File No: MA201.002

2 September 1999

Mr Robert Pullella
Office of Gas Access Regulation
Level 6 Governor Stirling Tower
197 St Georges Terrace
PERTH WA 6000

Dear Mr Pullella

Proposed Access Arrangement for the AlintaGas Mid West and South West Gas Distribution Networks

Apache Energy Limited offers the following comments on the proposed Access Arrangements.

Our perspective on the submission is not analytical, rather we are concerned about the role of gas distribution systems in the total scheme of things. That is, we believe true gas market competition can only be achieved if all parts of the gas supply chain are genuinely deregulated and provide reasonable terms of access to all players on a transparent basis.

Gas market deregulation in Western Australia

As a major gas producer and marketer in Western Australia Apache has been and continues to be an active supporter of and participant in the deregulation process in this State. There is no doubt that the significant changes that have taken place in the WA gas market in the second half of the 1990s have resulted in larger gas consumers, in general, being able to contract very competitive gas supply terms. This can only be beneficial in terms of economic growth and, importantly, also provides the opportunity for new project developments to be undertaken in the State, with benefits to all.

Apache believes that gas producers have, to date, provided the primary component of these consumer benefits, by way of reductions in the gas price at the point of delivery into the gas transmission systems. As had been targeted by Government, competition amongst the gas producers in both the north and south of the State has been very effective in lowering gas prices to the consumer. A comparison of WA gas prices with international (OECD) prices will testify to this.

However, we remain concerned that the Government's objective of maximising revenue will continue to elicit sale prices that may not provide customers the benefits they might have otherwise expected. It may also be in Government's interest to minimise competition in order to maximise sale price. This objective can in part be achieved by the terms of access to the distribution system, particularly in the light of the lack of ring fencing within the AlintaGas businesses.

Our comments therefore are targeted at the broad framework of the Access Arrangement in order to identify those areas that increase cost or reduce access.

Ring Fencing of Gas Distribution

Because of the lack of ring fencing of the Gas Trading and Gas Distribution function within AlintaGas, it is not possible to determine whether the existing distribution tariffs and the tariffs advanced under the Access Arangement are or will be those used by Gas Trading. Further, until ring fencing of Gas Trading occurs there is no obligation on Gas Trading to specifically and separately account for distribution charges in its costs, thus allowing the opportunity for significant cross subsidies and predatory pricing to occur.

It is illustrative that, despite active competition between producers and reductions to gas transmission tariffs, there has not been one grant of access to the distribution system and only a handful of customers have changed gas supplier, despite reductions in wellhead prices.

If AlintaGas claims there are no cross subsidies and it accounts for full distribution costs, it should be supportive of immediate ring fencing, rather than delaying this to 2002.

Delineation of the Distribution System

Apache is concerned that particular segments of the DBNGP were excluded from the sale of the DBNGP to Epic and effectively “transferred” into the AlintaGas Distribution System (ADS). For example, the Carnarvon lateral (where no real market exists) was purchased by Epic whilst the Geraldton lateral and the southern section to the Clifton Road Gate Station and beyond have remained with AlintaGas. There is a highly contestable market at the end of each of these pipelines. The same applies to the East Perth lateral.

Access to markets in these particular areas is thus subject to ADS tariffs, adding significant transport costs to the delivered price and effectively protecting the gas contracts AlintaGas already had in place. In the process, customers along or close to these segments do not receive the full benefits of gas market deregulation.

Whilst it would be pointless to argue a case that these pipelines are transmission pipelines and should be “returned” to the transmission system, perhaps the background to their acquisition is such that they warrant a separate network cost structure and tariff arrangement, rather than bearing typical distribution costs. It is arguable that all of the long laterals off the DBNGP be treated similarly.

Interconnection Distance

Following on from the above, the calculation of the demand charge and usage charge under Reference Service A has, as one of its components, the distance to the closest transmission pipeline. The use of this distance component invites by-pass, given the tariffs that result from Reference Tariff A calculations. In other words, Apache believes the prices are artificially high.

As noted above, this is particularly the case for delivery to customers at long distances from the DBNGP where no alternative transmission line is available. Our calculations yield tariffs of $1.68/GJ to the Capel region and $ 2.05/GJ to the Narngulu area (for 1 TJ/day customers at load factors of 1, ignoring user specific charges). This compares with the respective transmission costs of $1.00/GJ and $0.61/GJ. Gas producers and or retailers trying to access these markets are faced with total transport costs in excess of $3/GJ in competing against existing AlintaGas contracts which were structured at a time when AlintaGas Distribution and Trading were not ring-fenced entities.

One way of testing this is to examine delivered prices at key points in the network and by net-back calculate the distribution cost. This requires access to ring fenced data.

Standing Charges

The proposed standing charge imposes an immediate distribution cost of $0.50/GJ on the minimum-sized contestable customer (100 TJ p.a. from 1/1/99). This customer would face a $1.00/GJ transmission charge over approximately 1400 km and a further $0.50 distribution charge over 1 km. Admittedly the standing charge reduces as offtake increases but it still remains a significant cost at $0.137/GJ for a 1 TJ/day customer. Again, in conjunction with the demand and usage charges, by-pass is likely to have considerable appeal.

In any event, such standing charges are not likely to foster greater competition amongst gas suppliers but rather block their access to AlintaGas' market.

Comparison of Proposed Reference Tariffs with 1996 Gas Distribution Regulations - (Access Pricing Redetermination 1998/99)

Under the Gas Distribution Regulations (GDRs), the existing network prices (1998/99) for access to the AlintaGas high pressure distribution system are $0.0138/GJ/km (Demand Price) and $0.0198/GJ/km (Energy Price), as adjusted by a sub-network factor.

Apache's calculations indicate that, for the same service, the proposed Reference Tariffs are considerably higher than those currently applying under the 1996 GDRs. For a 1 TJ/day customer at interconnection distances of 1, 5 and 15 km, the respective proposed tariffs (and increases) are $0.22/GJ (+$0.20), $0.51/GJ (+$0.42) and $0.98/GJ (+$0.47).

These are very significant increases and would certainly attract the attention of all customers using the ADS, if such costs were to be incorporated in revised pricing and passed directly to buyers. One cannot help but think that the pricing is designed to ensure no access by third parties to AlintaGas customers.

Other Matters

Apache requests that OffGAR tests the validity of the following parameters used by AlintaGas in its Reference Tariff calculations:

- the Weighted Average Cost of Capital; and
- the value of "X", to be used in tariff indexation.

We are sure that OffGAR has access to the results of the debate in Victoria as to what constitutes an acceptable WACC for a regulated gas distribution business with guaranteed market pricing.

The Fixed Period

Perhaps its an oversight, but the fixed period, as we understand it, cannot be longer than the duration of the Access Arrangement .

Conclusions

In summary, Apache has concerns that the Access Arrangement may have been proposed to maximise sale price and minimise competition in a framework that will not allow scrutiny until 2002, due to the existing lack of ring fencing in AlintaGas' business.

If the proposed tariffs are accepted, access to contestable customers may be thwarted and competition reduced if not eliminated, to the detriment of those customers and future growth.

We strongly urge that the Access Arrangement provide pricing reduced from existing distribution prices, that special treatment be given to "long laterals" and that Gas Trading be requested to provide to the Regulator the network pricing used in its delivered gas prices to confirm the veracity of such prices on a net-back basis.

Yours sincerely

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