

16 March, 2000

Mr Robert Pullella
Office of Gas Access Regulation
Level 6, Governor Stirling Tower
197 St George's Terrace
PERTH WA 6000

Dear Mr Pullella

RE: ACCESS ARRANGEMENT PROPOSED BY EPIC ENERGY (WA) TRANSMISSION PTY LTD ("EPIC ENERGY") FOR THE DAMPIER TO BUNBURY NATURAL GAS PIPELINE ("DBNGP")

Wesfarmers Limited submits, for consideration, the following comments on the proposed DBNGP access arrangement submitted by Epic Energy.

Wesfarmers' interests in this matter are twofold:

- several of Wesfarmers' industrial operations purchase significant quantities of gas delivered via the DBNGP (the most significant purchasers being the Wesfarmers LPG and CSBP ammonia plants at Kwinana); and
- as a locally-based industrial company, Wesfarmers is concerned to promote the sustainable growth and international competitiveness of the Western Australian economy.

Epic Energy's proposed access arrangement would, if accepted by OffGAR in its current form, impose significant additional costs upon, and reduce the international competitiveness of, Western Australian industry.

We note that there is considerable commonality between Wesfarmers' specific concerns and concerns that other interested parties have already raised in considerable detail. Accordingly, we have sought to keep this submission relatively brief.

1. Initial capital base

Epic Energy has proposed an Initial Capital Base for the DBNGP calculated by reference to the price which Epic Energy tendered for acquisition of the DBNGP plus Epic Energy's associated acquisition costs, that is some \$2,450 million.

Wesfarmers is concerned as to the implications of Epic Energy's proposed approach to capital base determination. In effect, Epic is proposing that Western Australian gas users should financially compensate Epic Energy, not just for the fair capital value of the DBNGP but also for the premium which Epic Energy elected to pay over and above that fair capital value in the tender process for the DBNGP.

This premium is not, to our knowledge, reasonably reflective of the tangible assets comprising the DBNGP. Wesfarmers assumes that Epic Energy elected to pay a premium for the DBNGP as a result of additional value which Epic Energy attributed to business opportunities that would arise for Epic Energy from ownership of the DBNGP. To the extent that the purchase price did not relate to tangible asset values in the DBNGP itself, it is inappropriate that it should be included in the initial capital base.

In any event, this approach does not satisfy the requirements of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the "Code"). It is our understanding that the capital base should have regard for the Depreciated Actual Cost ("DAC") and/or the Depreciated Optimised Replacement Cost ("DORC"). Neither of these has been included in Epic Energy's proposal. This is surprising given that section paragraphs 8.10(a) and (b) of the Code require that these values be considered in setting an initial capital base and paragraph 8.11 provides that an initial capital base should normally be within the range of these values.

Based on the annual report of AlintaGas prior to the sale of the DBNGP, and industry studies on similar or duplicate pipelines, it would be reasonable to expect the DORC to be below \$1,000 million; the difference in rates if the proposed base is used would make gas transmission prohibitively expensive for many existing and potential shippers and users.

We note Epic Energy's assertion that the competitive process through which Epic Energy acquired the DBNGP removed the initial capital base from within the existing bounds of Section 8.11 of the Code. We are not aware of any reasonable basis for an assertion that the DBNGP should fall outside the ambit of the Code in such a critical respect.

With respect to the concept of the "deferred recovery amount" proposed by Epic Energy, we are not aware of any basis for such an approach in the Code. We query whether such a device would be necessary on a DAR or DORC determination of the initial capital base in any event. While it is understood that the "deferred recovery amount" concept has been applied to some new pipelines outside Australia where utilisation might be low in the early years, this is a totally different situation to the DBNGP where incremental capacity can be economically implemented more or less as required.

2. Proposed boundaries of “zone 10” – tariff implications

The proposed division of the network into 10 zones for tariff purposes, and in particular, the proposed boundaries of “zone 10”, result in a transportation tariff for the majority of gas delivered via the DBNGP (being to delivery points in the proposed zone 10) of over \$1.08/GJ. This outcome appears at odds with the intention of the Western Australian parliament at the time of consideration of the *Gas Pipelines Access (Western Australia) Act 1998* when the Minister stated:

“Firm full-haul tariff at 100% load will fall from \$1.19 per gigajoule to \$1.00 per gigajoule by the year 2000.”

(Second reading speech in respect of section 96 of the Gas Pipelines Access (Western Australia) Act 1998): 18 June 1998.)”

In view of the additional tariff impost on the majority of gas delivered via the DBNGP that would result from Epic Energy’s proposed zoning system, we request that OffGAR consider whether such a division of zones is consistent with the requirements of the Code and relevant legislation.

3. Weighted average cost of capital

We note that Epic Energy has proposed a weight average cost of capital (“WACC”) of 8.5% for the DBNGP.

We request that OffGAR review this determination to ensure that the beta component is an accurate reflection of the risk profile for the DBNGP and that the WACC, in respect of the DBNGP, is consistent with similar determinations in other states.

4. Proposed changes to “benchmark” service

The *Dampier to Bunbury Pipeline Regulations 1998* provide for a combined full-haul tariff for 100% load factor T1 service, both upstream and downstream of Kwinana junction.

We are concerned that the “Firm Service” proposed by Epic Energy is materially different to the T1 service in a range of key respects. The practical effect of these differences appears to be a significant increase in the effective transmission costs payable by pipeline users. This arises from:

- (a) a significant increase in the fixed component of transmission costs (approximately 95% as compared to 75% under the T1 tariff); and
- (b) an increase in incidental service costs charged by Epic Energy over and above the headline tariff (as a result of a significant narrowing of the scope of service included in the reference tariff combined with an increase in incidental and “penalty” charges). Issues include:
 - restrictions and additional charges on relocating spare capacity between delivery points;

- a queuing policy that does not guarantee continuity of access for existing users;
- more restrictive overrun provisions and additional overrun charges;
- a 75% reduction of the tolerable imbalance limit (from +/- 8% of total reserve capacity to +/- 2% of total reserved capacity);
- an effective 1500% tariff surcharge (\$15/GJ) for each GJ in excess of the imbalance limit whereas no imbalance penalties currently apply;
- a reduction in the winter hourly peaking limit from 125% to 120% and abolition of the ability for users to aggregate hourly peaking amongst multiple delivery points;
- an effective 1500% tariff surcharge (\$15/GJ) for each GJ taken in excess of the hourly peaking limit;
- new restrictions on the ability to sell unused capacity to other users;
- no provision for interruptible capacity; and
- seasonal flexibility to book different reserve capacities will become a non-reference service for which an extra charge is expected to be levied.

We request that OffGAR critically review the material departure by Epic Energy from the T1 service standard with a view to ensuring that:

- (a) Epic Energy offers a reference tariff for all services reasonably required by Part 3 of the Code;
- (b) the tariff services proposed by Epic Energy are genuinely reflective of actual incremental operating costs to Epic of providing those services and are not punitive; and
- (c) the overall costs to a shipper with “typical” patterns of usage and demand fluctuations only increase to the extent that additional services are offered at cost plus a reasonable return.

5. Indexation

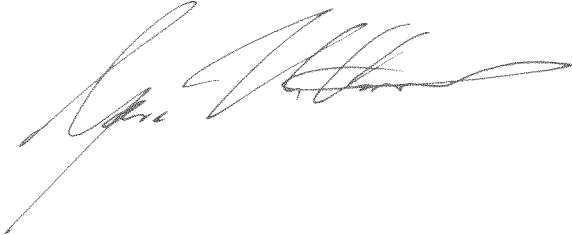
We note Epic Energy’s proposal to escalate all charges at 67% of CPI. As the bulk of the underlying cost is capital recovery and therefore fixed, this escalation rate would appear to overcompensate Epic Energy while penalising users of pipeline services. We request that OffGAR address the level of escalation that most appropriately balances the interests of Epic Energy and the interests of users. We would also note that a formula based on (CPI-X)% may more realistically allocate the benefits which should be achievable through economies of scale and progressive operating efficiencies.

6. Conclusion

In summary, it appears to Wesfarmers that the arrangements proposed by Epic Energy would result in greatly increased tariffs; tariffs which would far exceed those which would apply under application of the Code; while offering little or no additional benefits to shippers.

Please do not hesitate to contact the undersigned if you require elaboration on any of the matters raised in this letter or if require further information.

Yours faithfully

A handwritten signature in black ink, appearing to read 'G T Tilbrook', written in a cursive style.

G T TILBROOK
DIRECTOR
BUSINESS DEVELOPMENT