SUBMISSION 13: ERA Issues Paper Response

PUBLIC VERSION

Date Submitted: 26 May 2010

DBNGP (WA) Transmission Pty Limited
ABN 69 081 609 190
Level 6, 12-14 The Esplanade
Perth WA 6000

Contact: Trent Leach, Manager Regulatory and Government Policy
Telephone: 08 9223 4357
Email: trent.leach@dbp.net.au

TABLE OF CONTENTS

1. INTRODUCTION

1.1. On 7 May 2010, the Economic Regulation Authority (**ERA**) released an issues paper (**Issues Paper**) to assist in the public consultation of the following documents filed by DBP with the ERA on 1 April 2010:

(a) proposed revised Access Arrangement (**Proposed Revised AA**); and

(b) proposed revised Access Arrangement Information (**Proposed Revised AAI**).

1.2. The Issues Paper contains a number of matters that DBP considers require a response. The purpose of this submission (#13) is to outline these issues with the Issues Paper.

1.3. These matters can be grouped into two:

(a) General concerns with the Issues Paper – these are outlined in section 2 of this submission; and

(b) Concerns with specific aspects of the Issues Paper – these are outlined in section 3 of this submission.

2. GENERAL CONCERNS WITH THE ISSSUES PAPER

2.1. As a preliminary matter, DBP believes that many statements in the issues paper are misleading as the ERA has failed to provide even basic contextual information. Without the proper context outlined, the Issues Paper immediately puts the reader at odds with the proposed revisions from the outset of the process.

2.2. As an example:

(a) Dot point 3 of the summary of key issues is not a balanced summary and invites a level of suspicion from the reader. The ERA makes no attempt to provide the proper context to the proposed tariff increase.

The proposed reference tariff for the new R1 Service is approximately 40 per cent higher than the existing reference tariff for the current T1 Service. This increase is the result of DBP's proposed target revenue requirement, which is approximately 85 per cent higher than the current target revenue requirement under the existing access arrangement (2005-2010).

(b) It fails to explain the key reasons for the increase in the revenue requirement, being:

(i) the target total revenue in the current access arrangement included forecast capital expenditure that is $700m less than the capital expenditure actually incurred;

(ii) the target total revenue now includes a required return of that actual capital expenditure;

(iii) a higher rate of return due to higher costs of debt and equity; and

(iv) increased government charges.

2.3. DBP is also concerned with the regulator's interpretation of its use of full discretion. Rule 40 allows the ERA, if it has full discretion under a particular Rule, to withhold its approval to an element if a preferable alternative exists. However, the ERA may not exercise its full discretion unless, in the ERA's opinion, the preferable alternative (1) complies with applicable requirements of the NGL and NGR and (2) is consistent with the applicable criteria prescribed by the NGL and NGR. DBP notes that Rule 40 requires that, before the ERA can exercise its full discretion in accordance with Rule 40, it must first consider DBP's proposal in the context of the requirements of the NGL and NGR so as to be in a position to evaluate whether a more suitable alternative to DBP's proposal exists. In other words, in order to form a view that a more suitable alternative exists, the ERA must first consider if DBP's proposal fails to meet, or does not optimally meet, the requirements or criteria prescribed by the NGL and NGR. Logically, a "preferable alternative" will not exist if DBP's proposal optimally meets the requirements and criteria of the NGL and NGR.

2.4. An example of this is in paragraph 62 of the issues paper. It is incorrect in so much as the ERA misrepresents how full discretion can be utilised by the regulator under the rules. The ERA must consider Operator's approach and provide a better alternative if one exists. The ERA is not able to offer a preferable alternative with out due consideration of the Operators approach, and without ascertaining whether the alternative (a) complies with the applicable requirements of the law, and (b) is consistent with applicable criteria (if any) prescribed by the law.

62. Rule 87 is a full discretion rule. Under rule 40(3), full discretion allows the Authority to consider if a preferable alternative to the proposed rate of return exists.

2.5. Additionally, in paragraph 68 ERA significantly misinterprets and misleads reader on the intent of Rule 87.

68. Rule 87 provides the Authority with full discretion in making a determination on the proposed rate of return that requires it to have regard to prevailing market conditions, benchmark levels of efficiency and standards as well as what is considered a well accepted approach. The Authority will also have regard to the reasonableness of estimates and forecasts under rule 74.

2.6. DBP also believes the ERA should have guided third parties to have regard to the regulatory framework when considering their comment to the process. Without appropriate consideration of the NGL and NGR much of the comment on particular elements will be largely irrelevant when the ERA make its assessments. For example:

(a) Issue 4 regarding capital contributions highlights a general problem with the issues paper. DBP contends that the ERA should direct parties to provide comment in the bounds of the NGL and NGRs. By omitting reference to the regulatory framework in which the process takes place the ERA invited unrestricted comment that is likely to unduly complicate and slow the approvals process.

Issue 4 Capital Contributions
Submissions are invited from interested parties on:

- *aspects of the proposed revised access arrangement that deal with capital contributions;*
- *DBP's supporting information about capital contributions;*
- *information from interested parties about capital contributions actually made; and*
- *any other matters in relation to capital contributions under the proposed revisions.*

(b) Issue 5, once again, the ERA misrepresents the process it is tasked with administering by not directing the stakeholder to have regard to the NGRs.

Issue 5 Rate of Return
Submissions are invited from interested parties on:

- *the proposed rate of return (WACC);*
- *the proposed cost of debt;*
- *the proposed cost of equity including the methods used for calculating the proposed cost of equity;*
- *DBP's supporting information to justify its approach and proposed rate of return; and*
- *any other matters in relation to the rate of return under the proposed revisions.*

(c) DBP has a similar concern with paragraph 71 and Issue 6. Issue 6 is a general invitation to make submissions. However, the approach to depreciation is unchanged from that which was approved by the ERA for the previous access arrangement period, and overlooks the fact that the regulator's discretion under Rule 89 is limited.

3. SPECIFIC CONCERNS IDENTIFIED WITH THE ISSUES PAPER

3.1. DBP raises specific concerns with the following paragraphs.

Arrangements with shippers after 2015

3.2. In paragraph 25 the ERA is incorrect to suggest that, on 1 January 2016, the terms and conditions of the DBNGP shipper contracts would revert to the reference service terms and conditions under the access arrangement.

The DBNGP shipper contracts are currently substantially independent of the terms of the access arrangement, including reference tariffs. However, on 1 January 2016, tariffs payable under the long term gas transportation contracts with the major shippers (except Alcoa) are scheduled to revert to the reference tariffs that apply under the access arrangement. Subsequently, it is understood that the terms and conditions of the DBNGP shipper contracts will revert to the terms and conditions for reference services under the access arrangement. It is understood that current contracts extend to at least 2019.

3.3. The terms and conditions under the existing contracts will not revert to the terms and conditions of the reference services.

3.4. Also, it is not the case that, on 1 January 2016, the tariff under the standard shipper contracts will revert to the reference tariffs under the access arrangement. Clause 20.5 of the Standard Shipper Contract (available on DBP's website) outlines the agreement between DBP and these shippers.

The relevance of Special Circumstances to the ERA's assessment process

3.5. Issue 1 referring to 'special circumstances' invites stakeholders to comment on circumstances outside what should be appropriately assessed by the Regulator under this process. In addition to misrepresenting the 'special circumstances' in the preceding paragraphs DBP questions how this can assist the ERA in assessing the proposed revisions of the DBNGP's existing access arrangement. All that is relevant to the ERA's assessment of the proposed revisions is the way in which the total revenue is to be allocated between the reference services and the services ("other services") provided under the DBNGP shipper contracts.

Issue 1 Special Circumstances
Submissions are invited from interested parties on whether, and in what manner, the special circumstances of the DBNGP should have a bearing on the Authority's assessment of the proposed revised access arrangement, having regard to the NGL including the national gas objective.

The relevance of other reserved services

3.6. In paragraph 33 DBP questions the relevance of the ERA raising "other reserved services" in the context of the issues paper and what relevance the additional services have for the assessment of the proposed revisions. DBP also notes that Tx is a service that is no longer available to shippers as there is no capacity left on the DBNGP to provide such a service. It is also not a service requested by any shipper or prospective shipper.

*33. In addition to the pipeline services included in the current access arrangement, the Standard Shipper Contract includes an "Other Reserved Service" (which includes the **Ty, Tx** and **Tp** Services).*

Tp service

3.7. Paragraph 34 is misleading as the ERA doesn't adequately describe the Tp service. The Tp service is in fact, not generally available to shippers and was only extended to shippers participating in the Stage 5A project. DBP questions the paragraph's relevance in the context of the issues paper and the ERA's assessment of the proposed revisions to the approved access arrangement.

34. The Tp service offers shippers access to interruptible capacity at times when the actual heating value of gas distribution in the pipeline is higher than the minimum specification. The tariff for the Tp service includes a small capacity reservation charge and a commodity charge based on the additional costs to provide the Tp service. DBP's access arrangement revisions do not propose to include this service in the access arrangement.

Operating Expenditure

3.8. Paragraph 75, appears to be ERA judgement rather than a statement of fact. Additionally, DBP contends that the ERA takes this information out of context in the way it is presented.

75. It appears that there is a step increase in operating expenditure between the current and the forecast access arrangement periods. While fuel gas costs are lower in the forecast period, wages and salaries and government charges have increased. The increase in wages and salaries appear to be associated with the internalisation of services previously contracted out.

3.9. Justification for DBP's operating expenditure submitted to the ERA is outlined by supporting submission #12. DBP's expenditure can be explained by a number of key drivers, these cost factors included significant asset growth, inflationary trends, higher government charges, increased surveillance costs, increased information technology and communication costs, higher audit costs, consideration of the WA labour market outlook, an allowance for self insurance of asymmetric risk, future costs associated with climate change reform, higher regulatory costs, compressor overhauls and reactive maintenance costs. Additionally, the composition of DBP's has changed overtime as outlined in DBP's background information supporting submission #1.

3.10. Paragraph 77, DBP would like to understand the ERA's requirements regarding historical operating expenditure further and is available to discuss the matter at the ERA's earliest convenience.

77. DBP has provided only two categories of actual operating expenditure data for 2005-2010, stating that the nature of the pipeline has changed so much that a historical comparison is inappropriate.

Demand and capital expenditure

3.11. Paragraphs 91, 92 & 46 are misleading and confusing. The ERA seems to suggest there is something to gain by DBP creating a situation by which a demand forecast is lower than what could possibly transpire during the period. Forecasts provided for the 2005 – 2010 period were the best possible at the time. The ERA, without providing appropriate context, misleads the reader.

91. The Authority notes that forecast demand for the current access arrangement (2005-2010) may have underestimated actual demand based on the total actual expenditure for the same period (refer to paragraph 46).

92. Underestimated demand leads to reference tariffs being greater than what they should be, in so far as the cost of service is distributed across a smaller demand base. This means that too much revenue would be recovered based on actual demand. It also means that the service provider is likely to underestimate capital and operating expenditure.

46. The Authority notes that the last access arrangement revisions were approved on 15 December 2005, and that DBP shortly afterwards on 26 February 2006 submitted to the Authority a 310 TJ expansion project estimated to cost up to a maximum of $1.521 billion. This project received conditional draft approval by the Authority prior to being withdrawn.

Issue 12

3.12. Issue 12 misleads by implying a requirement for comparison with the terms and conditions in the access contracts which have been negotiated with shippers. The criteria by which the terms and conditions are to be assessed are those of the NGL and the NGR (and not those DBP has negotiated with others).

Issue 12 Terms and Conditions
Submissions are invited on:

- *whether the terms and conditions should vary from current approved terms and conditions under existing access contracts for full haul services negotiated with shippers, which go beyond amendments required to accommodate changed legislative requirements;*
- *any issues interested parties have with existing access arrangement terms and conditions (2005-2010) and the proposed revised terms and conditions;*
- *whether the proposed terms and conditions are consistent with the national gas objective and, if appropriate, the revenue and pricing principles, including comments on DBP's supporting information to justify the terms and conditions; and*
- *any other matters in relation to the terms and conditions under the proposed revisions.*

Capacity Trading arrangements

3.13. In paragraph 125, the ERA seems to be indicating that the capacity trading arrangements are deficient because they do not explicitly deal with the additional capacity that arises as a result of the difference between the quality of gas flowing through the DBNGP and the minimum gas specification. However, specific reference to this capacity is unnecessary. It is not generally available and, if it is Contracted Capacity, it can be traded in accordance with the capacity trading provisions off the terms and conditions.

125. The Authority also notes that the trading arrangements do not appear to explicitly deal with additional capacity that arises as a result of the difference between the quality of the gas flowing through the DBNGP and the minimum gas specification.