synergy

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9 July 2010

Access - Dampier to Bunbury Natural Gas Pipeline
Economic Regulation Authority
PO Box 8469
Perth BC WA 6849

by email: publicsubmissions@era.wa.gov.au

RE: SUBMISSION - DAMPIER TO BUNBURY NATURAL GAS PIPELINE: PROPOSED REVISIONS TO THE ACCESS ARRANGEMENT

Dear Mr Rowe,

Synergy is pleased to provide this submission to the Economic Regulation Authority concerning the proposed revisions to the Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline.

If you have any questions concerning the submission please do not hesitate to contact myself on 6212 1076 or at simon.adams@synergy.net.au. Alternatively contact Catherine Rousch on 6212 1125 or catherine.rousch@synergy.net.au.

Regards,

Simon Adams
Senior Legal Counsel
Synergy

Submission

to the

Economic Regulation Authority

regarding

Proposed Revised Access Arrangement for the Dampier to Bunbury Natural Gas pipeline

9 July 2010

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1 Background

Synergy is pleased to provide comment to the Economic Regulation Authority (**Authority**) on the revised access arrangement (**Access Arrangement**) proposed by DBNGP (WA) Transmission (**DBP**) for the Dampier to Bunbury Natural Gas Pipeline (**DBNGP**).

The proposed revisions to the Access Arrangement (**Proposed Revised Access Arrangement**) were submitted by DBP to the Authority on 1 April 2010. The Proposed Revised Access Arrangement is part of the regulatory framework establishing, among other things, the terms and conditions, including price, upon which a third party can gain access to the DBNGP for the 2011 to 2015 access arrangement period.

Since entering the retail gas market in 2003, Synergy has become the second largest gas retailer in Western Australia (**WA**). Synergy purchases gas from the Carnarvon and Perth basins and utilises the DBNGP to deliver gas to customers consuming 180 GJ of gas or more a year in the area bounded by the south west interconnected electricity system (**SWIS**), extending to Geraldton in the north, Kalgoorlie in the east and Esperance in the south east, which includes the Perth metropolitan area.

2 Executive Summary

The revenue proposal submitted by DBP for the 2011 to 2015 access arrangement period represents a substantial increase to the target revenue for the 2005 to 2010 access arrangement period. If accepted by the Authority, the proposed revenue would translate to significant tariff increases for customers.

Given Synergy's standard shipper contract with DBP, Synergy submits that the resultant tariff increases would be inconsistent with, and take away Synergy's rights under that contract and as such, the Authority must not approve such changes to the Access Arrangement insofar as Synergy is concerned. Synergy will make further confidential submissions on this aspect.

Given the magnitude of the increases proposed, Synergy submits that it is essential for the Authority to carefully scrutinise the information presented by DBP to ensure that the proposed expenditure is both necessary and meets the criteria specified in the National Gas Rules[1] (**NGR**).

Synergy has a number of concerns with the Proposed Revised Access Arrangement, specifically:

- The proposal by DBP to offer only one reference service, the full haul R1 Service. Data provided by DBP clearly indicates that 30 percent of throughput currently utilises a part haul or back haul service;
- The capital expenditure incurred during the 2005 to 2010 access arrangement period was considerably higher than that forecast for the same period. This would have a significant impact on the opening capital base for the 2011 to 2015 access arrangement period;
- The total proposed forecast operating expenditure for the 2011 to 2015 access arrangement period is significantly higher than the operating expenditure incurred over the 2005 to 2010 access arrangement period;

[1] National Gas Rules 2009

- The operating expenditure incurred over the 2005 to 2010 access arrangement period is not sufficiently categorised to enable a true comparison with the operating expenditure forecast for the 2011 to 2015 access arrangement period;
- The total revenue proposed for the 2011 to 2015 access arrangement period is substantially higher than that forecast for the 2005 to 2010 access arrangement period, resulting in a considerable tariff increase;

These issues are discussed in more detail below.

3 Comment on Specific Issues

- Synergy would like to provide comment on the following specific issues raised by the Authority in its Issues Paper[2].despite significant growth forecast for the WA gas market and DBNGP being the main asset delivering gas in WA.

Issue 1: Special Circumstances

Synergy utilises the DBNGP to deliver gas to customers in the area bounded by the SWIS and has the appropriate shipper contracts in place with DBP. Synergy is cognisant of the fact that on 1 January 2016 tariffs under long term contracts will revert to the reference tariffs that apply under the access arrangement at that time.

Synergy aims to act in the best interests of its customers and is thus motivated to minimise any cost increases. Whilst the Proposed Revised Access Arrangement may not significantly affect Synergy at this point in time, Synergy is aware that any elements accepted as a part of this revision will affect subsequent access arrangement provisions. Synergy has therefore prepared its submission with this in mind.

Issue 2: Reference Services

Synergy does not consider the proposal by DBP to offer only one reference service, the full haul R1 Service is consistent with the NGR.

Synergy currently utilises both the full haul T1 Service and the part haul P1 Service.

Further, Table 17 of DBP's Revised Access Arrangement Information[3] indicates that around 20 percent of the DBNGP's total throughput (TJ per day) is forecast to be part haul and another 10 percent forecast to be back haul. NGR rule 101(2) states that *a reference service is a pipeline service that is likely to be sought by a significant part of the market.* That some 30 percent of total daily throughput, considered by Synergy to be a significant part of the market, requires a service other than full haul indicates that the proposal by DBP to abolish its part haul and back haul services isis contrary to NGR 101(2).

A number of significant gas exploration and development projects are currently underway in WA. These include:

- Chevron's Wheatstone project, expected to become one of Australia's largest resource projects, for which Ashburton North, near Onslow on the Pilbara coast, has been selected as the location for the LNG and domestic gas (**domgas**) processing plants;

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[2] *Dampier to Bunbury Natural Gas Pipeline: Proposed Revisions to the Access Arrangement, Issues Paper,* Economic Regulation Authority, Western Australia, 7 May 2010

[3] *Revised Access Arrangement Information,* Public Version, DBNGP (WA) Transmission Pty Limited, 1 April 2010.

- Chevron's Gorgon project, which will include a domgas plant located on Barrow Island capable of providing 300 TJ of gas per day to WA;
- BHPBilliton's Macedon project, which will also utilise the proposed gas processing facilities at Ashburton North and which could supply up to 150 TJ of gas per day to WA, some 20 percent of the state's daily domgas demand (Macedon's low heating value means that previously it did not meet the strict DBNGP gas specifications);
- The proposed gas storage facility at Mondarra, located near Dongara approximately 360 km north of Perth, in which the APA Group is investing substantial capital; and
- The revival of gas exploration in the Perth Basin fields, also located near Dongara.

All of the above projects will entail gas being hauled a part distance along the DBNGP and indeed, project viability and underwriting of the above may well have been based on the provision of a part haul service. It is therefore Synergy's strong submission that the Authority should compel DBP to offer a distance-based part haul reference service. To this effect, Synergy would support a part haul reference service with zone-based tariff charges whereby the distance is measured from the point the gas is injected into the DBNGP to the end or designated outlet point.

Issue 3: Capital Expenditure

The actual capital expenditure incurred during the 2005 to 2010 access arrangement period was considerably higher (59 percent) than that forecast for the same period, which DBP ascribes as being due to a significant underestimation in the costs associated with its expansion program[4]. Whilst Synergy is aware that the expenditure was designed to meet only committed firm contracted capacity, due to the lack of publicly available information, it is not in a position to comment on the magnitude of the costs and urges the Authority to conduct a thorough review of the actual costs incurred and the extent to which such costs were recovered from users.

Synergy notes that the forecast conforming capital expenditure for the 2011 to 2015 access arrangement period is substantially less than that incurred during the 2005 to 2010 access arrangement period as DBP does not anticipate any expansion of the DBNGP, despite significant growth forecast for the WA gas market and DBNGP being the main asset delivering gas in WA.

Issue 4: Rate of Return

There is a significant increase in the proposed real pre-tax rate of return, up from 7.24 percent for the 2005 to 2010 access arrangement period to 10.76 percent for the 2011 to 2015 access arrangement period.

DBP engaged consultants to advise on apparently well accepted financial models with which to estimate the return on equity used to establish the rate of return as required under NGR rule 87. The consultants determined that the four financial models examined provided *a plausible range for the return on equity required by an Australian regulated gas transmission business of between 8.85 per cent and 14.40 per cent*[5]. Synergy observes that the cost of equity was set by DBP at the upper end of this scale at 13.5 percent, which DBP believes is a figure commensurate with the prevailing conditions in the market for funds and the risks involved in providing reference services, as required under NGR rule 87(1).

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[4] *Submission 9: Justification of Expansion Related Capital Expenditure*, Public Version, DBNGP (WA) Transmission Pty Limited, 14 April 2010, par. 4.1, p. 18.

[5] *The Required Rate of Return on Equity for a Gas Transmission Pipeline - A Report for DBP*, NERA Economic Consulting, 31 March 2010.

DBP requires a shipper to enter into a 15 year minimum term contract for the haulage of gas through the DBNGP. Synergy considers that this lengthy contractual arrangement should ensure DBP a stable return. This arrangement contrasts with that applied by Goldfields Gas Transmission (**GGT**), which does not set a minimum term contract for the haulage of gas through its Goldfields Gas Pipeline (**GGP**). The Authority's Final Decision[6] concerning GGT's proposed revisions to its access arrangement for the GGP requires that the nominal pre-tax rate of return be amended to 10.48 percent. Given that DBP receives a more stable return, Synergy submits the ERA should not accept a proposed pre-tax rate of return of 13.55 percent.

Issue 5: Operating Expenditure

Under NGR rule 72(1) DBP must include, in its information package, operating expenditure by category over the earlier access arrangement period. However, rather than include this level of detail, DBP provides only two components of operating expenditure ("fuel gas" and "other") citing that operating expenditure as currently configured *"is very different to that required in 2005, thus making the reference to historical Operating Expenditure inappropriate*[7]*."*

Synergy submits that expenditure past and present is not difficult to compare, noting that the categories provided by DBP to justify its proposed forecast operating expenditure for the 2011 to 2115 access arrangement period[8] ("wages and salaries", "non-field expense", "field expense", "government charges", "reactive maintenance" and "fuel gas") are not significantly different to those provided by DBP to justify its forecast non capital costs for the 2005 to 2010 access arrangement period[9] ("wages and salaries", "materials and services', "corporate overheads" and "fuel gas"). Synergy therefore queries why actual expenditure over the 2005 to 2010 period cannot be similarly categorised and asks the ERA to examine whether DBP is attempting to hide excessive expenditure in one or more categories.

Synergy notes that the total forecast operating expenditure for the 2011 to 2015 access arrangement period is significantly higher than that incurred over the 2005 to 2010 access arrangement period. However, without a breakdown of costs available for the 2005 to 2010 period it is not possible for Synergy to provide further comment other than that it appears DBP is seeking significant step changes in operational expenditure without any real justification of previous spending.

Issue 6: Total Revenue

The total revenue proposed for the 2011 to 2015 access arrangement period is substantially higher than that forecast for the 2005 to 2010 access arrangement period. Synergy considers that the composition of the building blocks used to determine total revenue needs to be carefully scrutinised by the Authority as, if more than a fair return is earned, or if any costs are recovered more than once, then the resulting cost to customers would be above an efficient level.

Synergy therefore urges the Authority to review the confidential material provided by DBP to ensure the requirements of the NGR are met, particularly:

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[6] *Final Decision on GGT's Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline*, Economic Regulation Authority, 2010, p.6.

[7] *Revised Access Arrangement Information*, Public Version, DBNGP (WA) Transmission Pty Limited, 1 April 2010, par. 42., p. 7.

[8] *Submission 12: Justification of Operating Expenditure,* Public Version, DBNGP (WA) Transmission Pty Limited, 14 April 2010, Table 1, p. 3.

[9] *Proposed Revised Access Arrangement Information, Dampier to Bunbury Natural Gas Pipeline*, DBNGP (WA) Transmission Pty Ltd, 21 January 2005.

- For the return on projected capital base building block:

(i) Review the rate of return to ensure it is appropriate for market conditions and for the risks in providing reference services; and

(ii) Conduct a review of the capital expenditure incurred during the 2005 to 2010 access arrangement period, which is considerably higher than forecast, to ensure that the opening capital base for the 2011 to 2015 access arrangement period is accurate;

- For the forecast operating expenditure building block, carefully review the sufficiency of the information provided by DBP, particularly concerning actual expenditure over the 2005 to 2010 access arrangement period.

Issue 7: Tariffs

Synergy is concerned that the proposed R1 reference tariff is more than 40 percent higher than the current full haul T1 reference tariff. This is a significant increase, which Synergy will have to ultimately pass on to its gas consumers once tariffs under long term contracts revert to the reference tariffs that apply under the access arrangement on 1 January 2016.

Of additional concern is the absence, under the Proposed Revised Access Arrangement, of an equivalent, distance-based, part haul reference service and back haul reference service. Currently, a customer seeking a part haul P1 Reference Service would expect to pay around 75 percent of the full haul T1 reference tariff. Under the Proposed Revised Access Arrangement that customer, in the absence of a part haul reference service, will endure a significant increase in the tariff it currently pays - of the order of 65 percent more. Synergy considers this magnitude of increase excessive and unwarranted.

Customers should not be allocated more than their fair share of costs. Indeed, if customers do not benefit at all from particular expenditure then they should not be allocated any cost. Synergy is concerned that, under the proposed tariff arrangement, 30 percent of the DBNGP's total throughput will be subject to a reference tariff which unfairly attributes costs to them.

Synergy also notes that the R1 reference tariff is comprised of 95 percent capacity reservation charge whilst the current T1 reference tariff is comprised of 90 percent capacity reservation charge i.e. DBP is recovering more revenue via the capacity reservation charge.

4 Summary

In summary, Synergy recommends that the Authority:

- Carefully consider the proposal by DBP to offer only one reference service, the full haul R1 Service, when some 30 percent of throughput currently utilises a part haul or back haul service;
- Determines whether the additional capital expenditure incurred by DBP during the 2005 to 2010 access arrangement period meets the criteria in Rule 79 of the NGR sufficient for it to be included in the opening capital base for the 2011 to 2015 access arrangement period;
- Establishes whether the proposed real pre-tax rate of return of 10.76 percent is reasonable;

- Ensures DBP has provided sufficient information to substantiate the increases sought in the financial elements of the Revised Proposed Access Arrangement, particularly information relevant to operating expenditure;
- Confirms that the building blocks used to calculate the total revenue ensure that no more than a fair return is earned by DBP;
- Considers whether customers have been allocated no more than their fair share of costs;
- Clarifies the terms and conditions upon which DBP will provide reference services.

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