ALLEN & OVERY

Allen & Overy

MEMORANDUM

To	Dominic Rodwell, Citic Pacific Mining
From	Allen & Overy
Our ref	JA/0103522-0000001 AU:12134398.2
Date	09 March 2020
Subject	**Application of Distance Factor to DBP P1 and B1 Overrun Charges**

As requested, we have considered whether the 'Distance Factor' should be applied to Overrun Charges under the B1 Terms and Conditions and P1 Terms and Conditions which have been included by DBNGP (WA) Transmission Pty Ltd as part of the Proposed Access Arrangement for 2021- 2025.

<u>Current calculation of the Reference P1 and B1 Overrun Charge</u>

Under each of the T1, P1 and B1 Reference Service Terms and Conditions, if a shipper receives Overrun Gas, then the consequence is:

- payment of the 'Overrun Charge' for each GJ at the 'Overrun Rate'[1], which is the greater of:
    - 115% of the [T1 / B1 / P1] Tariff; and
    - the highest price bid for Spot Capacity which was accepted for that Gas Day other than when the highest price bid was not a bona fide bid, in which case the highest bona fide bid,

and

- if the Operator has issued an Unavailability Notice (informing the Shipper that pipeline capacity for Overrun Gas in not available) then, <u>in addition to the Overrun Charge</u>, the shipper must pay the 'Unavailable Overrun Charge' for each GJ at the 'Unavailable Overrun Rate'[2], which is the greater of:
    - 250% of the T1 Tariff from time to time; and
    - the highest price bid for Spot Capacity which was accepted for that Gas Day, other than when the highest price bid was not a bona fide bid, in which case the highest bona fide bid.

[1] Clause 11.1
[2] Clause 11.6 and Schedule 2, row 4

Other than referring to the T1, B1 or P1 Tariff (as applicable) for the Overrun Charge only (the Unavailable Overrun Charge uses T1 Tariff for all contracts), the relevant provisions are the same for all Reference Service Terms and Conditions.

Comparison to Standard Shipper and Historical Reference Terms

In the non-reference P1 and B1 Standard Shipper Contracts published by DBNGP, the definition of Unavailable Overrun Rate differs, being the greater of:[3]

- 250% of the **[P1 / B1]** Tariff from time to time; and
- the highest price bid for Spot Capacity which was accepted for that Gas Day, other than when the highest price bid was not a bona fide bid, in which case the highest bona fide bid, **multiplied by the Distance Factor**.

We note that the P1 and B1 Reference Service Terms and Conditions historically did:

- refer to the P1 or B1 Tariff (which takes into account distance) in the first limb the Unavailable Overrun Rate; and
- expressly have the second limb of the Unavailable Overrun Rate adjusted for the Distance Factor,

in the same way as the current P1 and B1 Standard Shipper Agreements. However, all references to 'Distance Factor' were removed for the 2011 – 2015 access arrangement, as separate P1 and B1 contracts were not published. When P1 and B1 contracts were published again in 2016-2020, the distance factor was not reinserted and the calculation referred to the T1 Tariff only. No explanation appears to have been provided for this.

Not applying the Distance Factor discriminates against Reference P1 and B1 customers

A T1 shipper pays a tariff based on a full-haul service, so calculating the Overrun Rate on a full-haul basis produces a fair result for T1 shippers. At a transport capacity spot price of $1.20, we understand that a T1 shipper would be paying an Overrun Rate of 115% of its T1 tariff. By contrast, a P1 or B1 shipper pays a tariff based on distance (as this is the service they have contracted for) so calculating the Overrun Rate on a full-haul basis produces an obviously unfair result for P1 and B1 shippers. We understand that a spot price of $1.20 could result in a P1 or B1 shipper paying an Overrun Rate which could be in excess of a 3000% premium[4] on its P1 or B1 tariff (depending on the length of the P1 or B1 service). Should the Unavailable Overrun Rate apply, this would be doubled.

In a situation of Unavailable Overrun Charge, there is an additional layer of discrimination – not only are T1 shippers given preferential treatment, to a lesser extent so are P1 and B1 shippers using the Standard Shipper Contract. P1 and B1 shippers using Reference Service Terms and Conditions will be paying a penalty amount based on a full-haul tariff or the Spot Capacity bid price (on a full-haul basis). As set out above, in the Standard Shipper Contracts, the Unavailable Overrun Charge for P1 and B1 shippers is calculated using distance adjusted amounts. There is no obvious justification for this difference and, as stated above, this has not always been the case in the Reference Service Terms and Conditions. There does not appear to be any explanation available for the change in approach and it may be an unintended consequence of the way the reference terms were published following the adoption of the National Gas Law in Western Australia (with an R1 contract published before a return to T1, P1 and B1).

This increased penalty for P1 and B1 Reference Service shippers does not appear to be justified (it goes beyond a behaviour modifier) and does not reflect the consequential impacts or operational realities of the

[3] Schedule 2, row 4
[4] From information provided by Citic Pacific Mining

pipeline. We understand from our discussions with Citic Pacific Mining that there are large volumes of uncontracted and unused capacity in the northern part of the pipeline that would be most efficiently utilised by P1 and B1 shippers.

Not applying the Distance Factor to the Overrun Rate is inconsistent with the ERA's principles for allocating costs and the National Gas Objective

The importance of the 'distance factor' was discussed by the ERA in the 2016-2020 Final Decision[5], noting the principle should be that:

> *…users of part haul and back haul reference services will have the same costs allocated to them (on a dollar per kilometre basis) as users of the full haul reference service.*

This quote was in relation to the tariff, but the principle should equally apply to overrun costs.

The purpose of overrun charges is obvious – to economically incentivise parties to limit their overrun, to assist in the consistent operation of the pipeline. This purpose would be achieved by a percentage mark-up on the shipper's tariff (and increasing that percentage where the shipper has been notified that overrun gas is not available). This is the approach for the T1service. So arguably a fair basis for the P1 and B1 Overrun Rate and Unavailable Overrun Rate is the greater of:

- **[115 / 250]**% of the **[P1 / B1]** Tariff from time to time; and
- the highest price bid for Spot Capacity which was accepted for that Gas Day, other than when the highest price bid was not a bona fide bid, in which case the highest bona fide bid, **multiplied by the Distance Factor**.

The current formulation goes well beyond this fair allocation. By referencing the full-haul tariff (or full-haul spot market) an extraordinary mark-up to the P1 or B1 tariff is produced. This is applied even to the 'innocent' use of overrun (that is, where there is no notice that overrun is not available). This amounts to a significant (and discriminatory) penalty against P1 and B1 shippers.

A significant penalty limits any flexibility of shippers in pipeline use, which in turn will limit flexibility / tolerance in their operations and inflict a disproportionate financial burden on them. This financial and operational burden is inconsistent with the goal of providing cost-effective and reliable supply of gas to consumers (and so is contrary to the National Gas Objective).

[5] Final Decision on Proposed Revisions to the Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline 2016 – 2020 dated 30 June 2016, pages 92 and 242.