pipeline capacity. This can only provide an uncompetitive advantage to incumbent Users.

[13] The issue of incremental expansion pricing is dealt with in Epic Energy Submission DD2: Response to the Existing Shippers' Submission on Epic Energy's "Second Class Citizens" Argument filed on 5 October 2001.

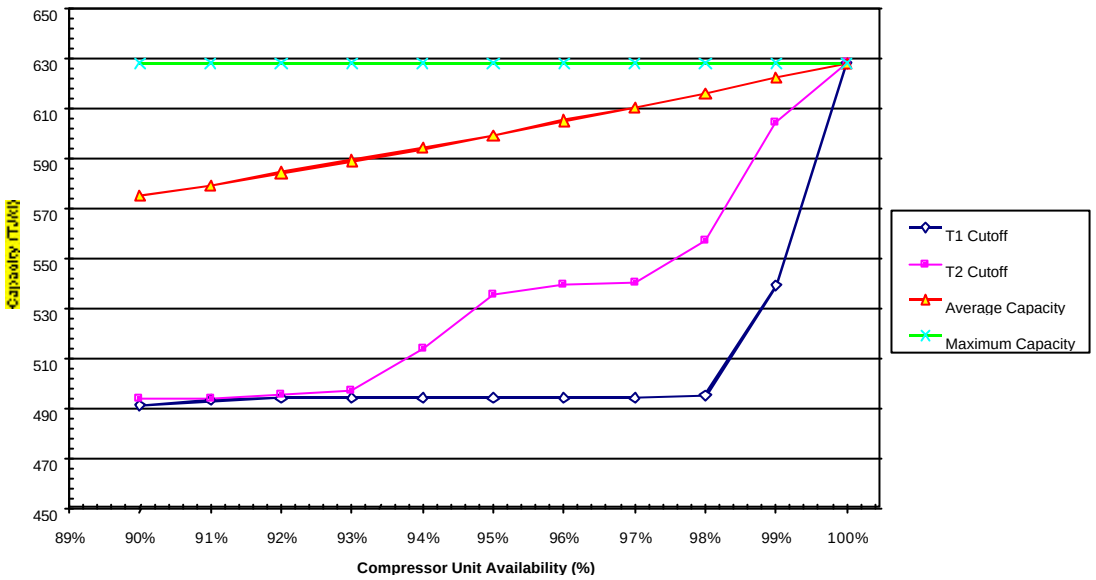
6. Conclusion

6.1 A notable and stated benefit to the State when Epic Energy purchased the DBNGP was a continuing commitment to expand the capacity of the pipeline. This commitment has already been honoured by the Stage 3A expansion, although the company remains committed to further expand the pipeline in the event of a satisfactory rates case outcome. Clearly such expansion, particularly that achieved at minimal cost through efficiency, is of considerable User and public benefit. The Regulator, should the Draft Decision be implemented, has acted contrary to this interest by removing the incentive to operate with higher risks, in addition to providing a return insufficient to allow Epic Energy to operate the pipeline to meet current contracted demand.

6.2 In making a decision that will likely result in constricting present capacity, certainly from 2005, the Regulator is causing serious harm to present levels of energy availability in WA, the logical outworking of which would be a climate in which energy price rises could be expected.

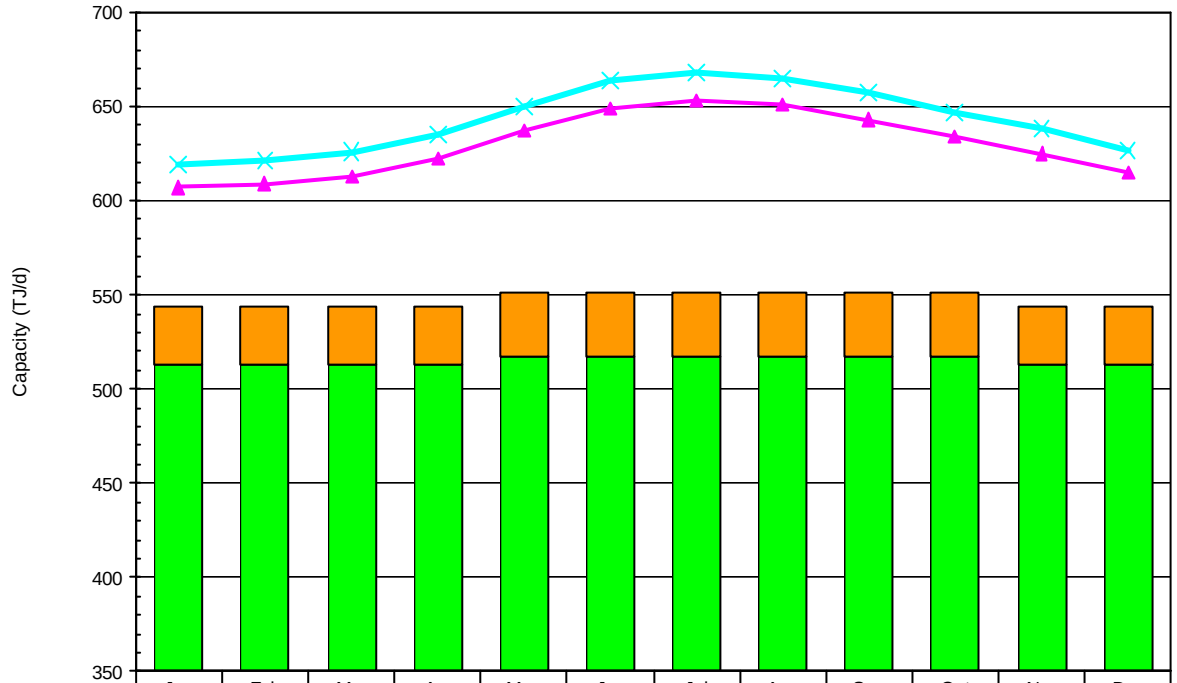
Attachment 1

Impact of Unit Availability on Tranche and Average Capacities



Attachment 2

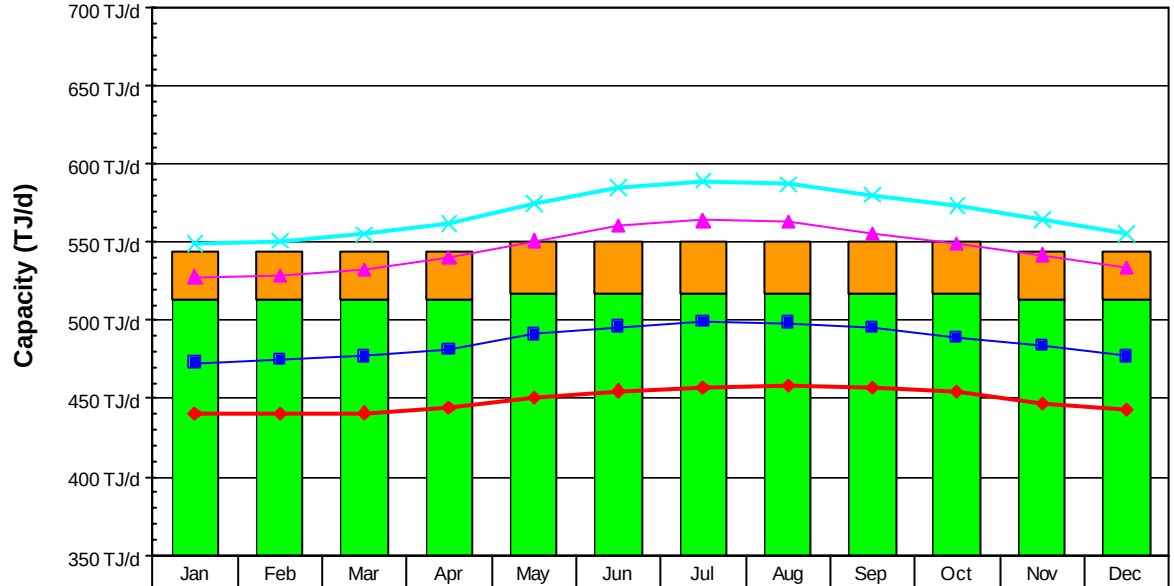
DBNGP Monthly Capacity (Current Average Gas Spec)
Compressor Unit Availability= 98% (Solar Mars) & 96% (LM500/PGT10)



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Contracted T2	31	31	31	31	34	34	34	34	34	34	31	31
Contracted T1	513	513	513	513	517	517	517	517	517	517	513	513
Max Cap	619	621	626	635	650	664	668	665	657	647	638	627
Avg Cap	607	609	613	622	637	649	653	651	643	634	625	615

Attachment 3

DBNGP Monthly Capacity with Worst Gas (6.5% inerts and 46MJ/m3 Wobbe)
Compressor Unit Availability= 96% (Solar Mars) & 96% (LM 500/PGT10)



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Contracted T2	31 TJ/d	31 TJ/d	31 TJ/d	31 TJ/d	34 TJ/d	34 TJ/d	34 TJ/d	34 TJ/d	34 TJ/d	34 TJ/d	31 TJ/d	31 TJ/d
Contracted T1	513 TJ/d	513 TJ/d	513 TJ/d	513 TJ/d	517 TJ/d	517 TJ/d	517 TJ/d	517 TJ/d	517 TJ/d	517 TJ/d	513 TJ/d	513 TJ/d
Max Cap	549 TJ/d	551 TJ/d	555 TJ/d	562 TJ/d	575 TJ/d	585 TJ/d	589 TJ/d	587 TJ/d	580 TJ/d	573 TJ/d	565 TJ/d	556 TJ/d
Avg Cap	528 TJ/d	529 TJ/d	533 TJ/d	540 TJ/d	551 TJ/d	561 TJ/d	564 TJ/d	563 TJ/d	556 TJ/d	549 TJ/d	542 TJ/d	534 TJ/d
T2 Cutoff	473 TJ/d	475 TJ/d	477 TJ/d	481 TJ/d	491 TJ/d	496 TJ/d	499 TJ/d	498 TJ/d	495 TJ/d	489 TJ/d	484 TJ/d	477 TJ/d
T1 Cutoff	440 TJ/d	440 TJ/d	441 TJ/d	444 TJ/d	451 TJ/d	455 TJ/d	457 TJ/d	458 TJ/d	457 TJ/d	454 TJ/d	447 TJ/d	443 TJ/d