

Dampier to Bunbury Natural Gas Pipeline – Treasury and Office of Energy Submission On the Proposed Access Arrangement

Introductory Comments

The State sold the DBNGP to Epic Energy on 25 March 1998 as a result of a trade sale process in which bidders tendered by binding bid. A complying bid required the bidder to agree and sign a particular DBNGP Asset Sale Agreement (the Agreement), that Agreement being available to be executed by the vendor on its acceptance of the bid. The vendor was the Gas Corporation, AlintaGas, an agent of the Crown in right of the State.

The form of the Agreement was specified by the vendor. The State required the bidder to stipulate the bid price that the bidder offered. It further required the bidder to indicate as Schedule 39 to the Agreement its proposed tariff rates for gas transmission and a tariff path. The bidder agreed that the proposed tariff rates and path indicated by the bidder could at vendor's discretion be disclosed by the vendor in the course of any public enquiry or other determination process relating to tariff rates for gas transmission. This includes a disclosure to the Regulator in connection with the Regulator's consideration of an access arrangement proposal for the DBNGP by the bidder.

In the sale process there was no other agreement between the vendor and the bidder, and no other obligation placed on the bidder by the vendor, or the State, in respect of tariff rates for gas transmission or a tariff path for third party use of the DBNGP. The sole right of the vendor with respect of the proposed tariff rates and path indicated to it by the bidder is to have discretion to disclose to the Regulator those tariff rates and path as being proposed by the bidder at the time of the sale. The effect of such disclosure continues to be viewed by the State, as providing an indication of the maximum tariff rates for gas transmission, which the bidder might be able to sustain in a regulatory process conducted by an independent Regulator. Nothing in that Agreement is viewed by the State as creating a binding obligation on the Regulator or any form of regulatory compact between the State and Epic Energy in relation to tariffs for third party use of the DBNGP.

For its part, the State has regulated third party user tariffs on the DBNGP since the sale of the DBNGP until an approved Access Arrangement comes into effect. Those transitional tariffs have been capped on a declining tariff path. The regulated cap for this period can be summarised for full haul use at 100% load factor as approximately \$1.19/GJ in 1998 and \$1.095/GJ in 1999, and 1.00/GJ from January 2000.

The State believes it has been warranted in its view that tariffs for third party users would be about \$1.00/GJ from 1 January 2000 not because it had implemented this regulation of transitional tariffs, but because Epic Energy indicated such a tariff as Schedule 39 in its binding bid for the DBNGP.

In its second submission to the Regulator on Epic Energy's proposed DBNGP Access Arrangement AlintaGas has exercised its discretion to disclose to the Regulator the proposed tariff rates for gas transmission and the tariff path which Epic Energy was required to set out in Schedule 39 to the Agreement. The State had sought and endorsed that disclosure as providing information relevant to the regulatory process being conducted under the *Gas Pipelines (Western Australia) Act 1998* and which the Regulator may make public in connection with consideration of Epic Energy's proposed DBNGP Access Arrangement.

1. State's Submission on the Proposed Access Arrangement

As a party to the 1997 Council of Australian Governments Natural Gas Pipelines Access Agreement, the State is committed to a uniform national framework applying to access to natural gas transmission pipelines. The *Gas Pipeline Access (Western Australia) Act 1998* (the Act) implements the uniform National Third Party Access Code for Natural Gas Pipeline Systems (Code) in this State.

The Regulator is, under the Act, independent of Government direction in respect of his conduct of regulatory functions, and this consideration of the Access Arrangement proposed by Epic Energy is required by the Act to be consistent with the obligations the Code places on him.

It is noted that the Regulator is required to have regard to each of the factors set out in section 8 and subsection 2.24 of the Code. One such factor is Epic Energy's legitimate business interests, including the investment Epic Energy has already made in the DBNGP. In this context the Regulator could consider whether the proposed tariff path will provide Epic Energy with a reasonable rate of return on its investment in the DBNGP having regard to the tariffs and supporting information set out by Epic Energy in its Proposed Tariff Rates and Path (Schedule 39 of the DBNGP Asset Sale Agreement).

At the same time, and amongst other factors, the Regulator also needs to consider the interests of users and prospective users of the pipeline, the public interest, including the public interest in having competition in markets and the economically efficient operation of the pipeline.

The State's position on the DBNGP statutory tariffs in 1998, 1999 and from 1 January 2000 until the Regulator's decision comes into effect, has been consistent from the time of the DBNGP sale. It should be noted, however, that the State does not in any way regard the level of those transitional tariffs as having any particular importance as a factor in the Regulator's decision on the proposed Access Arrangement. They may be relevant in considering the reasonableness of the various parameters proposed by Epic Energy, but they in no way bind the Regulator to a particular tariff outcome.

Some of the comments in this submission request the Regulator to consider whether the Access Arrangement Information is sufficient to permit interested parties to understand the derivation of the "elements" in the proposed Access Arrangement.

The Submission also raises a number of concerns with the proposed Access Arrangement. However, it is important to note that the State supports in principle the “innovative” approach taken by Epic Energy on various aspects of its proposal and considers that in many of those aspects the proposed Access Arrangement is aimed at improving the former access regime applying to the DBNGP. Two examples are the introduction of a zonal structure for the Reference Tariff to more accurately reflect costs, and the development of a secondary market for transmission services.

2. Reference Services

2.1 Services Offered in the Proposed Access Arrangement

The reference service offered by Epic Energy is Firm Service, which can be either forward haul or backhaul. (p6, Access Arrangement)

Section 3.3 of the Code requires Epic Energy’s Access Arrangement to offer a reference tariff for “at least one service that is likely to be sought by a significant part of the market, and each service that is likely to be sought by a significant part of the market and for which the Regulator considers a reference tariff should be included”.

It is noted that the single reference service (the Firm Service) offered by Epic Energy in its Access Arrangement appears different from the firm service which was offered under the Gas Transmission Regulations (GTRs) and the Transitional Regime under the Dampier to Bunbury Pipeline Act (ie T1 service) and is presently used by “a significant part of the market”, under contracts which are grandfathered under section 96 of the *Gas Pipelines Access (Western Australia) Act 1998* as to terms and conditions, but not necessarily, price.

Further, Epic Energy has not offered in its Access Arrangement a service similar to the current “interruptible” service, which is also at present used by some shippers on the DBNGP. It is also worth noting that the existing contracts utilise almost the entire capacity of the pipeline as currently configured. To form a view in relation to section 3.3 of the Code, it is considered that the Regulator should consult with the current and prospective DBNGP shippers in order to determine if the Firm Service offered by Epic Energy under the proposed Access Arrangement is the single reference service likely to be sought by a significant part of the market.

In addition, it is noted that non-reference services offered by Epic Energy such as the seasonal service, and the “park and loan” service appear to correspond to “services” embedded in the existing contractual arrangements consistent with the GTRs and the Transitional Regime. A number of those contracts are understood to have seasonal variation in contracted capacity, and imbalance tolerances substantially greater than the ones specified in the Access Arrangement. As such it is likely that the seasonal service, and park and loan service would be sought by a significant part of the market, indicating they should be included as reference services. Their inclusion as reference services would also result in their attracting a more transparent full cost allocation.

2.2 Limited backhaul, extra receipt points and interconnection

The proposed Access Arrangement notes that Epic Energy is currently in negotiations with CMS and AlintaGas concerning the interconnection of the Parmelia pipeline and AlintaGas' distribution system, including the joint provision of transmission services to the latter system.

Although the Firm Service proposed in the Access Arrangement can be either forward haul or back haul, it only involves receipt of gas in Zone 1. Effectively a reference service is available for back hauling only in Zone 1. There is no reference service for forward haul involving receipt of gas in zones other than Zone 1. In the light of the interconnection between the Parmelia Pipeline and the DBNGP, the availability of gas in the Perth basin and exploration being undertaken in the South West, the Regulator should consider the need for the proposed Access Arrangement to include reference services to cater for these sources of gas.

The Regulator may wish to request further information on the possibility of other receipt points and alternative reference services under the proposed Access Arrangement. This would provide the option of receipt of gas by the DBNGP from Perth basin producers.

Under paragraphs 3.2(b) and (c) of the Code, the Regulator could consider whether the proposed Access Arrangement could be amended to permit future applications by shippers who seek input at other points of the pipeline with recourse to the same reference tariffs for the applicable pipeline sections.

3. Reference Tariff Determination

3.1 Epic Energy's claims of a tariff "commitment"

Epic Energy's proposed aggregate reference tariff for a delivery point in Zone 9 is \$1.00/GJ from 1 January 2000. The aggregate tariff for a delivery point in Zone 10 is \$1.08/GJ. This is claimed to be in accordance with a commitment made during the bidding for the DBNGP. Epic Energy's calculations (using the cost allocation method on the forecast total cost of providing services) suggest \$1.41/GJ and \$1.62/GJ for Zones 9 and 10. The effect of applying the lower tariffs will be to postpone the recovery of part of the capital costs.

Epic Energy claims in the proposed Access Arrangement that in its bid for the DBNGP it gave a "commitment" to lowering gas transmission tariffs to \$1.00/GJ to Kwinana Junction, and \$1.08/GJ for gas transportation to delivery points downstream of Kwinana Junction. However, Epic Energy states in its proposed Access Arrangement that the tariffs required to service its investment would now be approximately \$1.41/GJ for Firm Service to delivery points in Zone 9, and approximately \$1.62/GJ to delivery points in Zone 10. To satisfy what it claims as its "commitment" at the time of the sale of the DBNGP, Epic Energy has made pro rata

adjustments to the tariffs determined from its forecast total cost of providing services using the pipeline. The lowering of the reference tariff to a level consistent with the “commitment” is compensated for through a postponement of recovery of part of the capital costs until that recovery is warranted by growth in demand for gas transportation services.

The components of the initial reference tariff are set out in the Tariff Schedule to the Access Arrangement. The reference tariff comprises five components: Pipeline Capacity Charge, Compression Capacity Charge, Compressor Fuel Charge, Gas Receipt Charge and Delivery Point Charge. Simple analysis of the reference tariff reveals that an “initial” reference tariff of \$1.00/GJ to Kwinana Junction, and \$1.08/GJ for gas transportation to delivery points downstream of Kwinana Junction, would comprise only the first four of the five components listed above and that the fifth component (the Delivery Point Charge) would not be included. Including the Delivery Point Charge is estimated to increase the “actual” reference tariff by between \$0.01 and \$2.20 per GJ (an average of around \$0.30/GJ) to Kwinana Junction and between \$0.01 and \$2.50 per GJ (an average of around \$0.30/GJ) downstream of Kwinana Junction. Therefore, it may be questionable that the reference tariff offered by Epic Energy in its proposed Access Arrangement is consistent with a claimed “commitment” at the time the DBNGP was sold as maintained in the proposed Access Arrangement Information.

Epic Energy has claimed that reference tariff efficiency is achieved through setting the reference tariff at a level which recovers no more than efficiently incurred costs of the resources used to provide the reference service. This is also a general requirement of the Code. However, it could be argued that this is not readily evident from the reference tariff determination, even though the “cost of service” approach proposed by Epic Energy is one approach supported by the Code. The Regulator should consider whether Epic Energy’s approach of basing its tariff on its claimed “commitment” achieves tariff efficiency. The Regulator could also consider whether there is any cross subsidising of the claimed tariff undertakings across the tariff zones.

It is suggested that the “tariff path” proposed by Epic Energy as part of the DBNGP sale process, and consequently under its Access Arrangement, would have involved a long term NPV calculation based on certain assumptions at the time of purchase. It is considered that the Regulator should request that Epic Energy now determine its proposed “tariff path” using an alternative long term NPV method based on realistic current parameters instead of the “cost of service” approach currently proposed. This would enable the Regulator, and the users of the pipeline, to fully understand the various assumptions underlying the reference tariff and to determine the adequacy of the “tariff path” in terms of providing a reasonable rate of return to Epic Energy.

3.2 Initial Capital Base

The proposed Access Arrangement includes adjustment mechanisms that result in the capital base “appreciating” over the life of the Access Arrangement. This “appreciation” does not arise from planned efficient new investment in pipeline capacity. Rather the justification by Epic Energy derives from the tariffs proposed in the sale process resulting in sub-normal returns on the adjusted purchase price. The

effect of this would be to prevent or delay passing on unit cost reductions from increased capacity utilisation (from efficient new investment) over the life of the Access Arrangement and upon the pass-over to subsequent access arrangements. The mechanism capitalises (and thereby will partially transfer to future shippers) the “economic loss” arising from proposed tariffs being insufficient to earn a reasonable return, despite negligible unutilised pipeline capacity.

On the one hand, under the proposed cost of service approach, tariffs are based on the required return on the capital base which would increase in the early years with a growing deferred recovery account balance. On the other, the proposed Access Arrangement involves a capping mechanism of “0.67 x CPI” within the Access Arrangement period. From the information provided in the Access Arrangement, it is unclear whether Epic Energy proposes that the “0.67 x CPI” mechanism will dictate the tariff path into the future or only for the period of this Access Arrangement. In conjunction with the proposal to set the method of calculation as a “fixed principle”, it is unclear whether tariffs would be prevented from rapidly increasing under subsequent Access Arrangements (to periodically reflect this “appreciation”) by adoption of 0.67 x CPI as a “fixed principle” and thereby lock in a decline in the real price of gas transportation over the longer term.

The Regulator would need to consider the reasonableness and impact on the long-term tariff path resulting from this net “appreciation”. In addition, the Regulator would need to satisfy himself that the proposed Access Arrangement would not underwrite above-normal returns to the detriment of end-users and the efficient use of natural gas resources.

It is expected that the main argument advanced by Epic Energy in favour of the proposed long-term tariff path, resulting from the inclusion of the deferred recovery account, would be based on the strong benefits to the current users of the pipeline from the initially lower reference tariffs. As argued above, however, the proposed “cost of service” approach does not present sufficient evidence to enable users to be content that in order to receive these substantial up-front benefits they would need to forego benefits from future reduction in tariffs. It is suggested that Epic Energy would need to offer a long term NPV calculation in order for users to be confident that the proposed Access Arrangement maintains an appropriate balance between their interests and the interest of the service provider.

3.3 Physical asset account balance

The main factor used by Epic Energy in determining the initial capital base is the price it paid for the DGNBP. The Asset Value as at 31 December 1999, which is the sum Acquisition Cost, and Depreciation and Capital Expenditure to 31 December 1999, is given as A\$2,570.35 million.

Epic Energy has not provided any information in relation to the DAC and DORC values for the pipeline (as required under section 8.10 of the Code). The proposed Access Arrangement contends that “the competitive bidding process through which Epic Energy acquired the DBNGP removed the initial capital base from within the indicative bounds of Section 8.11 of the Code”. Epic Energy might be relying on an

argument that the competitive bidding process through which Epic Energy acquired the DBNGP conformed to the competitive tender process prescribed under section 3 of the Code and therefore should be deemed to be approved by the Regulator. However, even if the Regulator accepted this approach and if the bidding process was confirmed to be fully compliant with section 3 of the Code, section 3 would still require the Regulator to satisfy himself that an initial capital base equal to the DBNGP acquisition costs would deliver the lowest sustainable tariffs to users over the proposed economic life of the pipeline.

The State does consider the purchase price paid by Epic Energy in 1998 as being one of the relevant factors to which the Regulator is to give consideration under subsection 8.10 of the Code. It is noted that the Code requires the circumstances of the purchase to also be considered. In assessing the relevance of that price in determining an initial capital base for regulatory pricing purposes, it is understood that the Regulator would need to take into account whether the price included certain premia over and above the efficient economic value of the assets. For instance, it may be argued that an early throughput forecast substantially higher than the actual throughput for the pipeline could have led to the owner paying a substantially greater price for the assets. It may be possible that the throughput projections made by bidders, including Epic Energy in late 1997 (the time of the bidding process) to an extent have not eventuated.

The Mid West Iron and Steel Project presents one notable example of a project that at the time of the DBNGP sale process may have appeared likely to commence construction in the short term but was later delayed because of factors other than the availability of gas transport to the site of the Project. According to public announcements at the time, the relevant contracts for the project involved an additional 170 TJ/d of gas transportation capacity from the North West to the Mid West of the State. Epic Energy was understood to be the successful bidder to supply that transportation capacity.

Some of the valuation of the DBNGP assets by bidders might also reasonably have derived from the potential to realise 'economies of fill', tapping into the pipeline's upgrade potential. It is against this background that the Regulator needs to assess the extent that the purchase price reflects a perfectly efficient (or currently relevant) estimate of asset values for regulatory pricing purposes.

It should be noted that the Mid West Iron and Steel Project announced on 28 January 2000 that it has achieved a significant milestone in the path to securing financial commitment to that Project. The proponents anticipate commencement of operations at the Oakajee site in 2003. Such an outcome would substantially increase the throughput of the DBNGP in the middle of the period proposed for the Access Arrangement. It would also crystallise the need for a further investment to enhance the DBNGP capacity at least to Geraldton, and increase the asset base of the DBNGP. The Regulator should seek confirmation of that expectation from Epic Energy and, if appropriate, a revision to the proposed Access Arrangement and supporting Access Arrangement Information.

Whether the Mid West Iron and Steel Project is to proceed or not on the announced schedule, it is considered that the Regulator should not dispense with assessing the

capital base of the proposed Access Arrangement against the full range of considerations listed in subsection 8.10 of the Code. For instance, the Regulator would need to consider the DORC and the DAC values for the pipeline simply in order to be able to assess the relevance of the Initial Capital Base value proposed by Epic Energy to the “normal” range of values prescribed under section 8.11 of the Code. This would also enable the Regulator to assess the adequacy of the initial reference tariff (of \$1.00/GJ and \$1.08/GJ) ie the starting point of the tariff path proposed by Epic Energy. To put this another way, the Regulator could more closely examine the business case required to support such an asset base.

The Regulator is encouraged to consider, under section 8.48 of the Code, the implications of the initial capital base being deemed to be a “fixed principle”. It would appear that calculating and revising the capital base in accordance with section 7.3 of the proposed Access Arrangement would be likely to impart an upward bias on the value of the capital base over time. The Regulator may need to consider whether flexibility should be retained to adjust any estimate of the initial capital base to reflect economic efficiency at the time that future access arrangements are entered into.

3.4 Deferred recovery account balance

The reference tariff proposed by Epic Energy in its Access Arrangement is lower than it has calculated using the cost allocation method on the forecast total cost of providing services. Consequently, without an increase in the demand for gas transmission services, Epic Energy expects the revenue from the delivery of the reference service at the reference tariff to be insufficient to recover the capital charges (asset return and depreciation) on the initial capital base.

Epic Energy will treat shortfall in the recovery of its capital charges by way of “economic depreciation”. Economic depreciation is given as the difference between the revenue expected and the sum of capital expenditure on new facilities, return on the capital base and the non-capital costs. The revenue expected is determined from the reference tariff and the price path of the proposed Access Arrangement.

Epic Energy claims that the use of economic depreciation will allow it to postpone recovery of part of the capital base until that recovery is warranted by growth in demand for gas transmission services. Epic Energy proposes the deferred recovery account balance as a mechanism for accounting for economic depreciation. The balance in the deferred recovery account at the end of any year is the accumulated economic depreciation at the end of that year.

Initially Epic Energy expects economic depreciation to be negative, since it expects sales of the reference service at the reference tariff to be insufficient to recover return on capital base and non-capital costs, and to cover capital expenditure on new facilities. With projected future growth in the demand for gas, higher revenues are expected, allowing economic depreciation to

increase, becoming positive and hence reducing the balance in the deferred recovery account.

As previously mentioned, the product of the deferred recovery account, should the estimates of the initial capital base be accepted, would be to impose a barrier to unit prices falling as demand increases (as would be expected in the normal course of events). Whether this price path is an economically acceptable outcome and fosters an economically efficient use of gas resources is a matter for the Regulator to consider under sections 8.10(h) and 8.33(a) of the Code.

The Regulator may wish to consider the impact on dynamic efficiency and investment signals in allowing this deferred recovery. It could serve as protection for the service provider from efficient new entry for the period until the deferred recovery account balance commences its run-down, whilst allowing it to also recoup (ie. still earn return on assets) the costs of this protection.

It is noted that it may be questionable whether the practice of “appreciating” the physical asset account balance complies generally with section 8 of the Code including with section 8.16 of the Code which governs the permissible increases in the asset base.

The Regulator may need to assess the suitability (and availability) of alternative mechanisms under the Code to achieve similar outcomes to the ones sought by Epic Energy via the application of the deferred recovery account balance. A key consideration in this regard could be the risk transferring properties of the relevant alternatives. One such mechanism may be able to be developed by deeming the pipeline to comprise “new facilities” in the context of its recent purchase by Epic Energy and thereby accept that part of Epic Energy’s investment is New Facilities Investment that does not satisfy the requirements of section 8.16 of the Code. This will present an opportunity to place a proportion of the proposed initial capital base in the “speculative investment fund” and subsequently add back corresponding portions of it when increases in throughput warrant investment in new facilities. However, if such a mechanism is applied the Regulator would be requested to consider increasing the “speculative investment fund” with a rate of return different than the one applied to the “contributing” initial capital base (commensurate with the risk transferring properties of such a mechanism), which would share volume forecast risks between the service provider and the users of the pipeline. Further the Regulator may wish to consider if it would be more appropriate to increase the “speculative investment fund” with the CPI or appropriate risk free rate and not the firm’s rate of return.

3.5 Depreciation

The proposed Access Arrangement Information does not appear to be sufficiently detailed for the Regulator, users and prospective users to determine the longer term depreciation schedule adopted by Epic Energy. It could be assumed (from the low rate of depreciation of physical assets over the term of the proposed Access Arrangement together with the assumed economic lives of the assets – Access Arrangement Information Tables 3.1b and 3.2) that the assumed schedule defers a considerable degree of depreciation to later periods. The extent of any deferral should

be transparently presented and would be a required input for any comparative NPV analysis.

4. Incentive mechanisms

Subsection 2.6 (“Incentive Structure”) in the proposed Access Arrangement Information states that “if Epic Energy is able to increase demand for the reference service above the forecast quantities used in tariff determination, its revenue from sales will exceed the forecast revenue. To the extent that the increase in demand can be accommodated without a proportionate increase in cost, Epic Energy will generate higher than expected profits. These higher profits are retained at least until the end of the Access Arrangement period.”

The above statement may be taken to imply that the benefits of that increased demand and thus higher profits will then be shared with users in the subsequent Access Arrangement period. However, under the general thrust of the Access Arrangement, including the concept of the deferred recovery account and the predetermined “tariff path”, it is more likely that those profits will be used to reduce the “deferred recovery account”. It would be more appropriate that this is transparently stated in the Access Arrangement Information.

A similar lack of transparency is noted in statements regarding the offer of some Non-reference services as rebateable services. Epic Energy states that a part (40%) of any revenue generated from rebateable services will be used to reduce reference tariffs for the next Access Arrangement period and a reference is made to section 3.4 of the Access Arrangement Information. In broad terms section 3.4 talks about higher revenues from growth in demand allowing Epic Energy to recover capital (“stored” in the deferred recovery account) without an increase in the absolute level of tariffs. If the “deferred” revenue generated from rebateable services is later used to reduce the deferred recovery account this should be transparently stated in the Access Arrangement Information.

4.1 Merits of “CPI – X” vs “% of CPI”

Although Epic Energy claims that the reference tariff adjustment set out in the Access Arrangement (ie. $0.67 \times \text{CPI}$) is the form of regulation to which Epic Energy committed at the time of the DBNGP sale, it notes that “this form of regulation places a somewhat tighter constraint on future tariffs than a $\text{CPI} - X$ price path with X determined from forecast efficiently incurred capital and non-capital costs”.

The purpose of an incentive mechanism is to ensure that efficiency gains over the life of the Access Arrangement, and across subsequent access arrangements, are shared between the service provider and shippers and ultimately end users. Ordinarily, the service provider is exposed to cost fluctuations beyond reasonable forecast expectations. On the other hand, users and prospective users could reasonably expect some fixed undertaking with respect to their participation in efficiency gains. Despite the upward bias imposed on the tariff path by the appreciating capital base (and the

arguments advanced for such a path), it may be worth considering the likely magnitude and incentive properties of the “0.67 x CPI” adjustment against its alternatives, discussed below.

A popular alternative is the CPI – X mechanism entailing a fixed undertaking by the service provider to deliver efficiency gains over the life of the agreement. The extent of efficiency gains accruing to end users would be independent of prevailing inflation.

It is not apparent why the proposed form of regulation is asserted to be a “tighter constraint” than the CPI – X model. Under the latter approach, the same incentives to minimise costs would exist, however the extent of efficiency gains that the access seeker undertakes to achieve would be more transparently stated.

Given the forecast inflation for the life of the agreement of 2.5 per cent, the service provider is undertaking to pass on 0.833 per cent per annum in efficiency gains.

4.2 Rebateable services

*Epic Energy defines the **Distributable Revenue** as **Rebateable Revenue (RR)** plus **Prior Revenue (PR)** minus the sum of **Threshold Revenue (TR)** and **Forecast Prior Revenue (FPR)**.*

***Rebateable Revenue (RR)** for a year is the sum of the revenue from rebateable services in the year (such as Seasonal, Park and Loan and Secondary Market services);*

***Prior Revenue (PR)** for the year is the total revenue from capacity reservation charges and commodity charges, and the like, in the year from Prior Contracts.*

***Prior Contracts** means contracts (other than for T3 capacity, as defined in the Dampier to Bunbury Regulations 1998) which were entered into before commencement of the Access Arrangement.*

***Forecast Prior Revenue (FPR)** means the revenue from capacity reservation charges and commodity charges and the like, that shippers under Prior Contracts would be obligated to pay in the year if they took their entire contracted capacity in the year.*

***Threshold Revenue (TR)** is defined by*

$$TR = (FSC - PAC) \times C_1 + (FSV - PAV) \times C_2 + r \times Q$$

Where

“FSC” and “FSV” for each year of the Access Arrangement are to be obtained from the following table:

<i>Year</i>	<i>FSC GJ</i>	<i>FSV GJ</i>
2000	217,105,650	194,482,950
2001	216,437,700	197,187,600
2002	217,112,950	197,815,400
2003	219,832,200	201,563,950
2004	221,894,450	203,702,850

“PAC” is the capacity contracted to shippers under Prior Contracts (other than Exempt Contract) for the year plus the use of capacity in the Year made by the Exempt Contract.

“PAV” is the volume of gas delivered in the year to shippers under Prior Contracts.

“C₁” is the sum of the Zone 10 gas receipt, pipeline capacity and compression capacity charge rates applying in the year.

“C₂” is the compressor fuel charge rate for a delivery point located between CS 10 and MLV 157A.

“r” is \$0.40/GJ in the first year of the Access Arrangement. In subsequent years, until the Revisions Commencement Date, r shall be adjusted in accordance with clause 16.2 of the Access Arrangement Terms and Conditions.

“Q” is the amount by which the total volume of gas delivered in the year exceeds FSV for the year.

It is considered that Epic Energy may have not provided sufficient information to enable users to determine the adequacy of the proposed “Method of Rebate” in subsection 9.2 of the Access Arrangement. Firstly, certain definitions such as the definitions of FSC and FSV have not been provided in the Method. Secondly, possibly because of the omitted definitions, the relevance of C₁ and C₂ is not immediately clear. Thirdly, it is not clear what is the purpose of the additional item (namely rxQ) included in the calculation of the “Threshold Revenue”. It is noted that “Q” is the amount by which the total volume of gas delivered in a year exceeds the FSV for the year and that “r” equals \$0.40/GJ (and is adjusted with 67% of CPI in subsequent years). The inclusion of that additional item in the calculation of the “Threshold Revenue” may mean that some of the “excess” rebateable revenue is retained by Epic Energy before its distribution as described in the Method. It may be more transparent to consider the “effective benefit” flowing to Epic Energy due to the inclusion of the threshold. This would be expected to exceed 15 per cent.

As noted above, if the initial capital base is set higher than warranted by the initial tariff path, and the deferred recovery account mechanism is accepted as a reasonable method for dealing with economic depreciation, a share of the 40 per cent contribution will effectively flow to Epic Energy. Recognising the likely benefit flowing to Epic Energy, the Regulator may therefore wish to consider whether it

would be reasonable for an appropriate cost allocation to occur in respect of Rebateable Services.

Under section 7.3(f) of the proposed Access Arrangement the deferred recovery account balance at the end of each year of the Access Arrangement period is the deferred recovery account balance at the beginning of each year less the depreciation of the deferred recovery account balance for that year, **plus 40% of the distributed rebateable revenue as described in the Method**. The Regulator may wish to consider whether the relevant part of the distributed rebateable revenue should be added to or subtracted from the deferred recovery account balance. In this respect regard should also be had to section 9(b) of the Access Arrangement.

5. Cost of Capital issues

It is noted that there are various accepted methodologies employed for estimating a firm's cost of capital and that estimates are sensitive to variations in methodology and the various parameter inputs. The debate over both methodology issues and parameter values has been hotly contested in utility pricing regulation. The task is made even harder by the need to determine parameters that remain relevant over the extremely long life of the assets in question (though the long term error may be reduced by periodically re-estimating these parameters).

There would be benefit in the Regulator requiring the use of a consistent methodology and transparently derived inputs for those parameters which are not company-specific (eg. inflation, typical gearing ratios, market risk premia, tax rates and gamma (dividend payout and imputation credit utilisation) factors).

It is also noted that certain parameters which can be argued to apply to all players in an industry may also reasonably be argued to vary over time in response to underlying economic conditions – so as to remain accurate estimates over the life of the arrangement. That said, given the relevant time horizon of up to 100 years for some assets, there is a case for considering outlying point estimates within the context of longer term averages of parameter values.

In addition to the detailed comments offered below, the Regulator might particularly wish to consider the following issues:

- The operating environment of the service provider, including its substantial market share and the likely continuation of its dominance in the near future. This is relevant in determining the relative market risks faced by the service provider – including an expected below average volatility in its operating revenues. In this respect it could be argued that Epic Energy faces a modest business risk on its investment in the DBNGP, and that it is this lower level of risk that needs to be reflected in the determination of an appropriate cost of capital;
- The impact of the proposed deferred recovery account in underwriting returns for the service provider over the long term. Such a mechanism is likely to result in reduced risk and hence a lower rate of return may be justified than if such arrangements were not in place. A prior question is whether it is efficient for the

entire risk of Epic Energy's investment to be transferred to users of pipeline services and end users in this manner;

- The high proportion of the fixed charges with the capacity charge payable in almost all circumstances including shipper force majeure.

Following are some specific comments on the various inputs into the calculation of the WACC:

5.1 Cost of Debt

Epic Energy uses 1.2% as the debt premium (or risk margin).

The debt premium or risk margin used by Epic Energy of 1.2% is the same as that used in the determination of the Victorian access arrangements by the ACCC and ORG. This submission considers this figure to be reasonable although the Regulator would need to undertake a review of the debt premium being proposed with due consideration of Epic Energy's credit rating and any special characteristics of its debt portfolio that affect its actual cost of borrowing.

5.2 Capital Structure

Epic Energy proposes a debt/equity ratio 55/45

The typical debt to equity ratio for the gas transportation industry is considered to be 60/40. This submission does not consider that Epic Energy has substantiated the use of its preferred 55/45 value.

The finance theories that postulate that Capital Structure is irrelevant (Modigliani and Miller's Invariance Proposition) are based on rather restrictive and unrealistic assumptions (eg. an operating environment without taxes or contracting costs). Modern finance theory has provided a more practical analysis by reversing the proposition and noting that a firm's capital structure may be value adding since it affects the firm's tax liability, its contracting costs and the firm's choice of future investment policy.

Variations in this parameter flow through to the calculation of the equity Beta (through the de-levering formula). With the equity Beta held constant, the WACC result is particularly sensitive to changes in the assumed capital structure.

The submission considers that section 8.31 of the Code calls for use of parameter inputs that reflect standard industry structure and best practice. Therefore it is contended that the standard debt to equity ratio for this industry of 60/40 should be adopted.

5.3 Dividend Imputation

Epic Energy has used a gamma value of 30.8%.

A slightly different methodology has been employed by Epic Energy than has been accepted by Australian Gas Access Regulators to date. While in other cases, the “gamma factor” is taken to be the product of the franking credit utilisation ratio and the dividend payout ratio, in this case Epic Energy has separated the two components. On a comparable basis, the relevant parameter input based on those figures proposed by Epic Energy is a gamma value of 30.8% (ie. 0.70×0.44). It is considered that a more appropriate value is 50%. This has been the recommended approach for past gas distribution access arrangements in Western Australia and is consistent with other access arrangements, including the ACCC's determination for the Victorian gas transmission access arrangements.

5.4 Risk Free Rate

Epic Energy proposed risk free rate is 6.37%.

Epic Energy has not substantiated the method of averaging past bond yields over 2 months in calculating the risk free rate that it proposes. The Capital Asset Pricing Model is a forward looking model and as such it is considered acceptable practice to use, as a starting point, a point estimate for a liquid long term debt security such as for the ten year Commonwealth bond or to use an average over a shorter period eg 20 business days as used recently by IPART and supported by the Office of Energy for Western Power's 1998/99 and 1999/00 electricity access pricing redeterminations. Recent spot rates have averaged around 6.7% for the month of December and the latest spot rate at 14 January is 7.19%. This indicates that the risk free rate of 6.37% proposed by Epic Energy is low. In determining the appropriate parameter input for the life of the Access Arrangement (noting that the relevant time horizon is the weighted average asset life), the Regulator is encouraged to consider the impact that recent bond market volatility has had on quoted returns.

5.5 Beta Value

Epic Energy uses an equity beta of 1.15.

This submission notes that the asset Beta value of 0.58 sits relatively high within accepted ranges and accepts that in determining this value full account should be taken of the commercial environment in which Epic Energy operates. It is noted that standard ranges within the industry for value of the asset beta appear to be between 0.4 and 0.6. It is also noted that the debt beta for Epic Energy (based on its assumptions) is 0.185, and not 0.12 as quoted. The Regulator would need to review and assess the equity beta, asset beta and debt beta being used and determine whether or not those proposed by Epic Energy adequately reflect the risk of the business. This submission encourages the Regulator to adopt a standardised methodology when considering all Western Australian access arrangements to allow direct comparability.

5.6 Market Risk Premium

Epic Energy assumes a typical market risk premium of 6.5%.

The assumed typical market risk premium of 6.5% appears to be within the range of accepted industry values, but above that previously contained in a draft determination by the Regulator. The Regulator would need to be satisfied that there is wide acceptance of 6.5% as used by Epic Energy as opposed to other values which may be represented to the Regulator by other stakeholders.

5.7 Inflation Rate

Epic Energy uses an inflation rate of 2.5%.

The inflation rate assumed by Epic Energy of 2.5% is the same as the most recent Commonwealth Treasury forecast of 2.5%. Perhaps more importantly due to the relevant time horizon, the parameter value of 2.5% is midway between the Reserve Bank of Australia's inflationary target range over the course of the business cycle. On this basis, the inflation rate assumed by Epic Energy of 2.5% appears to be appropriate.

5.8 Tax Rate

The Regulator is encouraged to consider an average tax rate to reflect the pending staged reduction in the Corporate Tax rate that, in the absence of other information, should be assumed to prevail over the life of the Access Arrangement. For example, an average rate of 30.8% would reflect the relevant rate as at 1 July 2000, where one year would be spent subject to a 34% tax rate and four years subject to a 30% tax rate.

5.9 Method of transformation

It is noted that Epic Energy has used what the ACCC has referred to as the "reverse transformation mechanism" where the nominal post-tax figure is first adjusted for inflation to represent a real value, and then grossed-up to a pre-tax figure. As explained by the ACCC at length, the order in which this transformation occurs has a considerable impact on quoted values of the real pre-tax WACC. In this case if the "industry transformation mechanism" is used, entailing the deflation of the nominal pre-tax WACC, the real pre tax WACC proposed by Epic Energy becomes 9.4 per cent.

5.10 Calculation of WACC

Once the correct debt Beta (0.185) is incorporated into Epic Energy's calculations, the real pre-tax WACC value reduces to 8.2%.

Using the input values quoted by Epic Energy and the "industry transformation" gives an outcome for the real pre-tax WACC of 9.4%. This compares with the Epic Energy real pre-tax result of 8.2% (adjusted for the debt Beta). The difference arises directly from the choice of "transformation mechanism" in converting nominal figures to real figures and post-tax to pre-tax. The Regulator would need to undertake a review of

the use of the “reverse transformation” equation to calculate WACC and consider whether it is appropriate in the specific circumstances.

6. Cost of service issues

6.1 Cost Allocation between Reference; Rebateable; and Non-Reference, Non-Rebateable services

The cost of service methodology employed in the proposed access arrangement purports to allocate costs to services (except Rebateable services) on the basis of their reasonable share of the total costs (including capital costs) and assuming provision of these services to current as well as prospective shippers. Epic Energy has allocated costs to shippers with gas transportation agreements entered into before the commencement of the Access Arrangement as if those shippers had been users of the reference service.

It is not clear, however, what implications would the above have for the reference tariff should shippers with existing transportation contracts elect to retain the terms and conditions, other than pricing, of their current transportation agreements, which they are entitled to do. In addition it is not clear how the seasonal variations in some of those contracts have been treated in the determination of the reference tariff and how the revenue corresponding to those seasonal variations is treated in respect of the rebateable revenue.

The Regulator could consider whether the proposed cost allocation methodology efficiently and fairly recovers costs from the full array of services provided by the pipeline. The relevant volume/share of capacity assumptions would be a key consideration. Moreover the interaction between the non-allocation of costs to rebateable services, the rebate mechanism, and the impact on the secondary market needs to be considered.

In addition, it should be noted that some of the non-reference services (including the peaking service) listed in section 6.1 do not appear to be proposed as rebateable services.

6.2 Non-capital (operating) costs and forecast capital expenditure

An independent appraisal of the various non-capital (operating) costs forecasts and forecast capital expenditure is required to ascertain their reasonableness.

6.3 Information regarding system capacity and volume assumptions

The annual volume forecasts by pricing zone (contained in table 6.4) imply an average annual increase in volume of just 1.17 per cent per annum (on a continuously compounding basis) over the life of the agreement.

Aside from the reasonableness of an estimate of the initial volume, the average annual increase appears to be extremely conservative.

It is considered that the Regulator should independently evaluate the reasonableness of the estimated volume assumptions especially in the light of the current position of the pipeline in the global Western Australian gas market. In particular, the impact of major new gas consuming industries such as the Mid West Iron and Steel Project needs to be considered when forecasting throughput over the longer term.

7. Secondary market

Epic Energy will allow shippers to “post” all or any part of their unutilised Firm Service capacity for a day in the Secondary Market, and sell it to Approved Third Parties on a firm basis. Epic Energy will also offer spare capacity it may have on the DBNGP for sale in the Secondary Market. Shippers will not be able to contract with Epic Energy for Epic Energy’s Secondary Market Service capacity for extended periods. Revenue from such a Service is uncertain, so it is offered as a Rebateable Service.

Given that such a market has not been in existence before, there is uncertainty as to how the market would develop and whether it would be an effective and efficient means of optimising the use of the DBNGP spare unutilised capacity. There may be a need for a trial period to provide parties with experience with the rules and to allow identification of potential deficiencies and improvements to the rules. There may also be a need for an effective consultation process, involving the Regulator, that would oversee the operation and the rules of the secondary market. It may not be seen appropriate for Epic Energy to determine the rules of a secondary market if it is proposing to participate as a player in it. The Regulator may wish to consider the possibility of classifying the capacity posted in the secondary market as a “market carriage pipeline” and the desirability for the Regulator to approve any amendments to the secondary market rules proposed by Epic Energy.

In assessing whether such an arrangement adequately balances the various interests, there may be a need for the Regulator to consider whether the significant cost advantages available to Epic Energy may affect the market itself or the facility for firm shippers to engage in alternative disposals such as via bare transfer. Essentially, Epic Energy may be willing to enter the secondary market in circumstances that recover its marginal costs (which would appear to be close to zero since other reference services have recovered its costs) subject to the \$0.40 per GJ price floor. However firm shippers will face a different decision, namely maximising secondary market revenue to minimise their losses (having acquired that spare capacity at full cost plus the contribution that reference services make towards rebateable services).

7.1 Prudential requirements appear onerous on third parties

Epic Energy applies the same prudential requirements to third-party participants in the secondary market as it does to prospective shippers.

The Regulator may wish to consider whether applying the same prudential requirements to third-party participants in the secondary market as apply to prospective shippers is warranted; or whether some lesser requirements would suffice. Since the original contract holders would continue to have liability for their contract quantities, it would be more appropriate for the prudential requirements in this respect to be determined by shippers agreeing collectively on appropriate requirements.

7.2 Impact of the proposed floor and ceiling prices

Epic Energy proposes a range of \$0.40 to \$100 per GJ for secondary market prices.

There has been no justification of the proposed range of secondary market prices applying to Epic Energy's activities in the secondary market. It may be appropriate for such prices to be struck for the various delivery points.

8. Other issues

8.1 Application for Access

An Access Contract is formed once the access request is accepted by Epic Energy.

In the context of its rules for accepting access requests and its queuing policy, it is not clear how Epic Energy is proposing to deal with applications of prospective shippers that may be competing by tender to supply a new project. Each prospective shipper is likely to be required by the tender process to have some degree of certainty regarding transport of gas but only one would succeed in the tender process. It is also not clear if the Capacity Expansion Options or capacity reservation options would be available to these tenderers.

8.2 Services Policy

Prospective shippers must nominate a minimum term of 5 years when lodging an access request for firm service, unless Epic Energy in its absolute discretion agrees otherwise.

In his Draft Decision on the proposed Access Arrangement for the Parmelia pipeline, the Regulator requested that the Terms and Conditions of that Access Arrangement be amended to make provision for minimum contract duration of no greater than one year for the proposed reference services. On this basis, the Regulator may need to consider whether the five year minimum contract duration proposed by Epic Energy is reasonable.

8.3 Queuing Policy

Epic Energy may deal with Access Requests out of order provided that the Access Requests, which were first in time are not ultimately disadvantaged.

It would be helpful if Epic Energy offers an indication of the possible situations the above might occur.

The interaction between the queuing policy and Capacity Expansion Options should be examined closely. Given that exercised Capacity Expansion Options will receive priority to prospective shippers in the queue, the initial allocation of the Capacity Expansion Options has the potential to subvert the queuing policy if they are not available on an open basis. The Regulator may wish to consider whether the Capacity Expansion Option terms and conditions, including purchase price, should be published by Epic Energy on a regular basis. On the other hand, the ability to trade these options is seen as a positive step.

8.4 Terms and Conditions

Epic Energy may vary certain Access Contract Terms and Conditions without the consent of the Shipper or the Regulator.

The Regulator may wish to consider whether it is appropriate for Epic Energy to vary any Access Arrangement terms and conditions without Regulator's consent. It is noted that there is a significant number of important terms and conditions that are proposed to be unilaterally varied by Epic Energy including, but not restricted to, matters such as gas specification, receipt and delivery points flexibility, nominations, invoicing and payment, metering, default and termination.

8.5 Initial Reference Tariff for Carnarvon

In its proposed Access Arrangement (table 3.1b in the Access Arrangement Information), Epic Energy has allocated to the Carnarvon lateral (Zone 4a) an asset value equal to its acquisition cost of \$67.49 million. In order to achieve a reasonable return on its proposed initial capital base for the lateral of \$67.49 million, Epic Energy has proposed a reference tariff of around \$11.50/GJ to transport gas to Carnarvon.

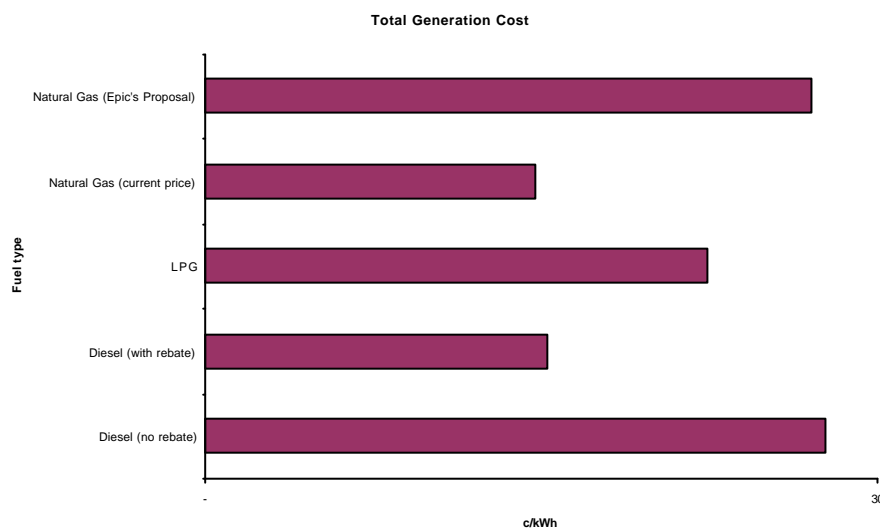
Under section 2.24 of the Code in assessing a proposed Access Arrangement, the Regulator must take into account, amongst other factors, the public interest, including the public interest in having competition in markets (whether or not in Australia). Further section 8.1 of the Code requires for a reference tariff to be designed with a view to achieving a number of objectives, including replicating the outcome of a competitive market.

The Regulator is requested to consider whether the proposed reference tariff to Carnarvon would promote the utilisation of the Carnarvon lateral or competition in any market including the markets for gas and electricity.

Currently the single user of the Carnarvon lateral is the Western Power Corporation which has a transmission contract for 1.5 TJ/d with an average daily throughput of around 1.1 TJ/d (tables 6.1 and 6.3 in the proposed Access Arrangement Information). The total gas quantity is utilised by Western Power to generate electricity at the Carnarvon power station.

It is the Government's objective to encourage competition in the Western Australian electricity markets especially in the regional areas of Western Australia, where the costs of generating electricity using diesel are particularly high. Given the uniformity of tariffs across the regional areas of Western Australia the objective to encourage competition and reduce prices to larger customers is also relevant to Carnarvon.

The following graph indicates the expected cost of generation in Carnarvon using different types of fuel. It should be noted that these costs represent rough estimates and are included only as a guide.



Given the high total cost of electricity generation with Epic Energy's proposed reference tariff, it does not seem likely that a third party other than Western Power would undertake to transport natural gas to generate electricity in Carnarvon. It also does not seem likely that, given its high delivered costs, natural gas would be used for any other purpose but electricity generation (by Western Power).

The Regulator is requested to examine the proposed reference tariff at Carnarvon in the light of the above mentioned requirements of the Code and especially taking into account the possible detrimental effect the proposed tariff may have on competition in the energy markets serviced by the Carnarvon lateral.

9. Access contract issues

The Regulator should take industry standards into account when assessing clauses of the Access Contract. All references below are to clauses in the proposed Access Contract Terms and Conditions.

Clause 2 Gas Specification

Epic Energy's reference tariff is based on the operating gas quality specification (currently prescribed in the DBNGP Access Manual). Epic Energy also states elsewhere in the Access Arrangement document that if it is contractually able to do so, and with the approval of the Coordinator of Energy, Epic Energy may broaden the gas quality specification.

The Access Manual (and the relevant provisions in the *Dampier to Bunbury Pipeline Act 1997*) will cease to exist on the day the Access Arrangement is approved by the Regulator. Therefore, the approval of the Coordinator of Energy will no longer be required for broadening of the operating specification under the former regulatory framework. In addition, the broadest specification will cease to exist with the repeal of the *Dampier to Bunbury Gas Pipeline Regulations 1998* (again on the day the Access Arrangement is approved by the Regulator). As a consequence there will be no regulatory control over the DBNGP gas quality specification except as provided for under the Access Arrangement. It should be noted, however, that by virtue of section 109 of the *Gas Corporation (Business Disposal) Act 1999* the Coordinator would be able to recreate the DBNGP gas quality specifications should this be considered necessary. Section 109 amends section 26 of the *Energy Coordination Act 1994* by inserting new subsections which empower regulations to be made providing for the Coordinator of Energy determining or approving gas quality specifications, which may apply despite being inconsistent with any contractual provisions.

It would be reasonable to expect that the broadest specification has been adopted by all post-sale contracts on the DBNGP signed under the *Dampier to Bunbury Pipeline Regulations 1998*. The Regulator would also be aware that AlintaGas has adopted, as part of its proposed Access Arrangement, a gas quality specification consistent with the broadest gas quality specification for the DBNGP. In order to ensure consistency in terms of gas quality across these interconnected pipeline systems, the Regulator may wish to request Epic Energy to reconsider the inclusion of the concept of the broadest specification in its Access Arrangement.

Given the efforts of Government over the years to put in place a gas quality specification for the DBNGP, which achieves the optimum balance between the interests of the upstream gas industry and the interests of the downstream gas end-users, it may be necessary to implement the above mentioned regulations in the event the specification remains overly restrictive after the expiry of the relevant current contracts. By way of example, the Government has made it clear that, although the current contracts would prevent lifting the restrictions for minimum LPGs before Mid-2005, it did not intend to continue to regulate for that restriction which intent was reflected in the "broadest" gas quality specification. It should also be noted that the AGA is working towards the establishment of an Australian Standard, which is expected to set down a specification wider than the one prescribed in the Access Arrangement and based on the current "operating" specification. The recommended AGA specification is, for most of its components, in line with the "broadest" gas quality specification for the DBNGP and for some of its components "wider" than the latter specification.

Going back to the clause 2 of the proposed Access Contract Terms and Conditions, under clause 2.4 (c) a shipper will pay Epic Energy a surcharge calculated by multiplying each GJ of Out of Specification gas by the Out of Specification Gas Charge (which is payable in addition to the other charges). It is not clear if this would apply to gas actually delivered by Epic Energy. Penalising for gas, which was vented by Epic Energy does not seem appropriate.

Clause 3.2 Receipt Points and Delivery Points

Where Epic Energy delivers gas to more than one shipper at the same delivery point, each shipper's share of the Delivery Point Charge is proportionate to its share of the total gas delivered to the delivery point.

Given that the delivery point charge recovers metering assets return and depreciation it is not clear why the Delivery Point Charge is shared between shippers on the basis of the total quantity of gas delivered at the delivery point and not the shippers MDQ. One outcome of this appears to be, for example, that where no gas is delivered at a Delivery Point by a shipper with an MDQ, but other shippers that have MDQ at that Delivery Point deliver gas on a day, the Delivery Point Charge (which is a fixed charge) will be shared only by the shippers actually delivering gas and the first shipper will not be charged on that day.

Clause 4 Nominations

The Access Guide indicates that a shipper may exceed its nominations for a Day at a Delivery Point provided that the shipper remains within its Delivery Point MDQ.

This is not explicitly stated in the Terms and Conditions.

Clause 5.3 Interruptibility and Liability

Clause 5.3(b) provides that if Epic Energy interrupts a shipper, directly or indirectly, as a result of another shipper taking overrun, then the second shipper is liable for all loss or damage (including indirect loss) suffered by Epic Energy or the first shipper, and the Capacity Charges and Receipt Charges which Epic Energy is required to credit to the first shipper.

Three potential concerns with 5.3(b).

First, this clause should be amended to make clear that it is not breached by any purchase by the Shipper of additional delivery capacity greater than MDQ. On its face, the clause could mean that the Overrun provisions are triggered by the Shipper participating in the secondary market.

Second, as Epic Energy has absolute discretion to interrupt Overrun and will presumably be in control of the equipment to achieve this the Regulator should

consider whether the Shipper should have any liability at all for Epic Energy's failure to prevent Overrun, particularly without notice or opportunity to correct the Overrun. There is no equivalent liability for Imbalance in clause 6.

Third, the clause purports to make the Shipper liable for loss or damage including indirect loss that Epic Energy suffers as a result of an action by Epic Energy, ie Epic Energy interrupting another Shipper as a result of a Shipper taking Overrun. This is at odds with Epic Energy limiting its own liability to exclude indirect loss. It means there is limited incentive for Epic Energy to minimise its indirect losses, despite the fact that it is in control of Interruption.

–It is noted that reference in 5.3(b)(ii) to clause 14.1(b) should be to 14.2.

Clause 6.4 Excess Imbalance Charge

Epic Energy purports to levy an Excess Imbalance Charge where on any day the Shipper supplies less than 98% or more than 102% of the amount of gas that is delivered to it.

Two potential concerns.

First, there does not appear to be an exemption where the actions of Epic Energy or another Shipper lead to this situation, leaving the Shipper at the mercy of forces beyond its control. The Regulator should consider requiring such an exemption.

Secondly, the 2% imbalance margin does not appear to be in accordance with industry practice accepted in Australia and even by Epic Energy for some of its other pipelines. Imbalance allowance of 8% seems to be more widely accepted by industry including in Western Australia. Similarly, the excess charge of \$15/GJ (or 1,500%) appears to be extremely excessive. As noted by the Regulator in his draft decision for the Parmelia Pipeline the imbalance rate typically ranges between 100 and 350 percent of the relevant service tariff.

Clause 7 Peaking

The proposed permissible hourly peak is 120% of 1/24 of the daily total.

The Regulator would need to consider if the permissible hourly peak is appropriate.

Clause 11 Notional Delivery Points

Under clause 11.1 Epic Energy may from time to time determine that there is a Notional Delivery Point between the DBNGP and a gas distribution system.

–It is noted that the clause seems inconsistent with the definition of Notional Delivery Point.

Under Clause 11.5, where gas is delivered to a distribution network (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.

Given the importance of allowing interconnect, the vagueness of this clause is unacceptable if it means there is any possibility of this clause being used to limit, delay or constrain access between Epic Energy's system and another network. Better explanation of what needs to be "taken into account" may be needed.

Clause 12 Metering

Clauses 12.1 and 12.4 require the Shipper to meter gas upstream of the DBNGP.

Requiring the Shipper to meter gas upstream of the DBNGP is reasonable, but the clause should be broadened so that it is satisfied if the Shipper runs metering equipment itself, or arranges for someone else to run metering equipment. This would ensure downstream purchasers can be Shippers by entering into suitable arrangements with upstream suppliers who would be better placed to operate upstream metering equipment.

Clause 13 Liability

Clause 13.1 provides that neither party is liable to the other party under any circumstances for indirect damage howsoever caused. Further, under clause 13.3 Epic Energy is not in any circumstances to be liable to the shipper for any loss, injury, or damage, arising out of any approval by Epic Energy of any design, location or construction of, or proposed operating or maintenance procedures in relation to, any equipment, apparatus, machine, component, installation, cable, pipe or facility connected to, or adjacent to and associated with, the DBNGP.

A limitation of liability clause refusing liability for such things as loss of profit is probably acceptable. However, the Regulator should consider whether the definition of Indirect Loss (–there seems to be inconsistency between use of “Loss” and “Damage”) is overly broad. It would be unacceptable to have Epic Energy effectively avoiding any obligation to actually deliver gas by seeking under this clause to exclude any liability for failure to do so.

For example, Epic Energy at a minimum might be required to compensate a Shipper for the value of any gas Epic Energy fails to deliver in a day, albeit possibly allowing Epic Energy some opportunity to make up the failure in a subsequent period. The Regulator should also consider whether Epic Energy should compensate a Shipper for loss of profits from the sale of gas that Epic Energy fails to deliver.

An alternative or possibly complementary approach would be to set performance targets that Epic Energy is required to meet.

Under clause 13.4(a), except to the extent caused by the negligence of Epic Energy, the shipper is liable for any loss or damage which occurs during the duration of the access contract, in or about, or incidental to activities in or about, any receipt point, any delivery point, the DBNGP, or any other premises, facilities or places used for the storage, transportation or delivery of gas received from or delivered to the shipper. Under clause 13.4(a), the shipper indemnifies Epic Energy and any person (except the shipper) contracting with Epic Energy, against all liabilities and expenses arising from or in connection with any claim, demand, action or proceeding made or brought by any person in respect of or in relation to any injury, death, loss or damage referred to in Clause 13.4(a).

This clause may not be acceptable. There is no requirement on Epic Energy to demonstrate any negligence or even involvement on the part of the Shipper before this clause attributes liability to the Shipper for any loss in or about, *inter alia*, the DBNGP. The clause would likely be read down by a court, but it is preferable to draft a more realistic provision. For example, insert a requirement that the Shipper is negligent.

The clause also purports to confer a benefit on a third party, running foul of the doctrine of privity and clause 33. In (a), Shipper's liability is limited to Epic Energy, and in (b) other persons are purportedly given an indemnity.

Clause 16 Charges

Clause 16.3 provides for the payment by shippers of GST related increases on charges.

It is noted that under the Code revisions to the reference tariffs only come into effect after approval by the Regulator. It is considered that this would also apply to any GST (or other tax) applicable passthrough. It is noted that clause 16.3 does not reflect the requirement for prior agreement of the Regulator with revisions of the reference tariff in this respect. The submission considers that it is in the interest of the users that the clause is amended to reflect that revisions to any of the charges only come into effect after approval by the Regulator.

Notwithstanding the above it is noted that the clause purports to make the Shipper liable to pay all Epic Energy's GST obligations, not just those under this contract, which would be unacceptable. Also, it should be clear that the Shipper is only obliged to pay the net cost of any tax changes, otherwise Epic Energy can keep any benefits while passing on any costs. Clause 16.3(f)(i) achieves this but is potentially limited in operation by 16.3(a).

This clause should reflect that the CPI increase for 2000-01 needs to be adjusted for the impact of the introduction of the GST (given the other compensation mechanisms).