Enquiries: Andrew Everett
Telephone: (08) 9326 4636
Facsimile: (08) 9326 4018

Western Power

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Economic Regulation Authority
Level 6 Governor Stirling Tower
197 St Georges Terrace
PERTH WA 6000

ATTENTION: RUSSELL DUMAS

Dear Russell

FOURTH SUBMISSION ON DRAFT DECISION (REVISED ACCESS ARRANGEMENT INFORMATION)

We refer to our letters of 14 February 2005 and 16 March 2005 and the Economic Regulation Authority's (**"Authority"**) notice of 14 March 2005, regarding the Access Arrangement information (**"AAI"**) provided by DBNGP (WA) Transmission Pty Ltd (**"Operator"**) as part of its proposed revised Access Arrangement (**"PRAA"**).

The Operator lodged a revised AAI on 2 June 2005 (**"Revised AAI"**) which amended the AAI submitted to the Authority on 21 January 2005 (**"Initial Revised AAI"**).

This submission sets out Western Power's (**"WPC"**) comments on the following:

1. Annexure 3 of the Revised AAI;
2. the remainder of the Revised AAI (including Annexure 2); and
3. the Operator's Submission #27.

As a courtesy, we are copying this submission to the Operator.

1. ANNEXURE 3

The Operator is to be congratulated for making the information contained in Annexure 3 available for review. However, there are still significant omissions and some new issues, which are discussed below.

1.1 Section 2 – Operator's Expansion Obligations

The Operator makes extensive submissions as to what it says are its contractual obligations to expand the DBNGP. The Operator's contractual obligations are not relevant to an assessment of whether the proposed New Facilities Investment complies with the Code.

1.2 Section 4 – MAOP

WPC notes the Operator's comments on MAOP and, subject to confirmation as to whether it will have an adverse impact on WPC's operations, supports an increase consistent with AS 2885.1. Clearly a change in such a fundamental parameter would have a significant impact on the Access Arrangement. Consideration must be given to how such a change is to be dealt with if it occurs during an Access Arrangement Period.

1.3 Section 5 – Risk Analysis

The risk analysis used by the Operator in selecting 26" looping is not relevant as to whether the forecast New Facilities Investment satisfies the test in section 8.16(a) of the Code because:

(a) lower risks for the Operator do not necessarily coincide with the objective of achieving the lowest sustainable cost of providing services; and

(b) a lower initial capital cost and/or the short term financing preferences of the Operator, by themselves, do not mean that the Code requirement of achieving the lowest sustainable cost of providing services is satisfied.

Annexure 3 provides no quantitative analysis to demonstrate how the expansion options adopted will achieve the lowest sustainable cost of providing future capacity.

1.4 Section 6 – Post Stage 4 Expansion Program

Stages 5 to 7 represent $530m (55%) of the $970m expansion capital expenditure program ($2005). Unlike stage 4, stages 5 to 7 comprise expansions to meet anticipated or forecast commitments rather than current contracted commitments (**"Anticipated Expansion"**).

There is no information provided on the impact on the Reference Tariff should this forecast demand (and hence forecast New Facilities Investment) not occur.[1]

WPC requests the Authority to consider:

(a) whether such significant and contingent expenditure involved in the Anticipated Expansion should be included in the Capital Base for this Access Arrangement Period; and

(b) if it is included in this Access Arrangement and the Anticipated Expansion does not eventuate – such that the Operator will have been recovering tariffs for costs never actually incurred (and thus over-recovering) – how the Authority will deal with this at the next reset.

1.5 Section 7 – Contracting Strategy

WPC observes that:

(a) paragraph 7.4 does not fully describe the Operator's obligations under section 8.16 of the Code;[2]

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[1] Nor can this be calculated without information on capacity increments.

(b) alliance contracting will not necessarily achieve the objectives in section 8.16 of the Code; and

(c) the Operator's asserted benefits of alliance contracting need particular scrutiny given that ANS is an associated entity of the Operator,

and requests the Authority to consider these issues when evaluating the related party costs of the Operator under the Access Arrangement. The contracting strategy is unlikely to be relevant when considering whether actual incurred costs are included in the Capital Base at the next Access Arrangement Period.

1.6 Section 8 – Proposed Forecast Capital Costs

WPC makes the following points in respect of the table in paragraph 8.3 of Annexure 3:

(a) the table is incomplete without a statement of the capacity increments added each year;

(b) scrubber and aftercooler expenditure are categorised as "compression" in the table, but as "pipeline" in table 4 of AAI;

(c) the omission of interest during construction implies that expenditure is being added to the Capital Base as incurred rather than when capacity expansion is commissioned and available for use. The policy should be confirmed and explicitly stated in the AAI and paragraph 8.15 of Annexure 3 should be deleted;

(d) the overhead and project management costs for compression exceed 15% of total costs and appear to be high particularly given the significant replication from Stage 3A. The Authority should consider whether this has any relationship with ANS' involvement; and

(e) liquidated damages insurance should also be capitalised with other insurance costs (see previous submissions on this issue). The Authority should require the Operator to confirm that its liquidated damages insurance will continue to be procured at its current cost under the alliance contracting approach.

1.7 Section 9 – Compliance with Section 8.16(a)(ii)

WPC disagrees with paragraph 9.5 of Annexure 3.[3] The test for whether New Facilities Investment is to be included in the Capital Base is one of "system wide benefits" not "public benefit".[4] System wide benefits are confined to the gas pipeline system and the longer term benefits (in terms of economies of scale or scope) across the whole pipeline system, but not upstream or downstream of the pipeline system.

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[2] i.e. a prudent Service Provider acting efficiently in accordance with accepted good industry practice and to achieve the lowest sustainable cost of providing services.

[3] Where the Operator states that forecast New Facilities Investment is to expand the capacity of the DBNGP will satisfy the test in section 8.16(a)(ii)(B) of the Code because it will provide "system wide benefits".

[4] Forcing Users to pay a higher tariff on this basis does not replicate a competitive market and has the potential to distort investment decisions in pipeline systems.

WPC is also concerned that if paragraph 9.5 is accepted it will set an inappropriate precedent. WPC has been told repeatedly that this next phase of expansion is expensive due to the commencement of looping but that once the DBNGP is 50% looped, average costs of further capacity will reduce substantially. WPC requests that the Operator confirm and demonstrate this[5], rather than attempt to rely a public benefit argument.

1.8 Section 9 – System Reliability Benefits

Paragraph 9.39, with respect to system reliability benefits, is irrelevant because the capacity of the DBNGP (and in particular T1 capacity) is already defined in accordance with its reliability or firmness. Therefore, statements about the reliability of a service improving as a result of looping or through utilisation of replacement compressors are both irrelevant and incorrect.

The Operator should translate this asserted "reliability of the system" into the impact upon capacity (particularly T1 capacity). Namely, if the system becomes more reliable, the capacity that can be offered (e.g. T1 or Spot service) should increase and if Users are bearing the costs of providing such capacity, Users should also benefit (or share) in any incremental revenue (see also WPC's previous submissions). If the retention of these compressors does not enhance capacity, the Users should not continue to bear the regulatory costs.

2. GENERAL COMMENTS ON THE REVISED AAI

WPC submits that the Revised AAI still has significant deficiencies and therefore does not comply with sections 2.6 and 2.7 of the Code.

Schedule 1 to this letter sets out the issues previously raised by WPC in respect of the AAI, the changes proposed by the Operator in the Revised AAI and the areas where the Revised AAI remains non-compliant.

2.1 Consistency with Draft Decision

The Revised AAI needs to be amended in line with the Authority's Required Amendments to the PRAA.[6]

2.2 Change from nominal to real figures

Tables 4, 7, 8, 9, 10 and 11 have been restated in $M Real 31-Dec-04 in the Revised AAI rather than $M Nominal as in the Initial Revised AAI. However, the Operator should be made to clarify whether this means that $M Real 31-Dec-04 is escalated by only half a years' CPI to arrive at $M 2005, or that $M 2005 is the same as $M Real 31-Dec-05.

Further, the assumed inflation rate throughout the Access Arrangement Period (2.55% per annum) and how it is applied (i.e. annually on 1 January?) should be explicitly stated.

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[5] A simple table showing projected future capital cost per TJ of T1 capacity through to a completion of the 26" looping would be sufficient.

[6] For instance, the Revised AAI still refers to the Tf Reference Service, part haul costs, capacity and expansion etc.

2.3 Section 5 – Non Capital Costs

WPC understands that the Operator's Submission #29 deals with the treatment of non capital costs. However, this submission has not been made public. To this extent, WPC is unable to comment on the validity of the non capital costs.

WPC requests that the Authority require the Operator to describe and justify the forecast non-capital costs and in particular, the real increase in materials and services over time, preferably in an Annexure similar to Annexure 2. The current level of detail in the Revised AAI does not comply with the Code.

2.4 Section 5.3 – Corporate Costs

Section 5.3 is misleading in that it does not refer to the fact that operations, maintenance and capital projects management is contracted out to ANS, an associated entity of the Operator.

Without further information regarding the relationship between the Operator and ANS,[7] there is insufficient disclosure to enable assessment of whether corporate costs comply with the requirements of the Code.[8] The current level of detail in the Revised AAI does not comply with the Code.

2.5 Section 7.1 – Maximum Delivery Capability

In Figure 1, the average forecast maximum capacity (full haul) for 2005 (**"Maximum Capacity"**) is at least 620 TJ/day. However in Table 14, The forecast contracted capacity (**"Contracted Capacity"**) is now projected at 594 TJ/day.[9]

WPC asks that the Authority consider the following[10]:

(a) what are the costs associated with the "gap" between Maximum Capacity and Contracted Capacity?

(b) who is bearing the costs of this "gap"?

(c) what level of usage is projected for this "gap"?

(d) what revenue is forecast to be earned from this "gap"?

and, as appropriate, to incorporate this into the calculation of the Reference Tariff.[11]

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[7] WPC does not see the difficulty in doing this, given that some information has already been disclosed in the DUET PDS.

[8] Both generally and also specifically whether such payments to ANS for goods or services are under an Associate Contract for the purposes of the Code and consistent with section 8.37 of the Code.

[9] See Table 14, Annexure 3. The Initial Revised AAI had a forecast of 576 TJ/day.

[10] Which are not addressed in the Revised AAI but are relevant for assessment of whether the Revised AAI complies with the Code.

[11] Particularly in relation to: (1) cost allocation; (2) forecast capacity and throughput; and (3) Total Revenue.

2.6 Section 7.3 – Contracted capacities and throughput

WPC notes that the forecasts for 2007-2010 in Tables 14 and 15 have been revised downwards from the Initial Revised AAI, without any explanation from the Operator. WPC is unable to comment on the validity (or otherwise) of these revisions without further information. In any event, the current level of detail in the Revised AAI does not comply with the Code.

2.7 Annexure 2 – Stay-in-Business Capital Expenditure

WPC requests that the Authority clarify the distinction between capital expenditure and maintenance costs (the latter of which is recovered as a non-capital cost rather than capitalised and amortised over 30 years).[12]

In addition, WPC request the Authority to consider whether any items of capital expenditure have asset lives of substantially less than 30 years[13] and should be amortised over a shorter period.

3. OPERATOR'S SUBMISSION #27

WPC's comments on the Operator's Submission #27 are as follows:

(a) As a general comment in relation to the Operator's submissions on the T1 Reference Service and T1 Terms & Conditions, as both a generator and gas retailer WPC supports of the Authority's position and rejects the Operator's arguments.

(b) As to part 2.1.2 (where the Operator lists reasons why it cannot incorporate amendments to the PRAA to include a T1 Reference Service):

    (i) the availability or otherwise of Spare Capacity is not relevant to the assessment under sections 3.2 and 3.3 of the Code;

    (ii) whether or not the Service Provider is to fund an expansion is also not relevant – this is a matter for the Arbitrator to determine;

    (iii) WPC does not believe that the inclusion of a T1 Reference Service would be inconsistent with the Operator's pre-existing contractual obligations;

    (iv) it is difficult to see how a T1 Reference Service would not reflect the practicalities of the operation of the DBNGP given that most of the DBNGP is currently contracted for T1; and

    (v) WPC submits that the legitimate business interests of the Operator need to be assessed, among other things, in the light of what the Operator undertook in 2004 to do.

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[12] For example "design changes to control systems" and "easement encroachment management".

[13] For example CCVTs and GEA upgrades.

(c) As to paragraph 2 of page 3, the fact that Users may have rights under clause 16 of the Standard Shipper Contract is irrelevant to the question of whether or not there potentially is a market for capacity under the Code. Users might seek capacity under the Code in preference to exercising their contractual rights.

(d) As to the Operator's claim on page 3 that the minimum term is unreasonable, the minimum term under the 2004 contracts reflects the fact that these are in effect foundation contracts for the pipeline sale.

(e) As to the minimum term proposed by the Operator on page 3, the Operator's proposal would have the Access Arrangement and future shippers underwriting the Operator's credit risk in relation to existing shippers. This is clearly not the intention of the Code – the Operator is not meant to be conducting a risk-free business, as is reflected in the calculation of the Rate of Return under the Code.

(f) As to part 2.3.2, the second paragraph on page 6 does not correctly state the position under the Standard Shipper Contract as to when a service can be provided. Furthermore, if "operational availability" is to be a test, then it should be an objective test, (i.e. as determined by a Reasonable And Prudent Person) and not a subjective test determined by the Operator (in its discretion). Furthermore, any test should not exclude the prospect of expansions.

(g) As to part 2.5, whatever view the Authority takes on whether capacity under existing Part Haul contracts forms part of the "market", the prospective demand for delivery of Part Haul capacity to Mondarra[14] alone would meet the Code requirements for Part Haul to be a Reference Service.

(h) As to the Operator's claim in part 2.11.2 that the imposition of a requirement to negotiate in good faith would produce uncertainty, any uncertainty as to the good faith test needs to be balanced against the Operator' disproportionate bargaining power if strict timelines were imposed without such a test. Likewise, the Operator's counterproposal that the parties be allowed to resort to arbitration would leave potential Users in the predicament of either having to accept the conditions proposed by the Operator or choose between losing their priority or commencing an expensive and lengthy arbitration procedure.

(i) As to part 3.2.2 regarding the intended use of the redundant compressors, WPC understands that:

   (i) there are only 2 compressor bays at each compressor station;

   (ii) the Operator is intending to install new compressors at 7 compressor stations; and

   (iii) in 5 of the 7 compressor stations where compressors are to be installed there are already 2 compressors in place.

   Accordingly, WPC assumed that the installation of the new compressors would automatically result in some of the existing compressors becoming redundant.

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[14] i.e. for the purposes of storage and for transportation through the Parmelia pipeline.

However, the Operator has suggested that the LM500 units are to be retained in "a fully operational state". WPC does not see how (if its understanding of the Operator's proposal to replace compressors is correct) this is viable. WPC requests the Authority to consider whether the retention of these "replaced compressors" in the Capital base (as argued in clauses 9.43 and 9.44 of Annexure 3) is appropriate.

(j) As to the Stage 3A Expansion Costs on page 17, the Operator's analysis is flawed. If the capital costs have been included once, this line of reasoning cannot be used to justify double recovery.

WPC reserves its rights in respect of the AAI should further iterations still not comply with the Code.

Please contact Andrew Everett on 9326 4636 if you have any queries regarding the above.

Yours sincerely

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BARRIR BRANDT
MANAGER GENERATION COMMERCIAL

Cc: Anthony Cribb

SCHEDULE

Access Arrangement Information

	Relevant section	Issue	Information to be disclosed under Attachment A of the Gas Code	Revised AAI 2 June 2005
1.	4.3 New Facilities Investment	Information on the effect of new facilities investment on system capacity and volume assumptions is not disclosed. The information is insufficient to understand the derivation of elements in the proposed revisions and/or form an opinion as to compliance with the Code.	**Category 5: Information Regarding System Capacity & Volume Assumptions** Description of system capabilities Map of piping system - pipe sizes, distances and maximum delivery capability	**Annexure 2 and 3 gives description of expansion program.** **New detail of 2005 maximum capacity now added (see section 7.1).** **No detail provided of existing system capabilities to provide services (i.e. capacity) or increments and timing of new capacity added through new facilities investment.**
2.	6: Total Revenue	The information provided covers only the Reference service and does not provide information on the revenue to be generated from all services (s.8.2 (a) of the Code) or an allocation of cost between services (s.8.2 (b) of the Code)	**Category 1: Information Regarding Access & Pricing Principles** Revenue generated by <u>all</u> services and cost allocation approach	**No new information provided – total revenue assuming only Tf service is all that is disclosed.**
3.	7: Information Regarding Capacity and Throughput	Forecast throughput is based upon full haul service only and allocation of costs and projected throughput for Non Reference Services (including part haul) is not available to allow assessment of the appropriateness of cost allocation between services.	**Category 5: Information Regarding System Capacity & Volume Assumptions** Description of system capabilities Map of piping system - pipe sizes, distances and maximum delivery capability Average daily and peak demand at "city gates" defined by volume and pressure Daily average and peak for the past one to two years, plus some forecast; at minimum average daily and average daily peak by month or season. Total annual volume delivered - existing term	**Historical information for 2004 (Figure 2) and forecast maximum capacity for 2005 by month (Figure 3) disclosed.**

			and expected future volumes Annual volume across each pricing zone, service or category of asset System load profile by month in each pricing zone, service or category of asset	
4.	7.2	Table 12 does not disclose pricing zones for each customer.	**Category 5: Information Regarding System Capacity & Volume Assumptions** Total number of customers in each pricing zone, service or category of asset	**No new information provided.**
5.	8	This section does not disclose the KPI's used by the Operator and how those KPI's justify costs.	**Category 6: Information Regarding Key Performance Indicators** Industry KPIs used by the Service Provider to justify "reasonably incurred" costs Service provider's KPIs for each pricing zone, service or category of asset	**Operator has not provided additional KPI's to justify "reasonably incurred costs"** **(Note: KPI's for compressor reliability and availability are relatively meaningless, KPI for Asset Utilisation suggests 30% spare capacity which is inconsistent with other areas of AAI and fuel ratio is increasing in a manner which would justify concluding inefficient costs.)**