DAMPIER TO BUNBURY NATURAL GAS PIPELINE

REQUEST FOR AGREEMENT UNDER SECTION 8.21 OF THE CODE

PUBLIC VERSION

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1. INTRODUCTION

1.1. The Dampier to Bunbury Natural Gas Pipeline ("DBNGP") is a Covered Pipeline for the purposes of the *Gas Pipelines Access (Western Australia) Act 1998*, which incorporates the *National Third Party Access Code for Natural Gas Pipeline Systems* ("Code"). The DBNGP is operated by DBNGP (WA) Transmission Pty Ltd ("DBP") and is owned by DBNGP (WA) Nominees Pty Ltd as Trustee for the DBNGP WA Pipeline Trust.

1.2. A further stage of expansion of the capacity of the DBNGP is now required to meet the demand of shippers and prospective shippers. This expansion is expected to require New Facilities Investment forecast to be between $1,457,000,000 and $1,521,000,000 ($2005), and the first tranche of capacity it will provide has been requested by shippers by late 2007. DBP is seeking a degree of regulatory certainty in respect of the investment which must be made so that it can complete financing arrangements for the expansion.

1.3. The regulatory certainty that is sought can be provided by the Economic Regulation Authority ("ERA") exercising its discretion under section 8.21 of the Code, and agreeing that the forecast New Facilities Investment meets the requirements of section 8.16(a).

1.4. In this submission, DBP requests the ERA's agreement under section 8.21. DBP's formal request for agreement is set out in section 3 ("Request"). Section 2 provides the background to, and the reasons for, DBP's Request.

1.5. An accompanying submission supporting DBP's Request sets out the technical and commercial details of the proposed expansion program, and the way in which the forecast New Facilities Investment is expected to meet the requirements of section 8.16(a) of the Code. DBP intends that this accompanying submission be read in conjunction with its Request. Some material in that submission is, however, commercially sensitive; and it is provided on the basis of its being commercial and in confidence.

2. BACKGROUND TO AND REASONS FOR THE REQUEST

2.1. Gas demand in Western Australia is growing rapidly as the State's economy responds to high levels of demand for its natural resources internationally, and to increasing prices for alternative fuels.

2.2. DBP has responded to this growth in gas demand by initiating a further stage of expansion of the capacity of the Dampier to Bunbury Natural Gas Pipeline. This expansion – Stage 4 – is now well advanced and, when completed, will provide a further 127 TJ/d of full haul (T1) capacity.

2.3. Once Stage 4 is completed, there will still be a very a substantial demand for pipeline capacity from power generation, minerals processing and other projects which are expected to proceed within the next five years. That demand is now much greater than was anticipated twelve months ago, when DBP submitted expansion plans to the ERA as part of proposed revisions to the Access Arrangement for the DBNGP.

2.4. The Access Arrangement drafted and approved by the ERA on 15 December 2005 ("Revised DBNGP Access Arrangement") anticipates forecast New Facilities Investment of $969 million (real, 31 December 2004) for four stages of expansion during the period 2005 to 2010, providing some 206 TJ/d of new full haul capacity (including the capacity from Stage 4).

2.5. In October 2005, DBP had four Access Requests for capacity which it expected would support a fifth stage of pipeline expansion. Knowing that the market was changing, DBP advised all of its shippers, and known prospective shippers, that if they now required additional pipeline capacity in the period 2007 to 2010, they would need to apply for that capacity by 31 December 2005.

2.6. A further 10 Access Requests were received. DBP now has Access Requests for an additional 339.5 TJ/d of full haul (T1) capacity although it considers that of these requests, executed shipper contracts will be entered into with shippers for a total of only 310 TJ/day.

2.7. The Access Requests for about two-thirds of this additional capacity are in the form of firm commitments from shippers and prospective shippers. In the Access Requests received for the remaining one-third, shippers and prospective shippers have indicated that that they will be unable to contract for the capacity requested until internal approval processes have been completed. This means that the capacity requirement supporting the Stage 5 expansion of the DBNGP will not be known with certainty before March 2006, and possibly not until May 2006.

2.8. With the very much larger capacity requirement, the profile of forecast New Facilities Investment over the period from 2005 to 2010 will be very different from that anticipated in the Revised DBNGP Access Arrangement. It will also very different from the profile of investment envisaged earlier, at the time the current owners of the pipeline acquired the DBNGP.

2.9. DBP currently forecasts the New Facilities Investment for Stage 5 to be between $1,457,000,000 and $1,521,000,000 (real, $2005).

2.10. The Stage 4 expansion of the DBNGP has proceeded broadly in accordance with the expectations held by the current owners when they acquired the pipeline, and the owners were able to expedite project financing.

2.11. In planning for Stage 5, DBP faces a very different situation. It is faced with the need to invest at a level higher, and to commit to larger expenditures earlier than was previously expected – in relation to some of the additional capacity it is more than 10 years earlier.

Furthermore, DBP has been exposed to the effects of a change in the quality of gas delivered into the DBNGP which was unexpected (in terms of both magnitude and timing) at the time the current owners acquired the pipeline, and to the uncertainty created by application of the Code in, for example, the setting of the gas quality specification.

2.12. In these circumstances, DBP is now proceeding cautiously and seeking to reduce, to the greatest extent possible, the risks to which its owners, and the banks which will provide the debt required to finance expansion, will be exposed.

2.13. To reduce the risks to which the owners and the banks will be exposed, DBP is proposing to expand the capacity of the DBNGP only to the extent that it has firm commitments from shippers and prospective shippers in the form of long term contracts.

2.14. These long term contracts will not, however, preclude the possibility of full haul capacity becoming available as spare capacity under the access regime of the Code, on the terms and conditions (including the reference tariff) of the Revised DBNGP Access Arrangement. Nor do they preclude the possibility of prospective shippers accessing part haul capacity and back haul capacity (which are not currently subject to capacity constraint) on the terms and conditions (including the reference tariff) of the Revised DBNGP Access Arrangement.

2.15. Furthermore, all of the shippers currently using the DBNGP do so in accordance with the terms and conditions of the Standard Shipper Contracts which were negotiated immediately prior to the sale of the pipeline in 2004. Under the Standard Shipper Contracts, shippers pay the specified base tariff at the contract commencement date, adjusted for inflation and expansion costs, until 1 January 2016. From 1 January 2016 they pay (in accordance with clause 20.5(g)), the reference tariff of the Access Arrangement in effect at the time. If the reference tariffs which prevail from January 2016 do not fully reflect the costs of expansion, DBP's revenues will not cover the costs of providing and operating the DBNGP and, other things being equal, the owners will not be able to recover the costs they incurred in acquiring the pipeline, or in financing its expansion.

2.16. For Stage 5 to proceed, DBP and its owners, and the banks which provide debt to finance the expansion, require, in addition to long terms contracts with the shippers and prospective shippers applying for the expanded capacity, reasonable certainty that the large investment they must finance can be recovered through the reference tariffs of the access regime of the Code.

2.17. This certainty can be provided, at least in part, by the ERA exercising its discretion under section 8.21 and agreeing that the forecast New Facilities Investment for Stage 5 will meet the requirements of section 8.16(a). The ERA would then be bound to add New Facilities Investment of the amount now forecast to the Capital Base of the DBNGP when it is asked to approve the next set of revisions to the DBNGP Access Arrangement.

2.18. If the ERA is bound in this way, DBP also reduces the risk that it may subsequently be in breach of one of the covenants of one of its agreements with one of its financiers - the Reimbursement Agreement. The Reimbursement Agreement is one of a series of agreements through which debt financing of the DBNGP is effected. DBP will be in breach of the Agreement if the ratio of net senior debt to the regulated asset base (which is defined in the Agreement and is based on the Capital Base) exceeds a certain level. If New Facilities Investment which has been debt financed is not included in the Capital Base, DBP is exposed to an increased risk of the ratio of its debt to regulated asset base exceeding the permitted upper limit.

2.19. The ERA's exercise of its discretion in accordance with section 8.21 of the Code, and its agreeing that the forecast New Facilities Investment for Stage 5 will meet the requirements of section 8.16(a), will provide DBP and its owners with relative certainty, clearing one the main hurdles to allow DBP to finance the expansion. In addition, the ERA's agreement will indirectly facilitate investments by the users of the additional capacity in processing facilities and power generation, and by gas producers supplying those users. Furthermore, the ERA's agreement will facilitate development of the market for natural gas in Western Australia, and promote competition in that market, consistent with the broad public policy objectives to be achieved by the Code.

3. DBP'S REQUEST FOR AGREEMENT UNDER SECTION 8.21 OF THE CODE

3.1. DBP requests that the ERA exercises the discretion it has under section 8.21 of the Code, and agrees that forecast New Facilities Investment required for the Stage 5 expansion of the DBNGP, investment in the range of $1,457,000,000 and $1,521,000,000, will meet the requirements of section 8.16(a), thereby binding the ERA's decision in respect of that investment when it considers proposed revisions to the Revised DBNGP Access Arrangement.

3.2. DBP makes this request on the basis of the following parameters critical for its total investment in the Stage 5:

(a) the expansion is to be designed to only provide contracted full haul T1 capacity, and capacity under any other pre-existing contract;

(b) the full haul T1 capacity to be provided by Stage 5 will be 310 TJ/day;

(c) the average compressor unit availability is assumed to be 98.0%;

(d) the gas composition is based on the outer limit of the specification set by the ERA in the terms and conditions of the Revised DBNGP Access Arrangement which came into effect on 30 December 2005, and the components of this specification are shown below;

Component	ERA AA Composition
Methane	87.850
Ethane	5.756
Propane	0.000
Iso-Butane	0.000
N-Butane	0.000
Iso-Pentane	0.000
N-Pentane	0.000
Hexane	0.000
Heptane	0.000
Octane	0.000
N_2	2.394
CO_2	4.000
Total	100.000
Derived Values	
HHV (MJ/m^3)	37.0
WI (MJ/m^3)	46.5
LPG (t/TJ)	0
Inerts (%)	6.39%

(e) the range of the estimated New Facilities Investment is as shown in the following table:

Dampier to Bunbury Natural Gas Pipeline
Stage 5 expansion
New Facilities Investment (real, 31-Dec-2005)

		Low	High
Looping			
Mainline North	$m	1,111.30	1,170.14
Mainline South	$m	58.82	62.14
Compression			
Mainline North	$m	111.54	111.13
Mainline South	$m	29.05	28.94
Compressor station upgrading	$m	101.66	103.61
Active cooling	$m	17.43	17.36
Restaging	$m	27.30	27.20
Total	$m	1,457.10	1,520.53

(f) the following specific assumptions about pressure apply at certain locations on the DBNGP:

Location	Pressure
deleted – confidential & commercial in confidence]	

3.3. DBP acknowledges that if the actual New Facilities Investment for Stage 5 exceeds the forecast New Facilities Investment which the ERA has agreed meets the requirements of section 8.16(a) of the Code, the difference is to be treated in accordance with section 8.16 when the ERA approves the next set of revisions to the DBNGP Access Arrangement.

4. AGREEMENT IN RESPECT OF A RANGE OF VALUES

4.1. DBP has framed its request for the ERA's agreement under section 8.21 of the Code as a request for agreement that forecast New Facilities Investment within a range of values meets the requirements of section 8.16(a).

4.2. While its investment forecast is based on the budget and expenditure incurred to date for the Stage 4 expansion, there are still some inherent uncertainties in the costing for the Stage 5 expansion because, for example, the nature of the expansion is different and also because the risks associated with Stage 5 are different.

4.3. Given the state of development of the project, a range of values for the Stage 5 expansion project can only be provided at this stage.

4.4. This range of values is determined by the ranges of values assumed for each of the parameters critical for the total investment in Stage 5 set out in paragraph 3.2 above.

4.5. During the period in which the ERA assesses DBP's Request, DBP expects that most, if not all, of the values of the critical parameters should be established with relative certainty. This will happen as:

(a) shippers and prospective shippers who have not yet committed to the capacity they have applied for enter into contracts for that capacity;

(b) the engineers responsible for the design and costing of the project gather further information to enable them to become more certain on forecast expenditure for certain key cost items;

(c) the issue of a gas quality specification appropriate for the purpose of pipeline design is resolved; and

(d) contracts with equipment suppliers and construction contractors are concluded, or at least, as firm pricing proposals are received.

4.6. In the event of DBP not being able to replace the range of values for one of the critical parameters with a relatively certain value, the ERA should make its assessment of DBP's request by reference to the upper limit of the range of values for that parameter set out in paragraph 3.2.

4.7. In these circumstances, although DBP has framed its request for agreement under section 8.21 of the Code in terms of a range of values, the ERA will, if it considers that it is appropriate to do so, agree that a particular value of forecast New Facilities Investment, determined from a specific set of values for the critical parameters, meets the requirements of section 8.16(a).

4.8. DBP expects that, were the ERA to adopt this approach, the specific set of values for the critical parameters (which may include the upper limits of the ranges of values proposed by DBP for some of the critical parameters) would form an integral part of the ERA's agreement.

4.9. DBP is of the view that nothing in section 8.21, or in any other section of the Code, precludes such an approach. Under section 8.21, the ERA has discretion in respect of its agreement, and may agree with or without conditions or limitations. DBP's request is, in effect, a request for agreement subject to conditions, the conditions being the specific values adopted for the parameters critical to the total investment in Stage 5.

4.10. DBP's approach – its seeking the ERA's agreement in respect of a range of values for the forecast New Facilities Investment for Stage 5 – may appear unnecessarily complex.

However, it would seem to be the only way in which an important precondition can be satisfied to enable commitment by DBP, its owners and banks to provide funds for the Stage 5 expansion in time to enable completion of the construction of additional pipeline capacity before the users of that capacity are to take deliveries of gas.

4.11. In order to be able to complete the construction of the additional pipeline capacity now required before the users of that capacity are to take deliveries of gas, DBP must have in place the financing for Stage 5 - and must have placed an order for line pipe - by the middle of 2006.

4.12. To be able to put the financing in place by the middle of 2006, DBP must be able to advise its owners, and the banks which will provide the debt to finance expansion, that the ERA has agreed that the forecast New Facilities Investment for the expansion meets the requirements of section 8.16(a) of the Code. The ERA's agreement under section 8.21 is, in these circumstances, required by the early June 2006.

4.13. The timetable for Stage 5 is now extremely tight. If the ERA were unable to agree that the forecast New Facilities Investment for the expansion meets the requirements of section 8.16(a) before early June 2006, this would compromise DBP's ability to provide the capacity shippers and prospective shippers now require by the time the users of that capacity expect to take deliveries of gas

4.14. If it is to provide the capacity shippers and prospective shippers now require by the time the users of that capacity expect to take deliveries of gas, DBP must proceed with planning, procurement and engineering work for Stage 5, while retaining flexibility in its organizational processes and commercial arrangements to permit adaptation to changed circumstances as these become known. It must also initiate the process of securing the ERA's agreement under section 8.21, even though the outcome of that process is also dependent on resolution of uncertainties in respect of Stage 5. DBP has therefore proposed an approach to securing the ERA's agreement under section 8.21 whereby the resolution of those uncertainties can be taken into account by the regulator as it assesses DBP's request.

4.15. DBP understands that there is no section of the Code equivalent to s. 8.21 which can provide greater certainty in respect of non capital costs. However, a significant change in the scope of DBNGP expansion, and the changed circumstances which have given rise to that scope change (in particular, the change in gas quality), will have major implications for the cost of operating the pipeline. In these circumstances, DBP must consider submission of revisions to the Revised DBNGP Access Arrangement prior to the Revisions Submissions Date.