

GENERATION BUSINESS UNIT OF WESTERN POWER CORPORATION  
(VERVE ENERGY)

Submission to the Economic Regulation Authority  
regarding DBNGP (WA) Transmission Pty Ltd's  
Request under Section 8.21 in respect of the DBNGP

**Submission on DBP's Section 8.21 Request**

**27 March 2006**

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## Definitions

References to “Section” in this submission are references to the Code, unless otherwise stated.

In this submission, the following defined terms are used (unless a contrary intention appears):

**Code** means the National Third Party Access Code for Natural Gas Pipeline Systems having effect under the GPAA;

**DBNGP** means the Dampier to Bunbury Natural Gas Pipeline;

**DBP’S Request** means the request by DBP dated February 2006, that the ERA agree, under section 8.21 of the Code, that DBP’s proposed forecast New Facilities Investment will meet the requirements of section 8.16(a);

**DBP’s Submission** means the public version of the submission by DBP, dated February 2006, supporting DBP’s Request;

**ERA** means the Economic Regulation Authority;

**Existing Approval** means the approved forecast New Facilities Investment to 2010 (being Stages 5 to 7) of \$537 million for a pipeline capacity expansion of 110TJ/d in the Revised Access Arrangement;

**GPAA** means the Gas Pipelines Access (Western Australia) Act 1998;

**NFI** means New Facilities Investment as defined in the Code;

**Operator** means DBNGP (WA) Transmission Pty Ltd;

**Revised Access Arrangement** means the Revised Access Arrangement in respect of the DBNGP drafted and approved by the ERA under section 2.42 of the Code on 15 December 2005;

**WPC’s 2004 Contract** means the contract between WPC and Operator for gas transportation provided for under the Deed of Amendment and Restatement (WPC’s 2004 Contract) (Full-Haul) dated 27 October 2004;

**Standard Shipper Contract** means the Standard Shipper Contract forming the basis of terms and conditions upon which shipper contracts (including the WPC’s 2004 Contract) were negotiated with individual shippers in October 2004 and which the Operator intends to use as the basis for future shipper contracts;

**Verve Energy** means the Generation Business Unit of Western Power Corporation established under the *Electricity Corporation Act 1994*, and after 1 April 2006 means the Electricity Generation Corporation established under the *Electricity Corporations Act 2005*.

## **Executive summary**

1. This Submission is made by the Generation Business Unit (“**Verve Energy**”) of Western Power Corporation, a statutory corporation established under the *Electricity Corporation Act 1994* which on 1 April 2006 will become the Electricity Generation Corporation under the *Electricity Corporations Act 2005*.

### *Part 1 – DBP’s Request and the section 8.21 process*

2. The section 8.21 process is important. It requires proper public consultation, which in turn requires adequate submissions and proper disclosure of submissions, especially when the proposed NFI would almost double the capital base.
3. DBP asserts that there are critical time constraints. Verve Energy does not want pipeline expansions to be delayed. However there must also be appropriate regulatory scrutiny, and the urgency should not result in users paying more than the Code permits.
4. Verve Energy supports the ERA’s proposal to issue a Draft Decision and a Final Decision with public consultation before each, but there needs to be sufficient disclosure of adequate information to permit proper public consultation.
5. DBP already has approval for \$537m of forecast NFI. It is not clear what is happening to this Existing Approval, or why it is apparently being discarded.
6. DBP’s various capacity forecasts are hard to reconcile with each other, and also hard to reconcile with DBP’s public announcements, but DBP’s Request only proposes NFI for 310 TJ/d even though its own submission discloses potential contracts of 339 TJ/d. This additional capacity should not be ignored.
7. Even if the ERA agrees to DBP’s Request under section 8.21, the capital base will not automatically be increased. The amount of any capital base increase will be determined at the time of the next access arrangement revision, taking into account what the actual NFI is, any conditions on the agreement, the ERA’s residual discretion under section 8.15, and the ERA’s discretion under section 8.22.

### *Part 2 – Code principles regarding NFI*

8. The policy intention of section 8.16 is very clear:
  - (a) first, the NFI must be prudent: section 8.16(a)(i);
  - (b) next, the NFI can be added to the capital base to the extent it does not cause tariffs to rise (ie. it pays for itself): section 8.16(a)(ii)(A); and
  - (c) finally, in certain specified circumstances, the NFI can be added to the capital base even though it does not pay for itself: sections 8.16(a)(ii)(B) and (C).
9. Any NFI which does not satisfy these roll-in tests should be dealt with by other means, for example as a surcharge on the incremental users or as speculative investment.

10. DBP has an incentive to inflate its NFI. The ERA's assessment of this incentive in its Final Decision was incorrect. In any event section 8.16 requires rigorous scrutiny by the ERA, not merely an assessment of incentives.
11. If DBP fails to make a clear case that the NFI comes within one of sections 8.16(a)(ii)(A) to (C), the ERA should reject it as not coming within any of them. "Pleading in the alternative" is not appropriate in this context.
12. A strict application of sections 8.16(a)(i) and (ii) to DBP's Request may result in an outcome in which the incremental users pay a surcharge. If so, the ERA should not shrink from this.

*Part 3 – The substance of the section 8.16 assessment*

13. There is insufficient detail for Verve Energy to assess whether DBP's proposed NFI satisfies **section 8.16(a)(i)**. On the information available, DBP has failed to demonstrate that it has acted as a prudent operator, acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services. Also:
  - (a) DBP has not properly addressed the "economies of scale" test in section 8.17(a), and the ERA should regard it as not being satisfied; and
  - (b) DBP has designed its expansion in a manner that does not look to future growth, which is clearly inconsistent with section 8.17(b).
14. The test in section **8.16(a)(ii)(A)** does not permit a rolling-in of NFI in a way that would cause all users' tariffs to increase.
15. DBP has failed to demonstrate any system-wide benefits that justify higher tariffs for all users under section **8.16(a)(ii)(B)**. General growth of the gas industry is not a "system-wide benefit" for the purposes of this test, and, in any event, DBP has provided no evidence to quantify that benefit or explain why it should result in a tariff increase for all users.
16. DBP has provided no evidence in support of any rolling-in under section **8.16(a)(ii)(C)**. The gas quality issue was settled in the Revised Access Arrangement and should not be reopened here.

*Part 4 – Conditions on any agreement*

17. To the extent that the ERA proposes to agree under section 8.21, it should impose some conditions or limitations on that agreement. Verve Energy submits that the conditions and limitations contained in Part 4 of this Submission are appropriate.
18. To assist the reader, certain key passages have been highlighted, like this. However Verve Energy's submission comprises the whole of this document, not merely the highlighted passages.

## **Part 1: DBP's Request and the section 8.21 process**

### **Key submissions**

- **The section 8.21 process is important. It requires proper public consultation, which in turn requires adequate submissions and proper disclosure of submissions, especially when the proposed NFI would almost double the capital base.**
- **Verve Energy supports the ERA's proposal to issue a draft decision and a final decision with public consultation before each.**
- **Verve Energy is also alive to the timing imperatives.**
- **However there has to date been insufficient disclosure to permit proper public comment.**
- **DBP already has approval for \$537m of forecast NFI. What is happening to this? If it is being discarded, why?**
- **DBP only proposes NFI for 310 TJ/d when its own submission discloses potential contracts of 339 TJ/d. Why is this additional capacity being ignored?**
- **The ERA's agreement under section 8.21 does not mean the capital base will automatically be increased at the next reset. That is affected by what the actual NFI is; by any conditions on the agreement; by the ERA's residual discretion under section 8.15; and by ERA's discretion under section 8.22.**
- **DBP's proposal is too imprecise for the ERA to be able to properly assess it. Its proposal of a range of values is inappropriate.**
- **DBP has made no credible case for urgency. If there is urgency, it can use the Existing Approval of \$537m to get started while an additional NFI proposal is properly prepared then assessed.**

### **Introduction**

19. Verve Energy supports a clear and transparent regulatory process. Verve Energy wants to see the DBNGP expanded, and does not want to see that expansion unnecessarily delayed.
20. However, that does not mean that expansion should occur whatever the cost. Nor does it mean that all users should subsidise the incremental users.
21. The section 8.21 process is a formal statutory process and should be approached accordingly, particularly in the context of a proposal which could potentially very nearly double the capital base of the pipeline.

22. Section 8.21 should not be used to re-open issues that have already been decided. It is not, and should not be used as, a substitute for revising an access arrangement under section 2.28.<sup>1</sup>
23. The ERA is not obliged to agree under section 8.21. One possible response for the ERA to the incomplete and unspecific information provided by DBP is to exercise its discretion not to agree.
24. The ERA should:
  - (a) critically scrutinise all proposed NFI;
  - (b) consider carefully who should, under the Code, bear the cost of expansion; and
  - (c) consider whether, and on what terms, to give its agreement under section 8.21.

### **Urgency**

25. DBP alleges that its expansion timetable is extremely urgent, such that it requires an abridged approval process and has been forced to lodge its Request before it is in an adequate state for consideration.
26. Verve Energy is not in a position to assess DBP's claims of urgency.
27. If the request is indeed urgent, Verve Energy does not want this submission or the regulatory process to delay those parts<sup>2</sup> of DBP's program which are urgent.
28. However Verve Energy also does not want this urgency to detract from the quality of the regulatory process or result in users paying more than is justified under the Code. Also, urgency does not derogate from the ERA's task as a statutory decision maker under section 8.21, nor does it enable the ERA to make decisions on incomplete or inadequate information.
29. Verve Energy has suggested two specific measures which will assist any need for urgency:
  - (a) DBP proceeding immediately using the Existing Approval, while it and the ERA work through a section 8.21 approval for the balance of the expansion – see paragraphs 42 and 43 below; and
  - (b) the ERA using conditions and limitations on the approval – see Part 4 below.

### **ERA should issue a Draft Decision and Final Decision as it has proposed.**

30. Verve Energy supports the position set out by the ERA in respect of the section 8.21 process in its 'Notice for Invitation for Public Submissions Dampier to Bunbury Natural Gas Pipeline Stage 5 Expansion' issued 24 February 2006.

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<sup>1</sup> At paragraph 4.15 of its Request, DBP foreshadows access arrangement revisions in any event. The interaction between those revisions and this Request is uncertain.

<sup>2</sup> Presumably not all of the expansion programme will be on the same critical timeline.

### **Inadequacy of information provided**

31. DBP is seeking pre-approval of an investment that could potentially almost double the capital base, with a potential concomitant impact upon tariffs for all T1 users. DBP is insisting the ERA do so in a very short timeframe and in circumstances where DBP has not provided interested parties with adequate information to substantiate its claims.
32. DBP's Request could have a major impact on the major part of gas transportation in Western Australia.
33. Verve Energy does not have sufficient information to express an informed view on all of the matters to be decided by the ERA under section 8.21. It asks the ERA to either:
  - (a) determine under section 7.12 that much of the purportedly confidential information provided by DBP be disclosed (perhaps in an aggregated or de-identified form); or
  - (b) decline to agree under section 8.21 on the ground that it has been unable to conduct an adequate public consultation process.
34. The Code does not envisage or permit a section 8.21 assessment being conducted in apparent secrecy between DBP and the ERA, shielded from proper public consultation and scrutiny.

### **Existing Approval**

35. The Existing Approval already gives DBP the ability to spend \$537 million in NFI to expand the pipeline by 110TJ/d in the previously approved Stages 5, 6 and 7 expansion. The Existing Approval involved 493km of looping and appears to form a subset of the new expansion proposed in DBP's Request. The expansion in the Existing Approval was approved by the ERA as meeting the requirements of section 8.16.
36. DBP's Request appears to ignore and replace the Existing Approval.
37. DBP's Request does not make clear how the Existing Approval is to be treated. This creates uncertainty as to the treatment of forecast and actual NFI and depreciation at the commencement of the next access arrangement period. It is also unclear how reference tariffs are to be handled in this and the next access arrangement period, if the previously-approved NFI is to be discarded following the extensive consultation and review process under the Code.
38. If the ERA accepts DBP's approach of replacing an existing approval of forecast NFI with an agreement under section 8.21, then the following uncertainties may result:
  - (a) what value is placed on regulatory certainty if a regulatory reset can be largely discarded (as distinct from augmented) within a few months of being approved;
  - (b) whether any particular expansion will occur;
  - (c) how forecast and actual NFI are to be treated;



- (d) whether future incremental users (ie. beyond the new proposed Stage 5) will be able to access developable capacity or whether they will have to wait until DBP judges that it has aggregated enough applications to implement a new stage.
39. The possibility of future incremental users beyond the new proposed Stage 5 is not hypothetical. DBP is only seeking to expand the pipeline by 310 TJ/d (full haul) despite acknowledging that it has at least a potential for users to contract for 339TJ/d (full haul).<sup>3</sup> DBP's treatment of its capacity forecasts is confusing, and not easy to reconcile with its public statements.
40. Section 8.17(b) obliges DBP and the ERA to consider the interests of future incremental users, including future users beyond those already discussed in paragraph 39. See discussion commencing at paragraph 121 below.
41. DBP has not given any reason why it cannot use the Existing Approval.
42. DBP has not explained why the DBP Request does not seek to build on the Existing Approval. For example, why isn't the DBP Request limited to the expansion required to meet the difference between the proposed 310TJ/d expansion and the expansion under the Existing Approval? While it is no doubt possible and desirable to undertake some optimisation to add the new capacity, it is also highly unlikely that the whole of the previously-planned expansion needs to be discarded.
43. This lack of explanation appears to be related to DBP's insistence that the ERA must approve the DBP Request within a very tight timeframe. If it were to make use of the Existing Approval, DBP would no doubt have more time before it needed the top-up approval.
44. See also the discussion of section 8.17(b) commencing at paragraph 121 below.
45. Verve Energy requests the ERA to address the above issues in its consideration of DBP's Request.

### **Impact of new capacity forecasts**

46. On a related point, when the NFI was being considered for approval in the Revised Access Arrangement, DBP provided forecasts of capacity and throughput through to 2011.<sup>4</sup> In retrospect, 6 months later, those forecasts apparently prove to have been dramatically less than is now anticipated. It is unclear what the impact would have been upon Reference Tariffs had the current capacity forecasts and NFI been incorporated in the Revised Access Arrangement.
47. Verve Energy regards this as disturbing, given that the service provider always has an incentive to understate its capacity forecasts. At the time, Verve Energy made submissions asking the ERA to critically review DBP's capacity forecasts because insufficient information had been made public for Verve Energy to make meaningful submissions.
48. Verve Energy now asks the ERA, as part of its assessment of DBP's Request, to:

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<sup>3</sup> DBP Request para 2.6.

<sup>4</sup> Table 15, DBP's Amended Proposed Revised Access Arrangement Information dated 2 June 2005.

- (a) obtain and critically assess detailed current capacity forecasts and associated forecast NFI, to provide a context for its assessment of DBP's Request; and
  - (b) in its Draft Decision on DBP's Request disclose what the reference tariff would have been had the Revised Access Arrangement been based upon these updated forecasts.
49. Verve Energy is concerned that:
- (a) reference tariffs could increase substantially as a result of the current proposed expansion; and
  - (b) further substantial expansions after Stage 5 are likely to occur in the next 3 to 5 years and DBP's approach to Stage 5 could be an inefficient way to provide all capacity required in the foreseeable future.
50. In particular, a reasonable and prudent operator would not seek to minimise current expansion capital expenditure at the cost of foregoing greater future economies of scale and scope, in such a rapidly growing market.
51. Verve Energy requests the ERA to address the above issues in its consideration of DBP's Request.

#### **Effect of agreement under section 8.21**

52. The effect of the ERA agreeing under section 8.21 is that, provided any conditions or limitations are met, at the time the ERA next considers revisions to an access arrangement proposed by the service provider, the ERA is bound to decide that the agreed forecast NFI satisfies the requirements of section 8.16(a).
53. However, an agreement by the ERA under section 8.21 that forecast NFI meets the requirements of section 8.16(a) does not mean that the NFI will automatically be added to the capital base at the next access arrangement review. Whether it is will be determined by:
- (a) what the actual NFI is;
  - (b) any conditions or limitations set by the ERA as part of its agreement under section 8.21;<sup>5</sup>
  - (c) the ERA's exercise of its separate discretion under section 8.15; and
  - (d) the ERA's determination under section 8.22, in light of the revisions to the access arrangement proposed at the time.
54. On this point, Verve Energy observes that paragraphs 6.3 and 6.4 of DBP's Submission are misleading. Not all of the factors listed in paragraph 6.4 will cause the actual NFI to vary. The items listed in paragraphs 6.4 (g) to (i) are only cost elements, and the items listed in paragraphs 6.4(a) to (c) are capacity measurements. Paragraphs 6.4(e) to (f) are design parameters which DBP has specified and which the ERA is currently being asked to assess under section 8.16(a)(i).

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<sup>5</sup> See Part 4 of this submission.

55. Verve Energy requests the ERA to address the above issues in its consideration of DBP's Request, especially in considering whether to include any conditions or limitations on any agreement it may give (see Part 4 below).

### **Section 8.15**

56. At the time the ERA next considers revisions to the access arrangement proposed by the Service Provider for the next access arrangement period, the Code requires the ERA to consider whether the actual NFI for the expansions that are the subject of this section 8.21 application should be rolled into the capital base. Under section 8.15, the ERA has a residual discretion to decide whether the capital base should be increased by this NFI. The ERA may decide that some or all of the actual NFI should not be added to the capital base for various reasons, including because doing so would, having regard to all the circumstances prevailing at the time including the then proposed revisions to the access arrangement, be inconsistent with some or all of the fundamental elements in sections 8.1 and 2.46.

57. Verve Energy supports the ERA's view of section 8.15.

### **Can ERA approve a range of values?**

58. DBP's Request outlines three options for expanding the DBNGP under Stage 5. These are:
- (a) complete looping (Option 1);
  - (b) mid-line compression (Option 2); and
  - (c) optimisation – looping and compression (Option 3).
59. DBP has indicated, without supporting its preference with qualitative analysis, that Option 3 is preferred.
60. DBP's Request indicates that the cost for Option 3 is between \$1,457 million and \$1,521 million. This appears to be a technical range rather than a range of cost estimates, given that some cost lines are greater in the lower case<sup>6</sup>. If it was only cost estimates giving rise to the range, a point estimate would clearly suffice.
61. Whilst it may be reasonable for the ERA to approve a range of values in relation to forecast NFI under section 8.21, taking into account the commercial realities of projects, the establishment of the parameters upon which that range is based is critical.
62. The foundation elements of DBP's Request are not known, even to DBP itself<sup>7</sup>. Therefore the range of values which DBP is asking the ERA to approve are, at best, estimates. The inputs to the estimates are not certain and therefore the range is inherently unreliable.
63. In particular, at the time of submitting its Request, DBP does not appear to be even moderately certain of the following "critical parameters":
- (a) users and prospective users who have contracted for capacity from Stage 5;

<sup>6</sup> See para 6.66 of DBP's Submission

<sup>7</sup> See for example para 4.2 of DBP's Request

- (b) forecast expenditure for certain key cost items;
  - (c) the design parameters (see paragraph 54 above) and in particular the gas quality specification appropriate for the purpose of pipeline design; or
  - (d) firm pricing proposals in respect of equipment supplies and construction contracts.
64. There is a very large difference between, on one hand, acknowledging that even a properly scoped expansion can have cost overruns (and hence that it is prudent to approve a value with a plus or minus tolerance), and, on the other, the ERA being asked to select between a range of guesstimates.
65. DBP submits that in the event of DBP not being able to replace the range of values for the critical parameters with relatively certain values, the ERA should make its assessment of DBP's Request by reference to the upper limit of the range of values for that parameter.<sup>8</sup> This is remarkable. DBP as a regulated service provider is unable or unwilling to undertake adequate planning and description of its proposed NFI, and then asks the ERA to simply choose the value that is most optimum for the service provider. It would be a very poor regulatory process if the ERA were to countenance this approach.
66. Verve Energy submits that it would not be appropriate, or permitted by the Code, for the ERA to implement DBP's suggestion by commencing its assessment now, with the intention of updating or changing its assessment as DBP filters more information into the process.
67. DBP suggests that the inadequacy of its data is due to the alleged (but not substantiated) urgency of its expansion. It is in effect asking the ERA to approve something – anything – now on trust so that DBP can get started, on the premise that DBP will firm up the numbers as time permits. Verve Energy rejects this approach, and says that there is another much preferable one: If indeed DBP's position is as urgent as it asserts, it should start work on the expansions using the Existing Approval, while it finishes adequate planning of the further expansions.
68. Verve Energy submits that given the uncertainty of the information provided by DBP, there is no way the ERA could properly form the view under section 8.16(a)(ii) that any "of the following conditions is satisfied".
69. In this context Verve Energy notes that if this were an access arrangement revision process, the ERA would be required to satisfy itself that any forecasts submitted by DBP represent "best estimates arrived at on a reasonable basis".<sup>9</sup> This test would not be met by DBP's Request. The Code does not intend that some lower standard of information apply under section 8.21.
70. DBP's Request is presently insufficient for the ERA to be able to properly discharge its functions under section 8.21.

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<sup>8</sup> Para 4.8 DBP Request.

<sup>9</sup> Section 8.2(e) of the Code

### **Irrelevant considerations**

71. In DBP's Request, DBP refers to its expansion obligations under a number of instruments including:
  - (a) the Standard Shipper Contract;
  - (b) the Financial Assistance Agreement; and
  - (c) the ACCC Undertakings of 22 October 2004.
72. Verve Energy submits that DBP's obligations under these instruments are irrelevant to assessing whether the proposed NFI complies with section 8.16(a). Whatever DBP's obligations under those other instruments, the DBNGP is a covered pipeline and DBP would have a statutory obligation to expand it under the Code, if ordered to do so.
73. Similarly, DBP refers to its obligations under the Standard Shipper Contract to minimise the capital costs of the expansion. Verve Energy submits that:
  - (a) DBP's obligations under the Standard Shipper Contract are irrelevant considerations relating to DBP's commercial interests for the purposes of the ERA's consideration under section 8.21; and
  - (b) the ERA should not accept a suggestion that the ERA's obligations under the Code are somehow reduced by the existence of these other provisions.
74. DBP has not accurately described some of the above instruments. However because they are not relevant, Verve Energy has not addressed those inaccuracies in this submission. If the ERA does not accept Verve Energy's submission on the relevance of these instruments, Verve Energy asks the ERA to make clear in its Draft Decision the use it makes of DBP's submissions, so that if necessary Verve Energy can make submissions on the issue.
75. In addition, Verve Energy questions the implication in DBP's Request that, without a binding section 8.21 agreement, DBP is unable to obtain finance for the proposed expansion. If DBP is acting as a reasonable and prudent operator, there ought to be insufficient incremental regulatory risk by the proposed expansion to prevent financing. Indeed, Stage 4 was funded without a specific section 8.21 agreement or its equivalent.
76. Verve Energy asks the ERA to disregard these irrelevant considerations.

## Part 2: Code principles regarding NFI

### Key submissions

Section 8.16 has a very clear policy intent.

- first, the NFI must be prudent: section 8.16(a)(i);
- next, the NFI can be added to the capital base to the extent it does not cause tariffs to rise (ie. it pays for itself): section 8.16(a)(ii)(A);
- finally, in certain specified circumstances the NFI can be added to the capital base even though it does not pay for itself: sections 8.16(a)(ii)(B) and (C).

NFI which does not satisfy these roll-in tests should be dealt with by other means, eg. a Surcharge or as Speculative Investment.

DBP has an incentive to inflate its NFI. The ERA's assessment of this incentive in its Final Decision in respect of the Revised Access Arrangement was incorrect.

Section 8.16 requires rigorous scrutiny by the ERA. Not merely an assessment of incentives.

If DBP fails to make a clear case that the NFI comes within one of section 8.16(a)(ii)(A) to (C), then the ERA should reject it as not coming within any of them. "Pleading in the alternative" is not appropriate in this context.

A strict application of sections 8.16(a)(i) and (ii) results in an outcome in which the incremental users pay a surcharge. If so, the ERA should not shrink from this.

### Overview of, and background to, section 8.16

77. Section 8.16(a) is not clearly drafted. However Verve Energy submits that it provides very clear policy guidance if one considers how thinking in this area evolved, during the development of the Code.<sup>10</sup>
78. The opening premise was that NFI should be kept to a prudent minimum, in the interests of efficiency. This is reflected in the "prudence" test in section 8.16(a)(i).
79. The next question was how much of the NFI should be rolled into the capital base, having regard to its impact on other shippers paying the reference tariff. A policy decision was made that NFI could be rolled into the capital base up to the point at which it caused other shippers' tariffs to rise. This is the "pays for itself" or "no price rises" test in section 8.16(a)(ii)(A).
80. The policy consequence of this was that the incremental shipper would have to pay a surcharge for any NFI over and above the "no price rises" limit.<sup>11</sup>

<sup>10</sup> See the Gas Reform Task Forces Exposure Draft of the Code dated 12 July 1996 and accompanying Information Paper dated August 1996. See also numerous comments made during the GRTF's public forums during the Code's development.

<sup>11</sup> See discussion of surcharges commencing at paragraph 101 below.

81. However, on further reflection, those developing the Code realised that in some cases a part of NFI might actually benefit all users, not just the incremental user, such that it would be unjust for the incremental user to pay a surcharge when all users were benefiting. This was drafted as the “system-wide benefits” test in section 8.16(a)(ii)(B).
82. Finally, it was considered that there was likely to be some NFI which did not fall in either of these two categories, such as stay-in-business capex and safety and reliability capex. Thus the third test in section 8.16(a)(ii)(C) came about.
83. In Part 3 of this submission, Verve Energy will demonstrate that DBP’s proposed approach would distort the above policy intention.

### **Incentives for a regulated service provider**

84. It is sometimes said that the service provider of a regulated asset is “in the business of getting assets into the ground” or “makes money from putting assets into the ground”. This statement is intended to reflect the fact that if the service provider is subject to some form of rate of return regulation, the primary means for it to grow its business and increase its returns is to increase the pool of assets on which the return is paid.
85. In general Verve Energy agrees with this proposal. However the above statement is in fact not entirely correct, because it misstates the way tariffs and hence returns are calculated. Rather than saying that a service provider “makes money from *putting assets into the ground*”, it is much more accurate to say that the service provider “makes money from *getting NFI rolled into the capital base*”.
86. This is a critical fact. It is a point of error in the ERA’s Final Decision on the Dampier to Bunbury Natural Gas Pipeline published on 11 November 2005, where the ERA said that “there is a substantial incentive for the Service Provider to seek efficiency in the nature of the works undertaken for the expansion of Capacity, and in the costs incurred in undertaking those works.”<sup>12</sup>
87. This may be true if the service provider ultimately bore the cost of an expansion.
88. But in the context of a user-pays regime, applying to a capacity-constrained monopoly asset where the users have no viable alternative, Verve Energy submits that the ERA’s assessment of incentives is entirely wrong.<sup>13</sup> In fact a service provider such as DBP has every incentive to inflate its capital expenditure, because that increases the base on which it gains its return. This is the primary way for DBP to grow its business.
89. This has been expressly recognised by the Essential Services Commission of Victoria:  

*“there are no clear incentives ... to undertake gas network extension projects that are expected to pass the economic feasibility test under the Code. **The potential for the spreading of costs across the whole ... customer base, following the ‘roll-in’ of the amount of the incurred New Facilities Investment into the Regulatory Asset Base at the time of the next Access Arrangement***

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<sup>12</sup> Para 223 of Final Decision

<sup>13</sup> See also Western Power Generation’s First Submission on Draft Decision dated 26 May 2005, paragraphs 5.1 to 5.5, and also Western Power Generation’s letter of 2 December 2003 entitled Final Decision – Other Matters, section 2. Verve Energy repeats and adopts those submissions.

*Review, can be seen as a disincentive to maintain lowest sustainable costs.”*  
(emphasis added).<sup>14</sup>

90. The ERA’s assessment of incentives in the Final Decision should be rejected, and the Essential Services Commission of Victoria’s assessment followed.

**The appropriate test for section 8.16(a)**

91. Furthermore, Verve Energy submits that section 8.16(a)(i) requires the ERA to undertake a far more rigorous and disciplined assessment than a mere speculation as to whether the service provider has an incentive to keep its NFI within prudent levels.

92. Rather section 8.16(a)(i) requires the ERA to form a positive opinion on credible evidence that the proposed NFI does not exceed “the amount that would be invested by a prudent Service Provider acting efficiently, in accordance with accepted good industry practice, and to achieve the lowest sustainable cost of providing Services”.

93. Verve Energy submits that if the ERA is unable to form a positive view in this regard, either on the evidence before it or due to inconsistencies and uncertainties in that evidence, then section 8.16(a)(i) obliges the ERA to decide not to roll the NFI into the capital base.<sup>15</sup>

94. The ERA’s assessment of DBP’s Request requires a detailed analysis, not just an assessment of incentives.

**Assessment against section 8.16(a)(ii)(A) to (C)**

95. The inadequacy of DBP’s submission is related to another point. DBP regards paragraphs (A) to (C) of section 8.16(a)(ii) as something which can be addressed in a holistic manner, as a “pleading in the alternative”. In other words DBP submits that some or all of DBP’s NFI falls within section 8.16(a)(ii)(A), further or alternatively that some or all of it falls within section 8.16(a)(ii)(B), and further or alternatively that some or all of it falls within section 8.16(a)(ii)(C).

96. In effect DBP says that it is not quite sure which bits are covered by which clauses, but hopes that collectively it all gets across the line.<sup>16</sup>

97. By adopting this approach, DBP is able to restrict its submissions to a vague and general level.

98. Verve Energy submits that the ERA would be in error to allow such an unspecific and imprecise approach.

99. On the contrary, Verve Energy submits that to the extent that any part of the proposed NFI falls outside the test in section 8.16(a)(ii)(A), it is for DBP to demonstrate with specificity how that component is then justified under section 8.16(a)(ii)(B) or (C).

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<sup>14</sup> See the last paragraph on page 15 of the Final Decision by the Essential Services Commission of Victoria dated 12 May 2004 “Application by Envestra for Approval of the New Facilities Investment to Provide Reticulated Natural Gas to Bairnsdale”.

<sup>15</sup> ACCC approach in GPU GasNet FD at page 16.

<sup>16</sup> See paras 10.1, 10.7, 11.1 et al of DBP’s Submission.



100. If DBP fails to make a clear case that the NFI comes within one of section 8.16(a)(ii)(A) to (C), the ERA should reject it as not coming within any of them. “Pleading in the alternative” is not appropriate in this context.

**Code position on surcharges for incremental users**

101. Verve Energy submits that the user-pays philosophy of the Code is entirely consistent with an outcome in which incremental users pay a potentially substantial surcharge.
102. Some regulatory regimes provide for expansion or other costs to be “socialised” regardless of the cost impact on users. This is not the case with the Code, and Verve Energy submits that it was never the policy intention for gas pipelines.<sup>17</sup> Section 8.16(a)(ii) sets specific limits on the amounts of NFI that get socialised (ie. rolled into the capital base).
103. Verve Energy submits that the ERA has a duty to apply sections 8.16(a)(i) and (ii) strictly, and that when the ERA comes to assessing the next round of revisions, it should not shrink from an outcome in which the incremental users (including Verve Energy to the extent it is an incremental user) pay a surcharge.

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<sup>17</sup> This intention is expressly stated in sections 8.38 and 8.42 of the Code. See also page 62 of the ACCC’s Final Decision dated 29 June 2001 in GPU GasNet’s Application for Revision in respect of the Southwest Pipeline, where the ACCC said it had “*considered the general cost reflectivity principle that there should be a nexus between those who enjoy benefits and those who bear the cost; on this basis costs associated with the benefits that clearly accrue only to a sub-set of users might be expected to be borne by them.*”

## **Part 3: The substance of the section 8.16 assessment**

### **Key submissions**

- **There is insufficient detail for Verve Energy to assess whether DBP's proposed NFI satisfies section 8.16(a)(i). However DBP's treatment of its expansion options is too cursory and appears inconsistent with its earlier submissions during the access arrangement revisions process.**
- **DBP has not properly addressed the "economies of scale" test in section 8.17(a).**
- **DBP has designed its expansion in a manner which does not look to future growth. This is inconsistent with section 8.17(b).**
- **DBP has misinterpreted the test in section 8.16(a)(ii)(A), and is proposing the rolling-in of NFI in a way which would cause all users' tariffs to increase. The Code does not permit this.**
- **DBP has failed to demonstrate any system-wide benefits (as that expression has been interpreted in connection with the Code) which justify higher tariffs for all users under section 8.16(a)(ii)(B).**
- **DBP has not provided any evidence in support of rolling-in under section 8.16(a)(ii)(C).**

### **Introduction**

104. Verve Energy asks the ERA to be careful to exclude any irrelevant considerations from its assessment of DBP's Request. For example, the assertions by DBP that it needs to expand the pipeline immediately in order to meet forecast demand and that it cannot do so unless it gets the ERA's agreement under section 8.21 is not a relevant consideration for the ERA in considering whether to give that agreement. Imprudent expenditure in breach of section 8.16(a)(i), or expenditure which fails the roll-in tests in section 8.16(a)(ii), cannot be brought within those sections simply by a (largely unsubstantiated) allegation of urgency.
105. Except in the hypothetical case of repairing accidental damage to the pipeline, it is hard to envisage a situation where urgency would render it appropriate for all users to pay higher tariffs as a result of the rolling-in of NFI which is imprudent or which does not comply with section 8.16(a)(ii).
106. There are other commercial mechanisms available to DBP and its prospective incremental users if the commercial pressures on those users require urgent expansion. For example those users could agree to pay a surcharge to the extent that the expenditure is imprudent, or they could make a capital contribution.

### **The "prudence" test — section 8.16(a)(i)**

107. The ERA must carefully consider the detail of the forecast NFI proposed by DBP to assess whether it meets the "prudent operator test" in section 8.16(a)(i).

108. Verve Energy submits that the ERA does not appear to have sufficient detail to do this.
109. Verve Energy requests an opportunity to make further submissions regarding section 8.16(a)(i) after more detailed information is made available. In the meantime Verve Energy is restricted to the observations already made about incentives and surcharges.<sup>18</sup> The magnitude of the proposed “Stage 5” expansion in no way creates an incentive for DBP to act efficiently, and in accordance with good industry practice, to achieve the lowest sustainable cost of providing Services. Quite the reverse.
110. Further, there may be other incentives for DBP to expand the pipeline inefficiently. For example, the expansion may primarily benefit shippers with whom DBP has some other relationship, to the detriment of those shippers’ competitors. Verve Energy does not have sufficient information about the details of the proposed expansion to comment further on this point.
111. As part of its submissions in support of the ERA approving the NFI for Stage 4, DBP proposed three options, being:
- (a) looping with 26” pipe or other diameters;
  - (b) mid-line compression; and
  - (c) a combination of the two plus increasing MAOP.<sup>19</sup>
112. DBP asserted that there were operational risks associated with mid-line compression, including additional (unspecified) non-capital costs and (unspecified) ongoing system reliability issues.<sup>20</sup>
113. In DBP’s Submission dated February 2006 in support of DBP’s Request, it asserts that mid-line compression, together with looping, is the optimised option for expanding the pipeline. DBP’s Submission does not deal with any of the problems it had previously identified with this approach.<sup>21</sup> It seems surprising that DBP’s views have changed in such a short time frame. Verve Energy does not have the information necessary to assess this issue.
114. DBP has not provided evidence that it has assessed, in any detail, the three options on the basis of life cycle cost, which is the normal, prudent approach to ensure lower capital cost projects are not preferred at the expense of significantly higher future operating costs. This is something that needs careful scrutiny.
115. Verve Energy has insufficient information to assess this test. The ERA must assess it critically. On the information available, DBP has failed to demonstrate that it has acted as a prudent operator, acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing Services.

**Economies of scale - section 8.17(a)**

116. In considering whether the test in section 8.16(a)(i) is met, the ERA must consider the matters in section 8.17.

<sup>18</sup> See commencing at paragraphs 84 and 101 above.

<sup>19</sup> Para 9.3 of DBP’s Amended Proposed Revised Access Arrangement Information dated 2 June 2005

<sup>20</sup> Para 5.8 of DBP’s Amended Proposed Revised Access Arrangement Information dated 2 June 2005.

<sup>21</sup> Option at paragraph 7.16 et seq and 7.20 et seq; comments at para 7.27 DBP Submission.

117. There is no evidence that the expansion proposed by DBP exhibits economies of scale or scope. In particular, there is some evidence that the expansion exhibits diseconomies of scale given the proposal to replace and restage compressors for limited additional capacity (compared to the Existing Approval which involved only 493km of looping).<sup>22</sup>
118. DBP asserts that all gas transmission pipelines exhibit economies of scale, principally because of indivisibilities of equipment<sup>23</sup> (mainly compressors). However, each stage of expansion (adding compressors to a free flow pipeline, then looping a fully compressed pipeline and then adding compression to a fully looped pipeline) is generally accepted to exhibit different economies of scale and scope. If in contrast DBP's assertion is accepted, then all expansions would meet the consideration in section 8.17(a) and there would be no point to the section. Verve Energy submits that this is simply not correct, and that section 8.17(a) requires proper analysis by DBP and consideration by the ERA.
119. DBP's attempt to argue that section 8.17(a) issues are not important for the proposed stage 5 expansion<sup>24</sup> suggests that DBP is of the view that some or all of its proposed expansion does not meet the section 8.17(a) test.
120. DBP has not provided any convincing evidence in connection with the test in section 8.17(a), and so the ERA is obliged to regard it as not met.

**Spare capacity - section 8.17(b)**

121. The proposed expansion does not satisfy the consideration in section 8.17(b) because it is not designed to provide capacity sufficient to meet forecast sales of services over a reasonable timeframe. In the context of DBP's Request, which proposes to expand the pipeline over the next two years, Verve Energy submits that three to five years is a reasonable planning timeframe.
122. In paragraph 7.93 of DBP's Submission, DBP asserts that it has "sought" and "been concerned" to provide for the lowest sustainable cost of providing services in the long run. It provides no details of how it has done this or what the outcome of such claimed endeavours might have been, and hence its claims should be given very little credence.
123. In fact, and in contrast to DBP's vague claims in paragraph 7.93, DBP has expressly admitted that its Request does not satisfy the consideration in section 8.17(b).<sup>25</sup>
124. In these circumstances, Verve Energy submits that in performing its functions under section 8.17(b), the ERA must regard the test in that section as being wholly unsatisfied.
125. In fact Verve Energy submits that contrary to DBP's very short-term approach of optimising only for its current applications, section 8.17(b) would be best satisfied by a pipeline with a published open-ended expansion programme that future incremental users could fit into as needed. This is the only practical way to pursue long term

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<sup>22</sup> Section 6 Annexure 3 DBP's Amended Proposed Revised Access Arrangement Information dated 2 June 2005.

<sup>23</sup> Para 7.33 DBP Submission.

<sup>24</sup> Para 7.37 DBP Submission.

<sup>25</sup> Para 7.38 DBP Request.

lowest sustainable costs. Focussing solely on the lowest upfront cost is not prudent, is not efficient, and is not accepted good industry practice.

126. DBP currently has Access Requests for 339.5 TJ/d<sup>26</sup>. Further, DBP has publicly stated that demand for capacity in the short term is up to 375 TJ/d<sup>27</sup>.
127. However, DBP only intends to expand the pipeline's full haul capacity by 310 TJ/d.
128. Further, DBP has admitted that the optimised design for the expansion does not provide capacity over and above what is needed to meet firm contractual arrangements for the expanded capacity and that it has given no consideration to installing New Facilities to meet forecast sales over a reasonable future period.<sup>28</sup> This should be contrasted to the Stage 4 expansion, which, unlike the current proposed expansion, was not limited to users and prospective users who had entered into firm arrangements with DBP for the expanded capacity. In its submissions supporting the Stage 4 expansion, DBP said that it had considered future forecast contracted capacity for the access arrangement period.<sup>29</sup>
129. By doing this, DBP is creating a barrier to entry and artificially constraining the market. The effect is to exclude a user or potential user who wants the 311th TJ/d from doing so until the next time DBP decides to expand the pipeline, despite the fact that DBP knows, with reasonable certainty, that there are people who will need that capacity in the short term.
130. Section 8.17(b) requires the ERA to consider the interests of such a person and whether the DBP Request adequately addresses this situation. Verve Energy submits that it clearly does not.
131. Verve Energy asks the ERA to consider the extent to which DBP's strategy of building only exactly as much capacity as it has firm contracts, and doing so only in large "stages":
  - (a) is inconsistent with section 8.17;
  - (b) constitutes a barrier to entry to prospective incremental users; and
  - (c) amplifies DBP's market power.
132. Verve Energy acknowledges that an expansion for a small incremental user may not be as cost effective, but submits that the Code nonetheless requires DBP to undertake such expansions and provides clear mechanisms for the user to meet the cost of that inefficiency.
133. DBP has clearly not acted in accordance with section 8.17(b).

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<sup>26</sup> Para 2.6 DBP Request.

<sup>27</sup> DBP Media Statement "Pipeline expansion hits \$1.5 billion as demand soars", 20 February 2006.

<sup>28</sup> Para 7.38 DBP Submission.

<sup>29</sup> Para 6.3 DBP's Amended Proposed Revised Access Arrangement Information dated 2 June 2005 (Annexure 3).

**Expansion pays for itself - section 8.16(a)(ii)(A)**

134. The forecast NFI in DBP's Request, if agreed to by the ERA, appears likely to have the effect of increasing future tariffs: see Annexure 1. DBP appears to accept this.<sup>30</sup>
135. Verve Energy submits that to the extent that rolling in the NFI may cause tariffs to increase, the test in section 8.16(a)(ii)(A) is violated.
136. However, DBP appears to have calculated NPV in respect of Anticipated Incremental Revenue for the purposes of 8.16(a)(ii)(A) in a manner which gives an inconsistent answer – tariffs will go up but so will incremental net revenue: see Annexure 1.
137. There is insufficient detail about the precise manner in which this NPV analysis has been carried out. It may be that it is consistent with the methodology previously described by DBP in June 2005 for the access arrangement. However, Verve Energy cannot assess this because it is based on references to Submission #26 which has not been made public.
138. Verve Energy is concerned about the black box approach taken by DBP which has delivered this surprising result (namely, a roll-in purportedly being justified under section 8.16(a)(ii)(A) even though it causes tariffs to increase). For example, DBP's analysis suggests that none of the capital expenditure which DBP attributes to the change in gas specifications is excluded from the section 8.16(a)(ii)(A) analysis.
139. However, there is insufficient information for Verve Energy to make detailed analyses. Inputs as to capital and operating expenditure per year, and the prevailing tariffs charged to new users are specifically not disclosed.
140. One specific observation can be made. DBP appears to assume that the "Prevailing Tariffs" test for section 8.16(a)(ii)(A) involves taking the current reference tariff and escalating it in perpetuity at 100% of CPI: see Annexure 1. This is an indefensible treatment of the future tariff path. Verve Energy submits that the clear intention of the Code in this regard is that the benchmark for determining Anticipated Incremental Revenue is the predicted future tariff path for a reference tariff, which would normally be expected to follow a "sawtooth" pattern with a step down at each reset.
141. The effect of adopting an inflated tariff path as DBP has done is to artificially increase the threshold for the section 8.16(a)(ii)(A) test, thus allowing NFI to be rolled into the capital base despite the fact that in so doing users will pay higher reference tariffs than they would have done had the NFI not been rolled in. Section 8.16(a)(ii)(A) is thus subverted: see Annexure 1.
142. Verve Energy submits that a consideration of the policy and economic underpinnings of the Code enables its arguments in paragraphs 140 and 141 to stand alone. However to the extent that the ERA disagrees, Verve Energy submits that to allow DBP to base its section 8.16(a)(ii)(A) assessment on such an inflated forecast tariff would be entirely inappropriate when DBP itself bases its Standard Shipper Contract on a forecast sawtooth tariff.<sup>31</sup>
143. In this context, Verve Energy submits that accepting DBP's abandonment of a sawtooth tariff path would seem to deprive all shippers on the 2004 Standard Shipper

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<sup>30</sup> Para 9.6 DBP Submission.

<sup>31</sup> See Schedule 9 to the SSC.

Contract of a prior contractual right, namely the right for the Schedule 9 tariff model (including assessment of NFI) to be applied against a projected sawtooth tariff.

144. However, Verve Energy is unable to express any informed, conclusive view as it does not have access to sufficient information to enable it to verify or make NPV calculations.

145. It is not possible for Verve Energy to accurately assess this critical factor on the information available to it, but:

- (a) DBP's proposal causes tariffs to rise and hence breaches this test;
- (b) DBP has used the wrong baseline in calculating Anticipated Incremental Revenue, which has inflated the amount of NFI which could be rolled in under this test.

**System wide benefits – section 8.16(a)(ii)(B)**

146. Section 8.16(a)(ii)(B) is mutually exclusive of section 8.16(a)(ii)(A).

147. Verve Energy submits that DBP has provided no evidence that any of the NFI falls within section 8.16(a)(ii)(B), for the reasons set out below.

*Capacity is defined by reliability*

148. The T1 service and other services such as the Tx service are defined by reliability.

149. Likewise, the capacity of the pipeline to provide T1 service and other services is calculated having regard to the reliability of the pipeline. In short, DBP calculates how much capacity it can sell by determining the reliability of the pipeline in transporting gas, and using that information to establish the cut-off of how much of a particular Service it can provide. In other words, the contractual model for the DBNGP is that DBP determines the amount of a capacity service it has available to sell by calculating the maximum amount it can sell without breaching its contractual reliability obligations.

150. The consequence of this is that an expansion which increases system reliability does not result in any increase in the reliability of services available to users because, by the way capacity is defined, there can never be extra security for users – only more capacity of the same reliability.

151. For example, suppose an expansion involves an increased use of looping rather than compression. Even if additional looping increases the pipeline's ability to reliably deliver gas, it will not result in increased reliability for a given shipper's T1 service. On the contrary, DBP will simply sell more T1 capacity until the 98% reliability cut off is reached.

152. DBP's own Submission illustrates this fact, where DBP states that the Stage 4 expansion "increases system reliability, reducing interruptible capacity by about 31 TJ/d, and increasing firm (Tranche 1) capacity by a similar amount."<sup>32</sup> None of the existing T1 shippers, and none of the shippers which buy the incremental T1 capacity, will experience any change in their contractual right to reliability. Likewise, because

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<sup>32</sup> Para 2.3 DBP's Submission

the capacity will be sold right up to the cut-off level (given DBP's stated aim of not building any spare capacity), the pipeline will be just as stressed as it is today, so neither will there be any practical increase in the reliability **experienced by these shippers** (as distinct by the gas transport reliability of the pipeline system as a whole).

153. The Code is about access to Services. Verve Energy submits that no expansion contemplated in DBP's Request will affect the reliability of any Service enjoyed by a shipper. Therefore, increased system reliability cannot be used as a justification for rolling-in under section 8.16(a)(ii)(B).

*What are "system-wide benefits"?*

154. Section 8.16(a)(ii)(B) only justifies rolling-in of NFI which fails the test in section 8.16(a)(ii)(A) if two conditions are met:

- (a) the NFI will have system-wide benefits; and
- (b) those benefits justify **all** (not just **some**) users paying higher tariffs.

155. Verve Energy submits that section 8.16(a)(ii)(B) does not involve wide, general considerations such as the global consideration of the public interest (eg. State wide benefits flowing from increased economic development) or impacts upon competition external to the gas pipeline system. Otherwise almost all expansions would meet this test.

156. In particular, private benefits accruing outside the pipeline are excluded from consideration of system-wide benefits<sup>33</sup>.

157. Even if this argument is not accepted, there is no evidence quantifying any such benefits. There must be some assessment of the quantum of the benefits so that the ERA can properly consider whether it is satisfied that the quantum of any system-wide benefits is sufficient to justify a higher tariff for all users<sup>34</sup>

158. Finally, even if such benefits were relevant and quantifiable, and there was evidence of such quantification, there needs to be a "close match between"<sup>35</sup> any such external benefit and the users who would be paying for the benefit by way of increased tariffs. Verve Energy submits that there is no "close match" between any public or State benefits and users. There is no policy intention in the Code for tariffs to be used as a form of State development tax, being borne by only one section of the community (users). Likewise there is no "close match" between any private benefits, such as new or expanded industry, and all users. Users should not be expected to pay for private benefits which they do not enjoy<sup>36</sup>.

159. Regulatory precedent establishes that section 8.16(a)(ii)(B) does not involve a balancing test between the interest of users in not paying a higher tariff and any wider benefits that will not occur if the expansion does not go ahead.<sup>37</sup> Rather, there must

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<sup>33</sup> ACCC Final Decision, "Access Arrangement for the Principal Transmission System, Application for Revision by GPU GasNet, Southwest Pipeline", dated 29 June 2001, at page 50.

<sup>34</sup> Ibid at page 54.

<sup>35</sup> Victorian Regulator General Multinet, Westar and Stratus Draft Decision May 1998 and Final Decision October 1998 at page 80.

<sup>36</sup> Ibid.

<sup>37</sup> ACCC Final Decision, "Access Arrangement for the Principal Transmission System, Application for Revision by GPU GasNet, Southwest Pipeline", dated 29 June 2001, at page 80



be a **match** between the benefits and the users who are paying for the expansion. If there is no such match, the expansion should not be paid for by users but by some other means, such as a Surcharge on the incremental users or by the parties who will benefit most from the expansion (such as new industry).

160. This is consistent with the intent of the Code that users should only pay for or contribute to costs which are allocated to them. In particular, as noted by the ACCC in GPU GasNet<sup>38</sup>, sections 8.38 and 8.42 establish the general principal that users contribute to revenue in accordance with the allocation of costs between users.
161. In the present case, there is no close match between system-wide benefits and all users, particularly as the expansion is limited to those users and potential users who have contractual arrangements with DBP for the proposed expanded capacity. The rest of the users and potential users get little, if any, benefit from the proposed expansion.
162. The proposed expansion may also be damaging to some users. For example, if the proposed expansion is primarily for the benefit of Verve Energy's competitors, then Verve Energy will, if the NFI is added to the capital base, be paying for a commercial advantage for its competitors. In such case there is clearly no system-wide benefit for Verve Energy, particularly if it may be only participating in a proposed expansion to a small extent.
163. DBP is proposing only to build extra capacity for users and prospective users who have binding arrangements with DBP for that extra capacity.<sup>39</sup> Likewise, DBP has admitted that the Stage 5 expansion has been deliberately designed without regard to the possibility of future forecast sales.<sup>40</sup> It is hard to see how, having taken such an approach, and despite its false assertion to the contrary in paragraph 9.3(a) of its Submission, DBP could credibly claim that Stage 5 offers benefits to anyone other than the specific incremental users concerned.
164. DBP provides no evidence in support of its contentions that the proposed NFI will result in lower cost generation of electricity<sup>41</sup> or that users' finance costs would be higher than DBP's<sup>42</sup>. Verve Energy considers both these propositions to be, at least, open to debate.
165. There is no evidence before the ERA of system-wide benefits which would justify **all** users paying a higher tariff:

#### *Other issues*

166. DBP made various assertions as part of the revisions to the access arrangement that the forecast NFI would provide system wide benefits, including:
  - (a) the expansion offered additional capacity to full haul, part haul and back haul users and prospective users because the forecast demand is located south of CS9 but the new facilities to be built were to be constructed along the entire length of pipeline which will benefit all users and prospective users<sup>43</sup>;

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<sup>38</sup> At page 49.

<sup>39</sup> Para 3.2 DBP Request.

<sup>40</sup> Para 7.38 DBP Submission.

<sup>41</sup> Para 9.6(a) DBP Submission.

<sup>42</sup> Para 9.11 DBP Submission.

<sup>43</sup> Paras 9.36 to 9.38 DBP's Amended Proposed Revised Access Arrangement Information dated 2 June 2005.

- (b) significant looping expenditure would provide a more reliable service because looping is less susceptible to supply interruption than capacity created solely by compression (ie compressors likely to break down).
167. In relation to these arguments, the ERA determined that, in the absence of further information from DBP on the nature of the capital works to be undertaken for the expansion of capacity, the ERA is unable to find that the NFI would have system wide benefits<sup>44</sup>.
168. DBP has, in support of DBP's Request, to some extent restated the arguments in paragraph 166 but has not provided any more evidence than it did in the revisions to the access arrangement.
169. Therefore, the ERA should reject DBP's arguments on this issue.
170. On another point, DBP asserts at paragraph 9.5 of its Submission that the expansion is needed in order to avoid increases in the frequency of curtailments of existing shippers. Verve Energy questions the accuracy of this assertion. As discussed above,<sup>45</sup> capacity is sold on a reliability basis. Either DBP is capable of meeting its contractual commitments in which case there is no substance to this point, or DBP has allowed a state of affairs to arise in which it has sold more capacity than it can service. If the latter is true, then there should be no suggestion of users paying for the cost of DBP extricating itself from that predicament. Certainly, any such expenditure would fail the test in section 8.16(a)(i).
171. If DBP is genuinely in an oversold position, then this is a situation which does not justify sharing higher costs with **any** user, let alone **all** users. DBP should properly absorb any higher costs and no user should be required to share these costs, particularly because DBP would be getting additional non-rebateable revenue.

*Conclusion on section 8.16(a)(ii)(B)*

172. In light of the above, Verve Energy submits that there is simply no evidence on which the ERA could base a finding that this extra capacity will create any benefits that would justify all users paying a higher tariff.
173. Therefore the test in section 8.16(a)(ii)(B) is not met.

**Section 8.16(a)(ii)(C)**

174. If a credible case is made that an expansion was needed within section 8.16(a)(ii)(C), and the expansion was clearly defined and fully costed in accordance with section 8.16(a)(i), then Verve Energy would not make any submission in opposition to that investment being rolled into the capital base at the next reset. However, the DBP Request does not do this. Users cannot tell precisely what DBP is seeking to do in this respect. Nonetheless, DBP does seek to have users pay for the expansion by rolling certain undefined costs into the capital base.
175. At paragraph 10.2 of its Request, DBP makes it clear that it does not rely on section 8.16(a)(ii)(C) in respect of any of the incremental capacity. The ERA has previously determined that this NFI is not directed at maintaining safety or integrity of pipeline,<sup>46</sup>

<sup>44</sup> Para 227 FD.

<sup>45</sup> See commencing at paragraph 148.

<sup>46</sup> FD para 225.

and Verve Energy assumes that the same will hold true for the proposed NFI in DBP's Request. Taking these together, the only candidate for rolling-in under section 8.16(a)(ii)(C) would be any NFI which could be justified on the grounds that a change in gas specification had taken the DBNGP's capacity below the existing level of contracted capacity.

176. This matter was extensively canvassed in submissions to the ERA on the recent access arrangement revisions, and in the ERA's Draft Decision and Final Decision. Verve Energy supports the ERA's position in those documents, and submits that the ERA should not permit this section 8.21 application to be used to re-agitate the same issues. On that basis, Verve Energy will only deal briefly with the subject in this submission. If the ERA contemplates departing from the position it adopted in its Final Decision<sup>47</sup> and Further Final Decision<sup>48</sup>, Verve Energy requests an opportunity to make further submissions.
177. DBP gives no details of:
- (a) the extent to which any change in gas specification impacts upon pipeline capacity;
  - (b) the expansion necessary to correct such change including when in the Stage 5 timetable the expansion is to take place;
  - (c) why DBP now proposes some NFI associated with a change in gas specification, when it had an opportunity to do so following the Draft Decision but did not do so;<sup>49</sup>
  - (d) why there is any urgency associated with any gas quality restoration to justify this vague section 8.21 application;
  - (e) why gas quality is not properly regarded as a risk that DBP assumed when it bought the pipeline just 18 months ago, which has already been factored into the capital base; or
  - (f) why a change in gas specification justifies abandoning the Existing Approval.
178. Indeed, DBP has expressly conceded that it has not placed any evidence before the ERA to justify a rolling-in under section 8.16(a)(ii)(C).<sup>50</sup>
179. Verve Energy submits that the ERA has no evidence before it which can justify rolling-in any amount of NFI under that section, and therefore that the ERA cannot be satisfied that the ground in section 8.16(a)(ii)(C) has been met.

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<sup>47</sup> FD para 146.

<sup>48</sup> FFD para 90.

<sup>49</sup> FD para 146.

<sup>50</sup> Para 10.7 DBP Submission

## Part 4: Conditions on any agreement

### Key submission

- **To the extent that the ERA proposes to agree to DBP's Request under section 8.21, it should impose some conditions or limitations on that agreement.**

180. Section 8.21 permits the ERA to impose conditions or limitations on its agreement.
181. Assuming that the ERA proposes to agree under section 8.21 in respect of some of the forecast NFI, Verve Energy submits that the ERA should exercise its discretion to impose conditions or limitations on the agreement, for the following reasons:
- (a) DBP's Request is, by its own admission<sup>51</sup> hasty and vague, and its plans for the expansion are ill-formed. In such circumstances, assuming the ERA is prepared to give any agreement at all, its agreement should be qualified to reduce the risk to users inherent in DBP's proposal.
  - (b) As DBP's submission makes clear, there is scope for disagreement about the role of a section 8.21 agreement when the next access arrangement revisions are being considered. Although Verve Energy supports the ERA's position in this regard and rejects DBP's arguments, the existence of that controversy again increases the regulatory risk for users. A suitably-qualified agreement, reserving sufficient rights to the ERA to scrutinise the actual outcomes before the capital base is increased, would bypass this controversy and hence reduce that regulatory risk for users.
  - (c) The ERA has been asked to assess a rushed application in a short timeframe, when the effect of the proposal is to effectively double the capital base. Imposing suitable conditions or limitations is a legitimate way for the ERA to maintain the quality of the regulatory process.
182. Verve Energy submits the following as appropriate conditions or limitations on any agreement under section 8.21:
- (a) That the rolling in will be of actual NFI and not forecast NFI.
  - (b) That the actual NFI will only be rolled in to the extent that it satisfied the test in section 8.16(a)(i) when incurred.
  - (c) That the actual NFI which relates to forecasts which have been agreed to as coming within section 8.16(a)(ii)(A) will not be rolled in if, in all the circumstances prevailing at the time of the revisions:
    - (i) it would actually result in an increase in tariffs.

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<sup>51</sup> Para 1.12 of DBP Submission; para 4.5 of DBP Request.

- (ii) doing so would be inconsistent with one or more of the fundamental elements in section 8.1 and 2.24.
  - (d) That the ERA retains its discretion under section 8.22 of the Code.
  - (e) That the agreement only applies to the extent that the NFI actually results in an increase in capacity of the nature, magnitude and timing set out in the Proposal or in the further details which DBP has undertaken to provide (Verve Energy notes that such a condition would require DBP's plans to be stated with much more specificity than is presently in the public proposal).
  - (f) That DBP specify either now or in its next proposed revisions to the access arrangement:
    - (i) how depreciation is taken into account given the abandonment of the Existing Approval;
    - (ii) how any of the capital assets that become redundant are to be dealt with.
  - (g) That DBP's compliance with these conditions be open to public submissions when the NFI is being considered for rolling in at the next access arrangement revision.
  - (h) That the ERA may audit DBP's compliance with these conditions and limitations from time to time.
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## ANNEXURE 1

### Comments on Calculations of Anticipated Incremental Revenue Test

1. Verve Energy submits that there are two manifest errors in the way that DBP has applied the test of section 8.16(a)(ii)(A) (“**the AIR Test**”).
2. Firstly, the calculations appear to be incorrect. Whilst it is impossible to replicate DBP’s calculations based upon the information available, the PV cumulative annual revenue increment is shown in the tables in 8.10 of DBP’s Submission for 10, 20 and 25 years, discounted at the real pre-tax discount rate of 7.24%.
3. Paragraph 8.3 of DBP’s Submission indicates the T1 tariff (at 100% load factor) used by DBP for the AIR Test is \$0.997038 per GJ (assumed to be in real 31 Dec 2004 \$), being the DBP calculated tariff assuming no further expansion after Stage 4. This compares to the determined reference tariff of \$1.003021 per GJ in the Revised Access Arrangement.
4. Paragraph 8.5(a) of DBP’s Submission states that DBP, in applying the AIR Test has used the Stage 5 capacity forecast of 310 TJ/d.
5. Either one of these two statements is incorrect or DBP’s calculations are in error. This is demonstrated as follows:

	PV of \$1 every year	PV Cumulative Annual Revenue Increment	Implied Capacity at 100% LF based upon Para 8.3	Implied Tariff at 100% Load Factor based upon Para 8.5(a)
		\$m	TJ/d	\$/GJ
10 years	\$6.9463	1012.832	400.66	1.29
20 years	\$10.3992	1535.561	405.75	1.31
25 years	\$11.4059	1687.984	406.66	1.31

Real Discount Rate: 7.24% Pre Tax

6. Secondly, these calculations assume that the current tariff escalates at 100% CPI throughout the assessment period. However, the reference tariff will be reset every five years, and it is anticipated that, at each reset, the previous year’s tariff will be reduced in real terms, producing the sawtooth effect shown in Schedule 9 of the SSC.
7. The “Prevailing Tariff”, as defined in section 10.8 of the Code, means, for a reference service, the applicable reference tariff. DBP asserts that the Prevailing Tariff is the reference tariff that would have applied on the assumption that the relevant NFI has not been made. Verve Energy agrees with this subject to the proviso that the reference tariff over 20 years is **not** the current reference tariff escalated at 100% CPI but the reset reference tariff producing the sawtooth effect in Schedule 9 of the SSC.

