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Jenness Gardner
Chief Executive Officer
Economic Regulation Authority
Via online submission

Dear Jenness

Proposed Revisions to the Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline: Issues Paper

We thank the Economic Regulation Authority (ERA) for preparing the Issues Paper on the proposed revisions to the Access Arrangement (AA) for the Dampier to Bunbury Natural Gas Pipeline (DBNGP). This response provides some further information in Attachment A on certain issues raised in the Issues Paper, including our proposals regarding:

- the appropriate economic life of the DBNGP;
- approach to forecast capacity;
- introduction of an operating incentive scheme; and
- the application of reference tariffs.

We are continuing to engage with our customers and stakeholders, including by continuing with our Shipper Roundtable Meetings, with the most recent meeting held on 25 March to discuss the ERA's Issues Paper. This continued engagement is focused on responding to any further queries shippers may have as the ERA's review of our Final Plan progresses. The presentation delivered at our most recent Shipper Roundtable and our responses to shipper questions raised at the meeting are included as Attachments B and C to this submission.

Once again, we thank the ERA for preparing the Issues Paper and its engagement so far with our business on our Final Plan. We welcome this opportunity to provide further information and are keen to continue to engage with our customers and stakeholders leading into the release of the ERA Draft Decision. Should you have any queries about the information provided in this letter please contact Peter Bucki, Head of Regulation [redacted], [redacted]).

Yours sincerely,

[redacted]

Craig de Laine

General Manager People and Strategy

Attachment A - Responses to the ERA Issues Paper

Revising the Economic Life of the DBNGP

We have reviewed the economic life of the DBNGP in the context of the requirements of the National Gas Rules (NGR). In particular, our proposal is made to ensure that we recover our investment in the DBNGP over its economic life and, more specifically, to ensure adjustment for changes in that economic life.[1] We have provided in our Final Plan reasonable and transparent analysis that outlines why we believe the change in the economic life of the DBNGP is required.

From this, there are a number of points we wish to clarify:

- Although our revenues will increase during AA5 as a consequence of the change to the economic life, we are not seeking to recover more revenue over the economic lives of our assets. We are merely seeking to recover the same revenue over a shorter number of years (we note that in net present value (NPV) terms, the sum of revenue recovered through time will be less as we earn a return on capital over fewer years).
- Our proposal therefore does not seek to transfer risk to customers, and we note that the NGR does not expect the economic lives of our assets to be fixed, but instead requires a consideration of an asset's economic life as part of preparing a Final Plan. Since assets are recovered over their economic life, there is no transfer of risk, rather our proposal ensures we are in a position to provide the services our customers value today into the future.
- Within the model, the economic life for the asset as a whole extends to 2059. However, as a business, our main concern is the point in time at which competitive alternatives equal our regulated price, which occurs before 2059.[2] We are not suggesting we will be out of business by 2059, but rather that we will be constrained by competitive market prices rather than regulation before that date.

Finally, we reiterate that the substantial changes occurring in the energy sector require a change in the approach to considering economic lives. While the costs of renewable energy and hydrogen today remain more expensive than natural gas for power generation, and other uses of natural gas like heat and chemical processes, the costs of these substitutes are falling rapidly. We therefore need to ready our assets to remain competitive and to provide services to our customers into the long term.

Our analysis demonstrates that the current implied economic life of the DBNGP as a whole is too long, and that a life up to 2059 is more appropriate. As contemplated in the rules, a change to the economic life of the DBNGP now can be adjusted if required as new information comes to hand. Importantly, our approach takes a measured step for addressing the new challenges arising from the transition to a low carbon economy. The impact to our customers will increase if we delay addressing this issue beyond 2021.

We would like to note that, in regards to our proposal to re-categorise certain assets in the DBNGP, there continues to be broad agreement regarding the reasonableness of our proposal. Specifically, there is recognition that our proposal better aligns with good industry practice.

Demand

We note that the ERA in the Issues Paper is seeking "views on the adequacy of the stakeholder consultation undertaken by to [sic] derive DBP's bottom-up demand forecasts".

[1] NGR 89(1)

[2] In New Zealand, the Commerce Commission has a notion of "economically stranded assets", which is essentially the value of the assets which cannot be recovered because regulation has not kept up with changes in sectors which may compete with regulated energy in future, and left businesses in a position whereby their assets cannot be recovered. Our proposal changes economic lives in order to render economic asset stranding risk to zero, by only leaving that part of the asset base which can be recovered in a competitive marketplace, exposed to that competitive marketplace. This asset value is positive, not zero.

It is important to note that our demand forecast is directly informed by what shippers are advising us (on an individual and confidential basis) of their requirements of the DBNGP for the AA5 (2021 to 2025) period. In this regard, the forecasts are underpinned by extensive engagement with our customers.

More specifically, the demand forecast replicates agreed contractual terms, historical utilisation and engagement with shippers on an individual working level. The basis of preparation for our demand forecast is outlined in Attachment 11.1 of our Final Plan, which outlines the specific steps undertaken in developing the forecast.

In our Final Plan, the ERA therefore received a demand forecast for each individual shipper. However, due to the commercial and confidential nature of the information we could not provide this level of detail at our Shipper Roundtables, and as agreed with our Shippers, aggregate demand forecasts were instead provided.

Shippers therefore sought that we engage an independent third party (KPMG) to verify that we were using the best, most recent available information to derive the forecast. This work was undertaken, and KPMG's report was provided as Attachment 11.1 of our Final Plan. KPMG noted the demand forecast was prepared in "accordance with the Basis of Preparation".

Incentive Mechanism

We note the ERA has identified the E Factor as a notable issue for consideration given the potential impact in future regulatory periods. We believe the proposed E-Factor will be a valuable addition to the regulatory framework, and that strengthening the incentive for DBP to increase operating expenditure efficiencies – and share these efficiencies with customers – is in the long term interests of our customers with respect to price, reliability and security of supply.

During the stakeholder engagement on our Final Plan, shippers were generally supportive of the E Factor design principles and saw value in increasing the incentive for DBP to reduce operating costs where practicable.

We welcome the opportunity to engage further with the ERA and stakeholders on this topic, and we will provide any additional information where necessary to aid the ERA's review process ahead of its Draft Decision.

Reference tariffs

On reference tariffs, we wish to briefly clarify the operation of overrun charges.

Overrun services are not a distinct service but are included in the terms and conditions of our reference services as a behavioral charge designed to encourage shippers to contract for the firm capacity they require. Further, these charges play a role in the operational management of the pipeline by imposing a charge on shippers nominating to take more gas than contracted, thus enabling DBP to prudently manage the pipeline for all Shippers on fair and equal basis.

Incorporating overrun charges into the tariff calculation, is likely to have the perverse incentive of encouraging more use of overruns. This is because a shipper who overruns would also receive a benefit through their reference tariffs under such an arrangement. As a behaviour charge, we therefore do not consider overrun charges should form part of the reference tariff calculation.