



DAMPIER TO BUNBURY NATURAL GAS PIPELINE

PROPOSED ACCESS ARRANGEMENT UNDER THE NATIONAL ACCESS CODE

FURTHER INFORMATION IN RESPONSE TO THE DRAFT DECISION

PUBLIC VERSION

Additional Information DD 4: Incremental Tariffs on the DBNGP

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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 paper forms part of a number of papers being provided to the Regulator by Epic Energy. Each paper focuses 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 Of 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 additional information is being provided with that background and may therefore need to be adjusted or supplemented once the Full Court's decision is known. The additional information is provided 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 Epic Energy has stated¹ that its proposed Access Arrangement was designed to ensure that any additional capacity expansions would not result in an increase in the reference tariff to all users and that the same tariff would be payable by all users of the same service, irrespective of whether the user was accessing original capacity or incremental capacity.
- 2.2 However, the Regulator's Draft Decision, if implemented, would preclude this approach. Instead, it will mean that where there is sufficient demand to warrant an increase in the capacity of the pipeline, the tariffs that Epic Energy must charge for users of the incremental capacity will have to be assessed on a case by case basis².
- 2.3 Furthermore, where any expansion has a higher marginal cost of capacity than the average cost of capacity, the Code only allows for the cost of that incremental capacity to be rolled in to the initial capital base (and therefore an increase in tariffs for all users) in very limited situations. Such occasions also only enable the Service Provider to earn a regulated rate of return on the additional capacity. However, this allowable rate of return does not reflect the inherent risk in the higher marginal cost of capacity, particularly as expansions cannot be done to precisely match contracted capacity. This therefore acts as a disincentive to the Service Provider to fund any part of that expansion. As a result, users of the incremental capacity will be forced to pay more for a service than users of the existing capacity will be paying for the same service.
- 2.4 Epic Energy has also advised the Regulator of the following³:

"Pipeline capacity expansion does not automatically imply an increase in tariffs. The marginal costs of some expansions are lower than the average cost of capacity. Those expansions result in a lowering of tariffs determined on an average cost basis (the average cost basis was used under the pricing methods of the GTRs). However, not all expansions have this desirable outcome. When a pipeline is fully compressed, additional capacity must be obtained by looping (duplicating sections of the line)⁴. Initial looping typically has marginal costs which exceed the average cost of capacity and, when undertaken, increases tariffs that have been determined on an average cost basis.

¹ Epic Energy Submission 1 (Confidential version) dated 15 December 1999. Epic Energy Revised Access Arrangement Information dated 28 July 2000.

² See paragraph 4.8 of Epic Energy's Additional Information Paper DD2: Response to the Existing Shippers' Submission on Epic Energy's "2nd class citizens' claim" dated 5 October 2001.

³ Ibid, paragraphs 4.2 to 4.4

⁴ See paragraphs 5.18 – 5.21 of Epic Energy's Confidential Submission DD1: Financial Viability filed on 20 September 2001.

As mentioned in Epic Energy's previous submission filed with the Regulator on 8 September 2000⁵, the DBNGP is close to being fully compressed and therefore the next expansion of the Pipeline's capacity will require looping. In fact the Stage 3A expansion (being the most recent expansion of the Pipeline) involved some looping of the southern section of the Pipeline.

As the pipeline must be looped to allow for the next expansion of the pipeline, the issue of a higher marginal cost of capacity, and therefore whether the tariffs and charges to be paid by prospective users seeking that additional capacity should be the same as the tariffs to be paid by users of the same service provided with the existing capacity, will be of immediate relevance as soon as there is sufficient demand to warrant the next expansion of the pipeline. If the current demand forecasts are realised, then the next expansion will be required in about 2005 to cater for an additional load of in the vicinity of 41TJ/day."

- 2.4 Attachment 1 shows an indication of the incremental cost curve for each staged expansion on the DBNGP. It quite clearly demonstrates that the initial stages will be the most expensive. Were Epic Energy to continue with its rolled in approach to incremental expansion, as in its proposed Access Arrangement, the impact of the expansion particularly to new Users is substantially mitigated.
- 2.5 The draft decision also gives rise to another consequence that has been outlined in another information paper⁶. In summary, the amendments required in the draft decision remove the incentive on the Service Provider 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. As stated in those other papers, Epic Energy has noted that the reason it adopted an average day approach to capacity in the draft Access Arrangement was to be consistent with Schedule 39 of the DBNGP Asset Sale Agreement. If Epic Energy's arguments around the sales process are rejected, as is the case in the Draft Decision, and it is required to incorporate such amendments in an access arrangement, it may be more appropriate to apply 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. As such, Epic Energy may be required to add capacity to meet existing contractual requirements.

⁵ Section 4.5 of Epic Energy's Additional Paper 3: Comments on AlintaGas' Fourth Submission to the Western Australian Independent Gas Access Regulator on Epic Energy's DBNGP Access Arrangement, dated 8 September 2000

⁶ Epic Energy's Additional Information Paper DD3 "Capacity of the DBNGP", dated 5 October, 2001.

3. Tariffs for the Expanded Capacity of the DBNGP

- 3.1 Attachment 2 sets out the likely tariffs that Epic Energy would have to charge for each future stage of incremental capacity that will need to be built based on current forecasts.
- 3.2 However, in calculating these tariffs the following key assumptions have been made:
- It should be noted that it is extremely difficult to provide, with any degree of accuracy, the likely tariffs that Epic Energy would need to charge for the additional capacity, given that there is no certainty as to the amount of additional capacity that will be required or the terms on which that capacity would be contracted⁷. The figures contained in this paper are based on the current forecasts as provided to the Regulator and Epic Energy's current projections of future demand beyond the current regulatory period.
 - It is assumed that there are no capital contributions payable by the new users, although this is a real potential outcome.
 - Given the impact of the draft decision referred to in paragraph 2.5 of this paper, the available capacity has been determined adopting the tranche method.
 - Finally, the tariffs shown in Attachment 2 do not take into account the additional expansion that would be required as a result of the impact on future capacity requirements that the draft decision, if implemented, will have on not just prospective users of the pipeline but also existing users. These arguments have been presented to the Regulator in another paper⁸. Suffice to say, were this situation to be taken into account for the purposes of determining the incremental tariffs required, the incremental tariffs would be higher than the tariffs provided in this paper.
- 3.3 Based on the above assumptions, Attachment 2 shows likely tariffs (to Perth) for each stage of expansion and the likely volumes required to support that expansion. It clearly shows that the tariffs will be greater for the initial stages than the tariff proposed by the regulator in the draft decision.
- 3.4 This further supports the argument that it is in the interests of users of the incremental capacity for the tariff path proposed in Epic Energy's proposed Access Arrangement to be adopted. As mentioned in the previous papers, this will also give Epic Energy an incentive to promote gas growth, so that it can build the latter stages of capacity which are a lower marginal cost than the initial stages.

⁷ Not only will the unit cost vary depending on the amount of capacity built at one time, but also where that capacity is required, financing costs, exchange rates and risk elements such as duration of the initial contract for the new capacity and the risk balance associated with the terms and conditions of the contract.

⁸ See Epic Energy's Additional Information Paper DD3: "Capacity of the DBNGP", dated 5 October 2001.

4. Conclusion

- 4.1 A notable benefit to the state and a critical element sought by 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. Epic Energy remains committed to further expand the pipeline in the event of its proposed Access Arrangement being approved. 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, will have 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.
- 4.2 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.

5. Deleted

ATTACHMENT 1

INCREMENTAL EXPANSION COST CURVE

Deleted – Commercial in Confidence

ATTACHMENT 2

Deleted – Commercial in Confidence