Submission

on

Epic Energy's Access Arrangement

for the

Dampier to Bunbury Natural Gas Pipeline

dated 15 December 1999

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GLOSSARY

AA	:	Access Arrangement
AAI	:	Access Arrangement Information
AC	:	Access Contract
AG	:	Access Guide
DAC	:	Depreciated Actual Cost
DORC	:	Depreciated Optimised Replacement Cost
Epic:		Epic Energy (WA) Transmission Pty Ltd
Grandfathered Contracts:		Pre - 15 December 1999 Existing Transportation Agreement
MLV7:		Main Line Valve No. 7
NWS:		North West Shelf Gas Pty Ltd
ORGV	:	Office of Regulator General Victoria
RRIA	:	Robe River Iron Associates
WACC	:	Weighted Average Cost of Capital

1. INTRODUCTION

1.1 Submission

Robe River Iron Associates (**RRIA**) is pleased to make this submission on the proposed Access Arrangement for the DBNGP in the form lodged by Epic Energy (WA) Transmission Pty Ltd (**Epic**) with the Western Australian Independent Gas Pipelines Access Regulator (**Regulator**) on 15 December 1999.

This submission has been discussed with the persons referred to in section 2.2, who share contracted capacity in the DBNGP with RRIA.

1.2 Description of RRIA

RRIA is an unincorporated joint venture formed for the purpose of mining, overland transportation, processing, pelletising, and loading for shipment of iron ore. The Participants in the joint venture are:

(a) Robe River Mining Co. Pty Ltd (**Robe**);

(b) Mitsui Iron Ore Development Pty Ltd;

(c) North Mining Limited;

(d) Cape Lambert Iron Associates (a business carried on under that name by Nippon Steel Australia Pty Limited, Sumitomo Metal Australia Pty Ltd, and Mitsui Iron Ore Development Pty Ltd); and

(e) Pannawonica Iron Associates (a business carried on under that name by Nippon Steel Australia Pty Limited, and Sumitomo Metal Australia Pty Ltd).

Robe is the manager of the RRIA Joint Venture.

RRIA's current mining operations are based near the town of Pannawonica, from which iron ore is transported by rail approximately 200 km to processing and port facilities at Cape Lambert. RRIA's employees in the region are based in the company's towns of Pannawonica and Wickham.

2. RRIA GAS SUPPLY REQUIREMENTS

2.1 Cape Lambert Power Station

Power for operations at Cape Lambert, for the townships of Pannawonica and Wickham and for sale, is generated by the RRIA's Cape Lambert Power Station.

Since 1984, the Power Station has been fuelled by natural gas purchased initially from SECWA and more recently the North West Shelf Gas Venturers and transported:

(a) from the Dampier facility along approximately 22kms of the DBNGP to the offtake at MLV 7 ; and

(b) via a dedicated use lateral pipeline constructed by RRIA, from the offtake at MLV 7 to the Cape Lambert Power Station (**Pipeline**).

The Power Station not only generates electricity for use in RRIA's operations but also for sale to Western Power, using gas purchased by Western Power from the North West Shelf Gas Venturers and shipped to the Power Station by Western Power under transport arrangements it concludes with Epic.

2.2 RRIA Current Transportation Costs

The North West Shelf Gas Venturers are responsible for arranging transportation of RRIA's gas supplies. This is done through the sellers' representative North West Shelf Gas Pty Ltd (**NWS**) shipping gas, under a gas transportation contract secured by them, up to MLV7 and then using the RRIA Pipeline to deliver the gas to the Cape Lambert Power Station. RRIA must reimburse the sellers the transport price incurred.

As part of the 1994 "dissaggregation" of the DBNGP foundation gas and transportation agreements NWS concluded a gas transportation contract on 31 December 1994 with the then service provider, SECWA. This was later assigned by SECWA's successor AlintaGas to Epic as a Grandfathered Contract as part of the sale of the DBNGP assets. The contract also caters for the capacity granted to Hamersley Iron Pty Ltd and Western Power. It may be extended for 6 years from 1 January 2001.

RRIA has discussed this submission with NWS, Hamersley Iron Pty Ltd and Western Power.

During 1999, RRIA paid transport costs based on the part haul equivalent of the full haul tariff for T1 Capacity of $1.09GJ, resulting in an overall approximate charge of 2.5cents/GJ.

2.3 Access Arrangement Transportation Costs

A schedule comparing methods of calculating RRIA’s transport costs under existing contract arrangements and the Access Arrangement is set out below:

CALCULATION $/GJ			
	Existing Contract	**Access Arrangement**	
Reservation	0.012898(1)	Gas Receipt Charge	0.0698
Commodity	0.004263(2)	Pipeline Capacity Charge	0.0129
Total	0.017161		0.0827(3)
(1)	$\frac{21.933}{1399} x \frac{0.822743}{1}$	(3) Plus Delivery Point Charge	$193.57/Day

(2) $\frac{21.933}{1399} x \frac{0.271971}{1}$	Plus if applicable • Unavailability charge • Nominations Surcharge • Excess Imbalance charge • Out of Specifications charge • Peaking Surcharge	 \$15/GJ \$15/GJ \$15/GJ \$15/GJ \$15/GJ

Under the Access Arrangement, RRIA will pay the tariffs and charges of a Zone 1(a) shipper.

RRIA estimates that under the Access Arrangement, RRIA's annual gas transportation costs would increase by about 700% from approximately 2.5cents/GJ to 18cents/GJ. Annual transport costs to RRIA are estimated to increase from approximately \$45,000 per annum to \$315,000 per annum.

Under the Access Arrangement additional costs of \$15/GJ are payable as surcharges for these or the most nearly equivalent services.

So, in addition to increased transport costs at a normal load factor RRIA's costs for load flexibility would increase dramatically.

This is an outcome which in our submission, should be regarded as inconsistent with the Government's statements regarding tariff reductions and implicit intention that full-haul pricing reductions should apply pro-rata to part-haul pricing.

The Reference Tariff is discussed further below.

3. ISSUES FOR CONSIDERATION

3.1 Required Contents of an Access Arrangement

Services Policy

Section 3.2 (a)(ii) of the Code requires the Services Policy to include a description of any Service or Services which in the Regulator's opinion should be included in the Services Policy.

To the extent practicable and reasonable, a User or Prospective User must be able to obtain a Service which includes only those elements which the User or Prospective User wishes to be included in the Service and Epic must provide a separate tariff for an element of a Service if that is requested by a User or Prospective User (sections 3.2(b) & (c)).

The Services Policy is limited to offering a single firm transportation service. No interruptible, spot or peaking service is offered otherwise than as a Non-Reference Service and as such a User or Prospective User will not be able to obtain, other than by way of negotiation, any form of interruptible, spot or peaking service.

Instead of offering an interruptible, spot or peaking service, the Access Arrangement is so structured with punitive charges as to make it unreasonably cost prohibitive for Prospective Users, which have a very flexible gas demand transportation requirement, to use the Pipeline.

The Pipeline system and its operational availability appear to make it practical for an interruptible, spot or peaking service to be provided in Zone 1(a). The Access Arrangement does not demonstrate how or to what extent, if any, if it would not be reasonable or practicable for an interruptible, spot or peaking service to be provided as a Reference Service.

We request the Regulator consider exercising its discretion to include an interruptible service within the Services Policy, especially for Zone 1(a).

Reference Tariffs

Section 3.3(b) of the Code requires the Access Arrangement to include a Reference Tariff for 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.

We submit that the Pilbara Region is likely during the five year term of the Access Arrangement to represent a significant part of the market for firm, interruptible, spot and peaking services and we request that the Regulator consider inclusion of a Reference Tariff for each of these services.

Reference Tariff Policy

Under Sections 2.5 and 3.4 of the Code the Reference Tariff Policy must in the Regulator's opinion, comply with the Reference Tariff Principles described in Section 8.

Section 8.10(a) and (b) requires the Depreciated Actual Cost (**DAC**) and Depreciated Optimised Replacement Cost (**DORC**) to be considered in establishing the initial Capital Base for the Pipeline.

The Access Arrangement does not contain any calculations of DAC or DORC.

Under Section 2.6 of the Code, the Access Arrangement Information must contain such information as in the opinion of the Regulator would enable Users and Prospective Users to understand the derivation of the elements in the proposed Access Arrangement and to form an opinion as to compliance of the Access Arrangement with the provisions of the Code.

We submit that in the absence of any DAC or DORC calculations it is not possible for a User or Prospective User to form an opinion as to the compliance of the Access Arrangement with the provisions of the Code.

Accordingly, we submit that the Regulator should insist upon inclusion of DAC and DORC calculations.

Attachment A to the Code

Section 2.7 of the Code specifies that the Access Arrangement Information (**AAI**) must include the material set out in Attachment A to the Code which includes information as to asset valuation methodologies - historical cost or asset valuations (see category 2). No such information is provided in the AAI.

Accordingly we submit that in order to comply with Section 2.7 that information must be included.

Grandfathered Contracts

Section 2.25 of the Code requires that the Regulator may only approve this Access Arrangement where its provisions, if applied, would not deprive any person of a pre-15 December 1999 contractual right (**Grandfathered Contracts**), other than a post 29 March 1995 Exclusivity Right.

RRIA, Hamersley Iron and Western Power quantities are currently shipped under a number of Grandfathered Contracts.

No details of the Grandfathered Contracts have been published in the Access Arrangement and as such it is unclear how the Regulator is in a position to be able to determine whether or not approval of the Access Arrangement may or may not deprive anyone of a pre 15 December 1999 contractual right.

For example, if Grandfathered Contracts contain contractual rights relating to exemption from surcharges or rebates it is not clear, without that detail being provided, whether or not the imposition of surcharges or the rebate mechanism in paragraph 9.2 of the Access Arrangement will distort, or deprive owners of, those pre-existing rights.

In determining its Reference Tariff it is noted that Epic has allocated costs to Grandfathered Contracts (see paragraph 7.9(a) of the Access Arrangement and paragraph 2.4 of the Access Arrangement Information).

Furthermore in the absence of detail regarding Grandfathered Contracts it is unclear how any person can form an opinion as to compliance of the Access Arrangement with the Code, as required by section 2.6.

It is submitted that the Regulator should require inclusion of detail regarding Grandfathered Contracts so that:

(a) the Regulator is in a position to make an assessment as to whether or not approval of the Access Arrangement will deprive holders of pre-existing contractual rights; and

(b) other persons can form an opinion as to compliance of the Access Arrangement with the Code.

3.2 Services Policy

NWS as shipper for RRIA uses approximately 22km of the Pipeline from Dampier to MLV7, without the need for use of Epic's compression or consumption of compressor fuel.

This is also the position in regard to the shipment of gas to MLV7 for use in the Cape Lambert Power Station for the account of Western Power.

Further, transportation of gas for Hamersley Iron involves the use of a mere 9.4km of the Pipeline, again without the need for use of Epic's compressor stations or consumption of compressor fuel.

The services offered will disadvantage Pilbara users of gas transported via the Pipeline.

(a) Reference Services

The Reference Service offered is a single firm non-interruptible service and in the case of the Pilbara effectively a front haul only service.

The Pipeline Capacity Charge is payable in advance, regardless of throughput or force majeure.

The nomination process is unduly inflexible.

There are quantity and price penalties applicable through the $15/GJ Surcharges, which surcharges are not cost reflective and are punitive.

The secondary market will not be applicable in the Pilbara because there are only two suppliers.

These factors mean that in order to achieve the flexibility of service required by the Pilbara users they will have to pay in addition to the:

- Pipeline Capacity Charge;
- Gas Receipt Charge; and
- Delivery Point Charge,

price penalties through the Surcharges (in the absence of negotiated or arbitrated terms for an appropriate Non-Reference Service.)

(b) Non-Reference Services

Whilst the terms and conditions for Non-Reference Services are negotiable the procedures for accessing those services are pre-determined by Epic in advance. For example, paragraph 2.3(e) of the Access Guide imposes pre-conditions for the negotiations by entitling Epic to reject Access Requests for Non-Reference Services thus precluding a request from being placed in the Non-Reference Queue, in certain circumstances.

Further, the Regulator's attention is drawn to paragraph 6.1(b)(ii) of the Access Arrangement which says that Non-Reference Services are also to include services provided by Epic under Grandfathered Contracts. The Regulator is asked to consider the implications of this for the purposes of Section 2.24 (b) and 2.25 of the Code and satisfy itself that approval of this provision will not deprive holders of Grandfathered Contracts of any pre-existing contractual rights (e.g. options for term extensions).

The references in paragraph 6.1(b)(ii) of the Access Arrangement; paragraph 2.6 of the Access Arrangement Information; paragraph 2.3(e) of the Access Guide and the Non Reference Service Request Form (particularly clauses 4 and 6) collectively appear to conflict with Section 2.50 of the Code to the effect that nothing (except for the queuing policy) contained in an Access Arrangement (including the description of the Services in the Services Policy) is to limit the services the Service Provider can agree to provide to a User or Prospective User or the terms and conditions a Service Provider can agree with the User or Prospective User.

3.3 Terms and Conditions Other Than Price

We question whether the following terms and conditions are reasonable and request the Regulator to give due consideration to the following comments and form its opinion on that issue as is required in Section 3.6 of the Code.

Access Arrangement

Clause 5.1(c) requires payment of a prescribed fee of $5,000.00 to accompany an Access Request. This is stated to be non-refundable even where an Access Request is rejected. This seems unreasonable.

The Prescribed Fee also applies in regard to an Access Request for a Non-Reference Service. This could be for a single day spot service and would require the payment of a $5,000 fee. Clearly this is cost prohibitive.

Clause 5.2 allows Epic to request such further detail and information from a Prospective Shipper as Epic reasonably considers necessary. Epic's ability to do so should be limited in order to prevent abuse and the reasons for the requests should be transparent.

It is submitted that the Regulator should consider whether Epic should only be able to request further information where:

(a) it relates directly to assessment of the Access Request;

(b) it is reasonable to do so (as distinct from being reasonable in Epic's opinion); and

(c) Epic states clearly the reasons for requesting the additional information.

Clause 5.2(d) provides that an Access Contract will only arise where the Access Request is accepted by Epic. There should be a stipulation obliging Epic to accept an Access Request where there is spare Capacity.

Clause 5.3 sets out the queuing policy. The queuing policy is expressed to be subject to any Capacity Expansion Options which may be granted by Epic from time to time. Capacity Expansion Options are described in paragraph 12. Apart from the concept of selling Capacity Expansion Options which can be traded there does not appear to be any other substance to the queuing policy. We submit that the queuing policy should be detailed more fully.

Clause 5.3(c) allows Epic to reject an Access Request at any stage prior to its acceptance. This should only be permitted where Epic can demonstrate sound reasons for rejecting the Access Request; otherwise the concept of queuing for Capacity as and when it becomes available is defeated.

Clause 6.2 requires there to be a minimum term of five years for an Access Contract. This seems unnecessarily and unreasonably long. Epic has an obligation under Section 3.2 of the Code to offer "services that are likely to be sought by a significant part of the market". The five year minimum term is not reflective of the requirements of the gas market in a contestable environment. Nowadays gas sales contracts can be for as little as one or two years reflecting the reality of today's contestable markets. The proposed term is too restrictive and will serve to reduce rather than promote competition.

We submit that this term should be any period of one to five years as nominated by the User.

Clause 10.3 allows Epic to vary the Access Contract terms and conditions without the consent of the Shipper or the Regulator except in regard to 12 specified areas. We acknowledge the need for some flexibility on variation of Access Contract terms and conditions to take account of operating experience and change of circumstances, however such variations should not disadvantage in any material way the rights (in addition to quantifiable monetary rights) of the

Shipper. Clause 10.4 tries to capture part of this principle but it is expressed in too vague and uncertain terms.

Clause 12.3 permits Epic to determine whatever purchase price it considers appropriate for sale of a Capacity Expansion Option. We submit that the purchase price should be reasonable relative to the cost of providing the Capacity Expansion.

Clause 12.7 permits Epic to seek surcharges or capital contributions from Prospective Shippers in respect of New Facilities Investment. No principles are described as to the quantum or the size of those surcharges or capital contributions. We submit that consistently with section 8.25 of the Code these principles should be incorporated.

Access Contract

Clause 2.3 permits Epic to accept Out of Specification Gas "on terms and conditions acceptable to Epic". These terms and conditions should be reasonable, otherwise the right could be exercised in a discriminatory way.

Clause 2.4 allows EPIC to vent Out of Specification Gas which enters the pipe without Epic's consent. The Shipper must then pay the Out of Specification Gas Charge of $15/GJ. There should be a requirement for Epic to advise the Shipper before the Out of Specification Charge is to be incurred.

Clause 6 imposes an Excess Imbalance Charge of $15/GJ where a daily imbalance exceeds 2% of the Shipper's MDQ. The 2% tolerance is too narrow; industry norms are usually between 5% and 10%.

Clause 7 allows Epic to charge a Peaking Surcharge of $15/GJ for Unauthorised Peaking. The amount of the Surcharge appears to be entirely unrelated to any additional costs which may be incurred by Epic in providing the unauthorised Peaking Service.

Clause 9.4 allows Epic to satisfy its obligations to deliver gas by using a gas pipeline other than the DBNGP, but still to charge tariffs derived from the capital and operating costs relevant to the DBNGP. If the Regulator is to allow this clause to stand then we request it be amended so that any savings in costs through using an alternate pipeline are passed on to the Shipper.

Clause 13.4 makes the Shipper responsible for its and its contractors' personnel and property. However, a reciprocal responsibility to the effect that Epic is responsible for its and its contractors personnel and property is not included. We submit it should be.

Clause 15 and the definition of "force majeure" excludes "strikes or industrial disputes" from force majeure events such that a Shipper will remain liable for all of its obligations even if its plant is shut down due to strikes or industrial disputes. We submit this is quite unconventional within the industry and unreasonable and request that it be amended.

Clause 21.3 allows Epic to seek confirmation from time to time that the Shipper is in a position to meet its obligations under an Access Contract. Under clause 21.4 if Epic is not so satisfied (and no reasonableness test is specified) then the Shipper must provide security for those obligations to Epic's reasonable satisfaction. A failure to provide, or inability to provide, the financial security amounts to an Event of Default allowing Epic to suspend the Service and/or terminate the Access Contract (see clause 17.2). We submit these provisions are susceptible to abuse and could be used to preclude continuing access to a Service by a Shipper and request their amendment.

3.4 Capacity Management Policy

No comments.

3.5 Trading Policy

There will be limited scope for trading Capacity in the Pilbara Region (Zone 1(a)) as there are only two existing actual/potential shippers with actual or economically proximate Receipt Points within that Zone.

3.6 Queuing Policy

Under Sections 3.12 to 3.15 of the Code the Access Arrangement must include a Queuing policy which explains the priorities of Users and Prospective Users in obtaining access to the DBNGP.

We submit that paragraph 5.3 of the Access Arrangement fails in that regard since it does not provide sufficient detail to enable Users and Prospective Users to understand in advance how a priority will be assigned and to the extent reasonably possible accommodate the legitimate business interests of the Users and Prospective Users or generate economically efficient outcomes.

The Capacity Expansion Option scheme overrides the Queuing scheme and the Queuing scheme is scant in detail as to when a party in the queue will become entitled to Capacity.

3.7 Extensions/Expansions Policy

No comments.

3.8 Review of the Access Arrangement

No comments.

3.9 Reference Tariffs

The Reference Tariffs Policy and the Reference Tariffs are intended to be designed to achieve the objectives set out in section 8.1 of the Code. We submit that the Reference Tariffs Policy and the Reference Tariffs fail to achieve these objectives; in particular the Tariffs setting policy is not consistent with recognised methodologies for pipeline asset valuations.

Relevantly:

- the initial Capital Base value falls outside the range of DAC and DORC;
- the regulatory rate of return is above the industry norm;
- the proposed new capital expenditure is unsubstantiated;
- forecasts of non capital costs need to be determined as realistic and reasonable; and
- the deferral of a portion of capital costs to the "deferred recovery account" with the intent of recovering these costs in future is unconventional and is not a generally recognised and acceptable depreciation technique.

We have the benefit of having read the posted submissions of Hon. Mark Neville MLC and AlintaGas in regard to these matters and below refer to them as the Neville Submission and the AlintaGas Submission.

(a) **Initial Capital Base**

Section 8.11 of the Code states that the initial Capital Base normally should be within the DAC and DORC valuations.

Here DORC or DAC valuations have not been included but it is conceded by Epic that the purchase price value of $2.5 Billion is outside of what would have been these valuations were they to have been included.

Whilst the Regulator may take into account the sale prices for the purchase of assets, this does not necessarily refer to the Pipeline (but could include recently acquired laterals to an existing pipeline). The Regulator is not obliged to accept that sale price as being determinative of the value of the initial Capital Base.

Adopting a purchase price value, which by industry standards appears to be only economically justifiable on the basis of significant increases in revenues, should not be used to force Users and Potential Users to provide recompense for Epic's optimistic projections.

We note from AlintaGas' Submission its estimates of a probable DAC and DORC of respectively $1 billion approx to $800 million approx and that on these figures the initial Capital Base for the DBNGP should be about 40% of EPIC's proposed figure of approx $2.5 billion, that is approx $1.0 billion.

Whilst RRIA has not undertaken its own valuation it submits that the Regulator should require further information to be included regarding DAC and DORC and indeed notes that section 2.7 of the Code requires such information to be included in category 2 of Attachment A of the Code.

(b) **Regulatory Rate of Return**

RRIA understands that on the basis of recent regulatory decisions in Australia a more acceptable figure is between 7.5% to 7.75%. On this basis adoption of the figure of 8.6% appears excessive and if this stands it will considerably inflate tariffs in the medium to longer term.

Some of the inputs for the determination of WACC adopted by Epic appear questionable:

- the equity beta of 1.15 appears high compared with the USA norm of 0.65 and 0.85 adopted by the Office of Regulator General of Victoria (**ORGV**)
- the equity/debt ratio of 45:55 is high compared with the ratio of 40:60 adopted by ORGV
- the risk free rate for cost of debt is high at 6.4 % versus 6.2% currently applying for 10 year bonds
- the corporate debt premium 1.2% is high versus 0.05% to 1% adopted by ORGV
- the market risk premium of 6.5% is high compared with 6% adopted by Officer, Hathaway as referred to in the Brattle Report
- the company tax rate should be 33% not 36%, in light of the recently announced Australian taxation changes; and
- the dividend payout ratio of 70% is high compared to the usual 50%.

We understand that if these revised figures are input to the formula adopted by Epic the WACC would reduce considerably.

We note with interest the calculations at pages 5 and 6 of Neville's Submission to the effect that by applying a WACC of 7.50% for:

(a) an initial Capital Base of $1.0 billion (which coincides with AlintaGas' valuation) the Reference Tariff, using depreciation over:

(i) 65 years should be $0.67/GJ; and

(ii) 45 years should be $0.70 / GJ; or

(b) to an increased Capital Base of $1.2 billion the Reference Tariff, using depreciation over:

(i) 65 years should be $0.76 / GJ; and

(ii) 45 years should be $0.80 / GJ

Not only are these tariffs considerably below the privatisation tariffs of $1.00 - $1.08 / GJ but also below the tariffs which Epic says in paragraph 2.5 of the Access Arrangement Information would apply if it were not bound by the privatisation tariffs.

We request that the Regulator check carefully whether or not the inputs adopted by Epic for inclusion in the WACC formula are commensurate with normal industry practice.

(c) **New Capital Expenditure**

We request that the Regulator verify the projected capital expenditures in the context of the assumed and expected likely expansion of the DBNGP market and be satisfied with the reasonableness of the projections.

(d) **Non-Capital Costs**

In paragraphs 2.4 and 4 of the Access Arrangement Information certain details of the non-capital costs and their recoupment are described. Basically the Gas Receipt Charge is stated to be designed to recover allocated overheads, head office costs, the costs of system operation and marketing costs. Further it is stated that these do not vary with the distance over which gas is transported and are not recovered on the basis of zones in which the capacity is utilized.

We submit that this approach is clearly inequitable for a User of say only 22 kilometres of pipeline capacity and request that the Regulator enquire as to an alternative and fairer means for allocating these costs.

We request that the Regulator verify that Epic's forecasted non capital cost of $39.11 million and increasing to $46.84 million in 2004 are reasonable.

(e) **Economic Depreciation of Assets (Return of Capital)**

The creation and adoption of the "deferred recovery account" appears to be a most unconventional form of depreciation.

We also note with concern Mark Neville's observation in his Submission at page 4: "In selling the DBNGP at such an inflated price the State Government has built in pressures for substantial rises in future transportation costs unless there is a significant increase in pipeline throughput very soon, which looks unlikely".

In light of the comments in paragraph 3.4 that any unrecovered "deferred recovery account" balances will represent an "imprudent investment", we request the Regulator satisfy itself that this accounting approach will not distort economic efficiency nor lead to excessive built in pressure for significant mandatory increases in tariffs after January 2005 (Revisions Commencement Date).

(f) **Incentive Mechanisms**

No comments.

(g) **Determination of Reference Tariffs**

In our opinion the determination by Epic of tariffs based on those promised at the time of the privatisation of the Pipeline is not consistent with, or provided for in, the Code.

Epic, at paragraph 2.5 of the Access Arrangement Information explains that Tariffs determined from the forecast total cost of service set out in Table 2.2 using the cost of allocation described in section 2.4 would be approximately:-

(i) from a Receipt Point in Zone 1 to a Delivery Point in Zone 9: $1.41/GJ; and

(ii) from a Receipt Point in Zone 1 to a Delivery Point in Zone 10: $1.62/GJ.

Epic acknowledges that this level of tariffs would be significantly higher than the tariffs expected by shippers using the Pipeline.

These comments appear to confirm that the so called "Reference Tariffs" are not tariffs which are consistent with the tariff setting principles of the Code.

It follows in our submission that it seems most likely that tariffs determined in accordance with the Code will not produce a Reference Service that is "likely to be sought by a significant part of the market" as is required by section 3.3(a).

Therefore the so called "reference service" currently being offered will need to be significantly redesigned so that it can be provided at a tariff which is:

(i) consistent with Epic's undertakings to the State; and

(ii) also consistent with the Reference Tariff determination provisions of the Code.

4. ACCESS ARRANGEMENT INFORMATION

The AAI document must be prepared in such a way as to permit interested parties to understand the derivation of the elements in the proposed Access Arrangement and form an opinion as to the compliance of the Access Arrangement with provisions of the Code.

Paragraph 2.5 of the AAI document glosses over the issue of determination of tariffs in accordance with the Code with generalised statements such as:

> "Epic Energy has made pro rata adjustments to the tariffs determined from its forecast total cost of providing services using the pipeline."; and
>
> "The lowering of the Reference Tariff to a level consistent with the commitment to the Government of Western Australia at the time of the DBNGP sale, is effected through a postponement of recovery of part of the capital costs until that recovery is warranted by growth in demand for gas transmission services".

These generalised statements do not provide sufficient detail for an interested person such as RRIA to be able to understand the derivation of the elements of the proposed Access Arrangement, as is required under section 2.6 of the Code.

Furthermore, the AAI document must include the categories of information described in Attachment A. Category 2 of Attachment A calls for information regarding Capital Costs in particularly information as to asset valuation methodologies-historical cost or asset valuations. In our submission this information has not been provided.

5. CONTACT DETAILS

The person who may be contacted in connection with this Submission is:

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