

Submission to the Gas Access Regulator concerning Epic Energy's “Second Class Citizens”

AlintaGas Sales Pty Ltd

Apache Energy

North West Shelf Gas

Wesfarmers CSBP Limited

WMC Resources Ltd

Western Power Corporation

Worsley Alumina Pty Ltd

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ON EPIC ENERGY'S "SECOND CLASS CITIZENS"

1. INTRODUCTION

This Submission has been prepared in response to a request from the Western Australian Independent Gas Pipelines Access Regulator ("**Regulator**") for submissions from interested parties concerning the Regulator's Draft Decision ("**Draft Decision**") on Epic Energy's proposed Access Arrangement ("**Access Arrangement**") for the Dampier to Bunbury Natural Gas Pipeline ("**DBNGP**").

This is a joint submission, prepared by a number of DBNGP shippers ("**Existing Shippers**") that have contracts with Epic Energy for firm full-haul capacity on the DBNGP, or are affected by such contracts. The Existing Shippers are:

- AlintaGas Sales Pty Ltd;
- Apache Energy Limited;
- North West Shelf Gas Pty Ltd;
- Wesfarmers CSBP Limited;
- WMC Resources Ltd;
- Western Power Corporation; and
- Worsley Alumina Pty Ltd.

The Existing Shippers are concerned by arguments being put forward by Epic Energy that the Regulator's Draft Decision, if approved, would create "second class citizens" on the DBNGP.

This submission argues that the *National Third Party Access Code for Natural Gas Pipeline Systems* ("**Code**") contains ample mechanisms to avoid the situations to which Epic Energy alludes in a way that would not create a set of "second class citizens".

2. EPIC ENERGY'S "SECOND CLASS CITIZENS" ARGUMENT

Epic Energy has asserted that some shippers will become "second class citizens" on the DBNGP if the Regulator approves the Draft Decision.

Assuming that the approved Access Arrangement reflects the Draft Decision, Epic Energy will be required to transport gas to Perth for around \$0.78 per GJ, to the Kwinana industrial area for about \$0.85 per GJ, and to locations South of Kwinana for around \$0.89 per GJ [Part B: p268]. Epic Energy has indicated that it will not expand the DBNGP at these prices.

Epic Energy suggests that shippers that do not already have contracted capacity on the DBNGP will have to pay more for capacity because Epic Energy will not undertake pipeline expansions at the reference tariffs currently proposed by the Regulator. Epic Energy will require shippers to pay more than the reference tariff, either by way of a capital contribution or surcharge, to ensure an expansion of the DBNGP is economically feasible.

Epic Energy has used the example of a new 50 TJ/day load in Perth, such as a 280 MW combined cycle power station. Epic Energy claims that the required expansion of the DBNGP to cater for such a load would require the shipper contracting for the capacity to pay a tariff of at least \$1.32 per GJ¹.

The underlying implication of Epic Energy's example is that an expansion of the DBNGP will cost more, on a per unit basis, than the proposed firm service tariffs.

Epic Energy suggests that this will create a barrier to competition, creating a set of "second class citizens" that will be paying higher prices than the approved firm service tariff in order to gain access to DBNGP capacity. This, says Epic Energy, will restrict economic development in the South-West of the State.

3. EXPANSIONS OF THE DBNGP COULD COST MORE THAN THE AVERAGE

The Existing Shippers acknowledge Epic Energy's underlying contention, namely that some expansions of the DBNGP may cost more, on a per unit basis, than the proposed firm service tariff. For example, the first phase of looping on the DBNGP might have a relatively high incremental cost.

However, the Existing Shippers would also expect that other expansions, such as the final stages of looping and additional compression, are likely to cost less, on a per unit basis, than the proposed DBNGP tariff. Existing Shippers note that when Epic Energy purchased the DBNGP it claimed that it would double the capacity of the pipeline over a ten year period at a cost of A\$874 million. This being the case, the per unit cost of doubling the capacity would be less than the per unit cost implicit in the Regulator's proposed capital base of \$1.234 billion upon which the prices proposed in the Draft Decision are based.

Epic Energy seems to be inferring that the "second class citizens" issue can only be solved by increasing the proposed firm service tariffs. Presumably, if the Regulator were to approve higher firm service tariffs, then incremental expansions of the DBNGP would no longer be more expensive, on a per unit basis, than the applicable firm service tariff.

However, this does not solve the problem, since all shippers will then be paying unacceptably high tariffs that are not derived in accordance with the provisions of the Code using sound economic principles.

¹ The Existing Shippers have not attempted to verify whether Epic Energy's tariff calculation is appropriate. This would be established by determining the efficient cost of undertaking an expansion and applying a reasonable rate of return and depreciation schedule to the efficient cost.

The solution to the problem raised by Epic Energy is to apply the principles and provisions of the Code, as discussed below.

4. A SOLUTION TO EPIC ENERGY'S CONCERNS

4.1 **Capacity expansion costs can be added to the capital base**

There would be no “second class citizens” on the DBNGP if the costs of expansions were simply added to the capital base in accordance with provisions of the Code.

Adding expansion costs to the capital base would result in a change to the tariff payable by all shippers. It would ensure that all shippers within a zone would pay the same tariff, with no shipper being at a disadvantage. There would then be no “second class citizens”; economic development in the South-West of the State would not be constrained.

In principle, the Existing Shippers accept that adding the cost of capacity expansions to the capital base may, on occasions, result in an increase in the firm service tariff. On other occasions, the firm service tariff would decrease.

Section 8.16 of the Code, and in particular sections 8.16(a) and 8.16(b)(ii), allows Epic Energy to add the cost of an expansion to the capital base if:

- (i) Epic Energy is acting efficiently in accordance with good industry practice and the expansion costs are prudently incurred; and
- (ii) the capacity expansion has system wide benefits.

In all likelihood there would be system wide benefits from expansions of the DBNGP where work on the mainline, such as looping, additional compression and various modifications to the communications and control systems is involved. All shippers would benefit from the improved supply reliability and security provided by such expansions of the mainline.

Further, the zonal system of allocating costs will ensure that shippers upstream of a particular expansion, who would not benefit from the increased reliability provided by the expansion, would not have a modified tariff as a result of the expansion costs being added to the capital base.

The addition of expansion costs to the capital base also avoids the potential inequities faced by shippers seeking access to the DBNGP at different times in the DBNGP expansion cycle. No shipper would find that they were forced to pay a high price to fund an increase in capacity, only to find that the next shipper to require a capacity increase simply has to pay the published tariff.

This submission is proposing that, to address Epic Energy's concerns, DBNGP expansion costs that have a system wide benefit should be added to the capital base. However, it is not being suggested that the Regulator should approve the addition of expansion costs to the capital base where the expansions are specific to the requirements of individual shippers. Such shipper specific expansions might include the provision of new receipt and delivery points and the construction of dedicated laterals, for example.

4.2 Timing issues

Capacity expansion costs, if they are to be added to the capital base, might be added on the date that subsequent revisions to the Access Arrangement commence (the “**Revisions Commencement Date**”). In Epic Energy’s case, the Revisions Commencement Date is proposed to be 1 January 2005. The Existing Shippers submit that this may not be ideal as it could disadvantage Epic Energy and/or the shipper seeking access to additional DBNGP capacity, because:

- (i) Epic Energy may not be able to recover its expansion costs until the Revisions Commencement Date, which could be a few years away depending on when the expansion occurs; and
- (ii) Epic Energy, if it proceeded with the expansion, would be incurring costs without certainty that the Regulator will allow the costs to be added to the capital base.

However, the Code contains provisions to overcome such potential problems. Options available to Epic Energy and the Regulator are:

1. Epic Energy could include the costs of planned capacity expansions within its current Access Arrangement forecasts. If the Regulator approves the forecasts, then the expansion costs will be incorporated into the capital base for the purposes of determining reference tariffs for the current Access Arrangement period.
2. Epic Energy can, in accordance with section 2.28 of the Code, submit revisions to its Access Arrangement at any time. Thus, an unplanned expansion can be added to the capital base in accordance with section 8.16 of the Code when it becomes clear that the expansion is proceeding.
3. Under section 3.17 of the Code, the Regulator may include a trigger mechanism within the Access Arrangement to require Epic Energy to submit revisions to the Access Arrangement if Epic Energy expands the DBNGP by more than a specified quantity of capacity. This provides an automatic facility whereby capacity expansions can be considered for addition to the capital base prior to the Revisions Commencement Date.
4. At the time Epic Energy seeks to expand the DBNGP, Epic Energy may, in accordance with section 8.21 of the Code, apply to the Regulator for a binding agreement that the expansion costs will be included in the capital base when the Access Arrangement is revised. This will give Epic Energy the certainty it needs to expand the DBNGP.

5. CONCLUSION

The Existing Shippers submit that:

1. The Regulator should dismiss Epic Energy's arguments that the tariffs proposed by the Regulator in the Draft Decision should somehow be increased in order to avoid creating a group of "second class citizens".
2. As part of the DBNGP Access Arrangement final decision the Regulator should clarify that the Code provides for the timely addition into the capital base of efficiently incurred DBNGP expansion costs that have a system wide benefit, thereby ensuring that:
 - Epic Energy receives a reasonable rate of return on its incremental investment;
 - the regulatory risk associated with Epic Energy undertaking additional capital expenditure is minimised;
 - the associated uncertainty for new gas based industrial projects is removed;
 - there is a level playing field in energy competition, for both gas and electricity markets; and
 - all shippers in the same zone pay the same tariff as the DBNGP is progressively expanded over the coming years.