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Mr Robert Pullella
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Dear Mr Pullella

EPIC ENERGY ACCESS ARRANGEMENT FOR THE DBNGP
WESTERN POWER SUBMISSION NUMBER 1
CARNARVON TRANSPORT SERVICE

Western Power submits for review by the Office of Gas Access Regulation (OffGAR), Western Power's present concerns on Epic Energy's proposed DBNGP Access Arrangement for gas transport to Carnarvon.

BACKGROUND

Western Power has a Gas Transmission Regulation (GTR) contract with Epic Energy, which reserves 1.5TJ/d of firm (T1) part haul capacity on the Dampier to Bunbury Natural Gas Pipeline (DBNGP).

The contract features an overrun service, an imbalance tolerance of 8% and no peaking penalties.

The contract also includes all the shipper specific charges for the 167km lateral from the MLV55 branch point to Carnarvon Power Station. These charges are calculated on an annuity basis for the recovery of approximately $10.4 million over the remaining contract term until 2014. These charges were specifically contracted to recover all the costs of the capital assets disaggregated from SECWA. Once these charges have been paid, all these capital charges cease and the cost of delivering gas to Carnarvon would be reduced accordingly. This was, or should have been, fully known by Epic Energy when it purchased the pipeline.

The Carnarvon Power Station is the sole user of gas delivered through the lateral. Under the principles of Western Power's GTR contract, any other shipper requiring gas delivery would share in the existing capital charges.

REFERENCE TARIFF

A breakup of the current contract charges is shown in the table below. Currently, the average transport cost (excluding lateral charges) of delivered gas is around $0.56/GJ. Shipper specific charges for the lateral amount to an additional $3.84/GJ on a delivered basis. The total average transport cost for gas delivered to Carnarvon Power Station is currently around $4.40/GJ, based on the regulated price under the Dampier to Bunbury Pipeline Regulations 1998 at January 2000 and Western Power's historical average annual usage of approximately 1 TJ/d.

WESTERN POWER'S CARNARVON GTR CONTRACT COSTS[1]		
(Based on Year 2000 full haul price of $1/GJ combined)		
Reservation Charge (1.5TJ/d)	$0.301006/GJ	$164,800
Commodity Charge (1.0TJ/d)	$0.112298/GJ	$41,000
	Total	$205,800
Shipper Specific Charges	$118,400/Month	$1,420,800
Average Delivered Cost (1TJ/d)		
• Excluding Lateral Charges	$0.5569/GJ (Fixed Charges = 80%)	
• Including Lateral Charges	$4.40/GJ	

Transport costs for Carnarvon Power Station under the proposed Reference Tariff are shown in the following table, based on a capacity reservation (MDQ) of 1.5TJ/d, and an average annual gas usage of 1TJ/d.

PROPOSED CARNARVON ACCESS ARRANGEMENT COSTS[1]		
(Based on Initial Reference Tariff Schedule)		
Gas Receipt Charge	$0.0698/GJ MDQ	$38,200
Pipeline Capacity Charge (Zone 4)	$0.3639/GJ MDQ	$199,200
Compression Capacity	$0.0299/GJ MDQ	$16,400
Compressor Fuel	$0.0211/GJ	$7,800
Delivery Point Charge	$177.77/day	$64,900
	Total	$326,500
Pipeline Capacity Charge (Zone 4A)	$11.1924/GJ	$6,127,800
Average Delivered Cost (1TJ/d)		
• Excluding Lateral Charges	$0.8808/GJ (Fixed Charges = 98%)	
• Including Lateral Charges	$17.40/GJ	

1 All calculations in the above table are rounded

The Gas Receipt Charge, Pipeline Capacity Charge, Compression Capacity Charge are payable on the Maximum Daily Quantity (MDQ) reserved by the shipper, and the Delivery Point Charge is a fixed daily amount. Thus, Epic Energy would receive the full payment of these charges regardless of the actual gas delivery, which represents a guaranteed return to Epic Energy of 98% of the proposed Reference Tariff. Under the existing GTR contract tariff structure, the reservation charge is a fixed component at 73% of the total part haul tariff.

Under the proposed Reference Tariff, the average transport cost to Carnarvon Power Station, excluding the Pipeline Capacity Charge Zone 4A and penalty charges, would rise from $0.56/GJ to $0.88/GJ, an increase of 36%. The proposed penalty charges, if lawful, are punitive and difficult to quantify, but can be expected to add significantly to the proposed Reference Tariff charges.

Epic Energy does not indicate in the proposed Access Arrangement whether Western Power would receive a rebate from the Zone 4A pipeline capacity charges recovered from a new shipper using the Carnarvon lateral as it would under its current contract.

The proposed Reference Tariff is predicated on the returns gained from the purchase price paid, ($2.4 billion) by Epic Energy for the DBNGP. In Western Power’s opinion, the choice of the sale price as the initial capital base valuation is the prime factor influencing the higher transport charges proposed by Epic Energy. However, Epic Energy would know from the contracted shipper specific charges that the payment for the specific costs relating to Carnarvon was $10.4M. In contrast, Table 3-1(b) of Epic Energy’s Access Arrangement Information purports to value the Carnarvon lateral at more than $67M. No justification is given for this six-fold increase in valuation.

The capital recovery charge currently being paid by Western Power for the Carnarvon lateral was set using a higher WACC than the one proposed by Epic Energy. Even using Epic Energy’s WACC, therefore, Western Power would expect the capital recovery charge to decrease, not increase, under the Reference Tariff.

Furthermore, the choice of the sale price as the valuation basis does not conform to the National Access Code, which requires the initial capital base normally to fall between the values set by two valuation methodologies, namely the Depreciated Annual Cost (DAC) and Depreciated Optimal Replacement Cost (DORC). The DAC is identified in Western Power’s current access contract for the Carnarvon lateral.

At $17.40/GJ, the proposed Reference Tariff would deter prospective shippers to Carnarvon, even without taking the cost of gas supply into consideration. The total delivered cost of gas for a new shipper would exceed the cost of alternative liquid fuel supplies.

The level of existing lateral charges under the GTR contract has, in the past, been a barrier to Western Power and was instrumental in switching away from gas to liquid fuels during 1995. In the light of this experience, it is difficult to understand the prohibitive level of pipeline capacity charges proposed for Zone 4A.

REFERENCE SERVICE

Epic Energy has proposed only one Reference Service, a Firm Service, in its Access Arrangement. The Firm Service does not have the flexibility of the existing GTR contract for transport to Carnarvon Power Station and is therefore, not an appropriate Reference Service.

Significantly, for Western Power, the Firm Service has tighter balancing provisions (ie 2% compared to 8% in the GTR).

It is unclear how the proposed peaking regime would be implemented for Zone 4A, as the Carnarvon Lateral is operated effectively as a pressure vessel separate from the DBNGP.

The proposed overrun charges (110% of Pipeline Capacity and/or Gas Receipt Charges) are likely to double the costs under the present GTR contract (105% for authorised service over deliveries). In some circumstances, overrun charges could be linked to the Secondary Market price, increasing the cost exposure.

The penalty provisions of the Firm Service proposed for daily imbalances, hourly and daily peaking and overrun usage are considered to be punitive and unjustifiable, and possibly unlawful, at $15/GJ. The impact of these surcharges for a peaking power generator, such as Carnarvon Power Station, could be substantial, and may exceed the current annual capacity reservation charges. Epic Energy has not demonstrated that the proposed surcharges are based on the cost impacts of operating the DBNGP.

Western Power seeks and will continue to seek access to the DBNGP on terms equivalent to its GTR T1 service. Accordingly, Western Power requests that the Regulator exercise his discretion under section 3.3(b) of the Code to require Epic Energy to offer an equivalent part haul T1 Reference Service in its Access Arrangement.

IMPACT ON ELECTRICITY CUSTOMERS

It is currently not settled between Western Power and Epic Energy whether an offer under section 20 of the Dampier to Bunbury Pipeline Act 1997 ("section 20 offer") has been made and accepted in respect of (among others) Western Power's Carnarvon Part-Haul GTR contract. If the section 20 offer has been (or is) made and accepted, the potential impact of the proposed Reference Tariff on the price payable under the GTR contract would be financially adverse for Western Power's business in the Carnarvon area, potentially adding several million dollars of additional costs each year to the operation. Such additional costs could not be absorbed without substantial additional subsidies and higher prices for Western Power's electricity customers, at a time when tariffs will already have been increased following the introduction of the Goods and Services Tax.

If the proposal from Epic Energy is accepted, it will have an effect on future energy costs in the area, significantly altering the opportunities for economic development.

Even disregarding the section 20 offer, Western Power will in the future seek access to the Carnarvon lateral under the National Access Code, either for incremental capacity or for replacement capacity when the GTR contract expires. Tariffs for that access will be heavily influenced by the initial capital base set during the current approval process. Epic Energy's proposal to use its purchase price for the initial capital base will thus, if approved, have long term implications for electricity users in the Carnarvon region.

There is no doubt that currently the use of gas in place of liquid fuels for electricity generation at Carnarvon has reduced costs for Western Power. However, even now the cost of electricity in Carnarvon (about $0.24/kWh) is more than double the cost for tariff customers in the south west. Only the current State Government standard tariff policy requiring subsidies to Carnarvon makes electricity available at south west rates.

The Reference Tariff proposed by Epic Energy would increase the effective gas delivery cost to about $17.40/GJ, about four times the current cost. The net effect of such an increase would be to increase electricity costs to about $0.38/kWh.

CONCLUSION

In summary, it is Western Power's view that the proposed Reference Tariff is not competitive with, and would represent a very substantial tariff shock from, the existing price it is paying for part haul transport to Carnarvon on the DBNGP. This is particularly the case when the range of services that form part of the existing GTR contract (which are unavailable with the proposed Firm Service) are taken into consideration.

Western Power requests the Regulator to require Epic Energy to amend its Access Arrangement to include a T1 equivalent part haul Reference Service and corresponding Reference Tariff.

Western Power intends to comment further on the proposed Reference Service and Tariff in later submissions to OffGAR.

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Yours sincerely

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