



26 May 2005

Mr Lyndon Rowe  
Chairman  
Economic Regulation Authority  
GPO Box 8469  
Perth Business Centre  
WA 6849

**Sent by email to: [russell.dumas@era.wa.gov.au](mailto:russell.dumas@era.wa.gov.au)**

Dear Mr Rowe,

## **DRAFT DECISION – DAMPIER TO BUNBURY NATURAL GAS PIPELINE**

We refer to the Economic Regulation Authority's ("ERA") Draft Decision ("**Draft Decision**") on the revised DBNGP Access Arrangement for 2005-2010 proposed by DBNGP (WA) Transmission Pty Ltd ("**DBNGPT**") and to the ERA's notice of 11 May 2005 inviting submissions on the Draft Decision. We also refer to the meeting with you, your officers and other industry representatives on 19 May 2005.

CSBP Limited ("**CSBP**") has an interest in the Draft Decision as set out in CSBP's submission of 14 March 2005 on the proposed revised Access Arrangement ("**CSBP's Initial Submission**"). As explained to you at our meeting, CSBP is particularly concerned regarding the ERA's Draft Decision Amendment 15 in relation to gas quality. CSBP contends that this draft amendment should be withdrawn as it does not take sufficient account of the legitimate interests of all stakeholders, in particular shippers and users of the gas (who may be shippers or shippers' customers), and could potentially cause existing commercial contracts to be overridden or breached. CSBP's arguments in support of this contention are explained in more detail below.

CSBP makes the following submissions on the Draft Decision:

### **1. Gas Quality**

1.1 As set out in CSBP's Initial Submission, any change to broaden the gas specifications under the Standard Access Contract Terms and Conditions for the Reference Service or otherwise may have significant detrimental effects on CSBP for the following reasons:

- (a) CSBP uses natural gas as the major process feedstock in the production of ammonia, an important input to downstream fertiliser and chemical processing in Western Australia. The introduction of lower quality gas into the DBNGP would have the potential to adversely impact the quality of gas delivered to CSBP at its DBNGP Delivery Point (outlet point) which would have a negative impact on the production capacity and



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process efficiency of CSBP's ammonia plant, which in turn would increase CSBP's ammonia production costs. This would have the potential to cause consequent cost increases to downstream users, most of which compete in export markets.

- (b) CSBP, appointed by Australian Gold Reagents (“AGR”)<sup>1</sup> as the operator of AGR's sodium cyanide production facilities, uses natural gas as a critical process feedstock in the production of sodium cyanide, an important reagent used by the gold industry. The introduction of lower quality gas into the DBNGP would have the potential to adversely impact the quality of gas delivered to AGR via the DBNGP which would add significant costs to the manufacture of sodium cyanide which could, in turn, have negative impacts on the costs of the domestic gold industry or reduce AGR's ability to compete with imported product. AGR is also a significant exporter of sodium cyanide, having recently invested significant capital to produce an export oriented product, and any such increased costs will have a negative impact on AGR's ability to compete in the highly competitive global market.
  - (c) CSBP has significant capital invested (over \$200 million) in the ammonia and sodium cyanide plants. These plants have been recently expanded to support growth in the domestic and export markets and any future returns on this capital would be seriously damaged by any widening of gas specifications. CSBP made initial investments, and further investments, in these plants on the basis of the gas specifications under CSBP's contracts at the time of the relevant investments and on the basis that the gas specifications could not be broadened other than by a negotiated commercial arrangement consented to by CSBP. Any broadening of the gas specifications other than by way of a negotiated commercial arrangement consented to by CSBP would constitute an interference with CSBP's contractual position.
  - (d) CSBP understands that a broadening of the gas specifications will reduce the quantity of gas that can be transported through the DBNGP. This will have two adverse impacts on CSBP, and other shippers. The first adverse impact is that, until an expansion of the DBNGP can be carried out to increase the capacity of the DBNGP to make up for this reduction, shippers are more likely to have capacity interrupted. This will adversely affect CSBP's plants, which require a consistent gas flow to operate efficiently. Secondly, although an expansion may be able to be carried out to increase the capacity of the DBNGP to address this issue, this is likely to result in all shippers paying higher gas transmission tariffs, making those that compete with imports or in international export markets less competitive.
- 1.2 Without limitation to any of its rights whatsoever, CSBP makes the following submissions in relation to Draft Decision Amendment 15 with reference to paragraphs 386 to 432 (inclusive) of the Draft Decision:
- (a) In paragraph 413 of the Draft Decision, the ERA states that “*renegotiation of existing contracts or entry into new contracts with a gas quality specification narrower than the Broadest Specification would be at the commercial risk of the parties to these contracts*”. CSBP contends that this is an incorrect inference from the principle of moving towards a broader specification, as it infers that those parties which would be impacted negatively by such a broader specification have no rights to negotiate a commercially fair outcome. Put more bluntly, it suggests the removal of contractual rights.

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<sup>1</sup> AGR is a joint venture between CSBP and Coogee Chemicals Pty Ltd.

- (b) Throughout the section of the Draft Decision dealing with gas quality, the ERA regularly refers to the interests of gas producers. While section 2.24 of the Code provides that the Relevant Regulator must take into account the public interest, including the public interest in having competition in markets (whether or not in Australia) and any other matters that the Relevant Regulator considers are relevant, these are only some of the matters that the Relevant Regulator must take into account and CSBP submits that these are much less important matters for the Regulator than the interests of shippers and the pipeline owner. CSBP understands that the role of the Regulator is to balance the interests of shippers and the pipeline owner, taking into account the wider public interest. In CSBP's view, it is not correct for the ERA to favour the interests of gas producers at the expense of both shippers and the pipeline owner. In other words, the ERA has given inappropriate and undue weight to the interests of gas producers.
- (c) Further, the interests of gas producers are not directly relevant to the requirement under sections 2.24 and 3.6 of the Code that the terms and conditions of provision of a Reference Service must be reasonable. The only parties to such terms and conditions are DBNGPT and shippers, who are either themselves users (customers) of the gas, which is the case for CSBP, or responsible to end users of the gas for the suitability of the gas quality. Whether gas producers consider such terms and conditions as reasonable is not directly relevant as they are not bound by them. The ERA has taken into consideration, and given undue weight to, the interests of gas producers in arriving at Draft Decision Amendment 15.
- (d) The mechanism proposed (and currently used) by DBNGPT for dealing with the possibility of the transport of broader specification gas through the DBNGP is reasonable, practical and addresses the concerns of all interested parties. There is a clear mechanism for any shipper to ask for the right to deliver gas of a broader specification into the DBNGPT (and hence for gas producers to sell gas of a broader specification), but a clear acknowledgement that if the provision of this right to a shipper causes commercial disadvantage to the pipeline owner (either directly or due to the impact on another shipper) then a commercial negotiation will need to be reached.
- (e) However, the ERA is instead proposing that any shipper will now automatically have the right to deliver gas of a broader specification into the DBNGP under a contract for T1 Service granted pursuant to the Access Arrangement, and will not be required to negotiate with, and possibly compensate, those adversely affected by the existence of this right, despite the fact that those adversely affected have existing contracts under which they specifically and intentionally negotiated the right to base any decision to permit a broadening of their delivery point specifications on a commercial negotiation and possible settlement with any party seeking broader specifications.
- (f) The ERA states in its Draft Decision that shippers and DBNGPT have been aware of the proposal for broader specifications for some time. However, the ERA appears to be ignoring the following facts:
  - (i) the original shipper contracts for the DBNGP continued for considerable periods of time (and would not yet expire for some time) and did not contain any provision for broadening the gas specifications; and
  - (ii) users and DBNGPT have recently renegotiated contracts to provide for the possibility of broader specifications, but as set out above, based on a commercial negotiation and possible settlement with any party or parties seeking broader specifications, recognising the various different interests that exist and the importance of the principle of preserving the sanctity of existing contractual rights.

- (g) The ERA appears to be arguing that directors of companies, including public companies, should fail to act in the interests of their companies (and the shareholders of their companies) and should instead act in the interests of the shareholders of other companies (in this case, the gas producers) by anticipating possible government reform which would achieve increased royalty revenue for the government. The ERA also appears to be arguing that directors or shippers should have negotiated gas transmission arrangements that failed to give their own companies any protection against such anticipated government reforms, and in a situation where both negotiating parties (ie. the shipper and DBNGPT) have a common interest. This fails to realise normal commercial interests and the statutory and common law duties of directors in acting in the best interests of their companies. If the ERA is suggesting that DBNGPT and the shippers should negotiate based on the broadening of gas specifications, this should have been made clear to DBNGPT and shippers in 2004 when amendments to the existing shipper contracts were being negotiated, although, for the reasons discussed above, we question whether this would have been within the remit of the ERA.
- (h) Given that all shippers have recently negotiated amendments to their gas transmission contracts for the DBNGP, CSBP is surprised that the ERA has made a finding that it would be unreasonable for the terms and conditions for the T1 Reference Services to not include a wider gas quality specification than the Operating Specification proposed by DBNGPT for the Tf Reference Service in light of CSBP's understanding that none of the existing shippers negotiated an absolute right to a broader specification during these negotiations. These parties negotiated provisions of the form set out in clauses 7.10 and 7.14 of the Standard Shipper Contract proposed by DBNGPT, which these shippers clearly thought reasonable at the time of negotiation of these amendments in late 2004.
- (i) Furthermore, in paragraph 414 of the Draft Decision, the ERA states that "*no party can reasonably oppose the broadening of the gas quality specification for reason of an erosion of current contractual rights*", because "*the ERA is not aware of any gas transmission for the DBNGP that pre-date the 1998 Regulations and have not been subject to renegotiation during or after 1998*". This appears to presume that such renegotiation of transmission contracts should have either automatically resulted in revision of the gas specification to the Broadest Specification or that the parties' contractual and commercial rights should be foregone. In the case of CSBP's transmission contracts, there was no commercial incentive (rather the reverse) to move to the Broadest Specification at the time of the renegotiation of the contracts with DBNGPT in 2004.
- (j) CSBP is not aware of the ERA having carried out a detailed investigation of the benefits, risks and costs of the change it is proposing. In CSBP's view, the ERA has not properly performed its duties (and does not have a valid basis for its view expressed in paragraph 426 of the Draft Decision) unless and until it has carried out this analysis and can weigh the actual direct and indirect benefits against the actual direct and indirect risks and costs (to shippers, DBNGPT, the wider public (including electricity customers put at risk of power cuts due to lower pipeline capacity) and the reputation of the State) and has given proper weight to the relevant factors.
- (k) The ERA states that the fact that the gas quality specification has not been widened to date may be due in part to the fact that there are a number of parties that will need to be party to negotiations and that have differing interests in a widening of the gas specifications. CSBP submits, based on economic rationale, that if the commercial and economic justification for a widening of the specifications existed (ie. if the benefits did in fact outweigh the costs), then these negotiations would already have taken place and a commercial settlement would have been reached. Any action by the ERA to attempt to

“fast track” this process is likely to result in a distortion of what would otherwise occur based on rational economic principles.

- (l) Furthermore, although the ERA contends that Draft Decision Amendment 15 simply removes a perceived barrier which currently prevents affected parties reaching a negotiated outcome, the decision could in fact force a broadening of the gas specification with no commercial negotiations taking place. There is evidence to suggest that gas producers have or will require their customers, both existing and prospective, to accept gas at the gas quality specification adopted by the ERA in the DBNGP Access Arrangement regardless of the specification agreed by shippers and DBNGPT. The ERA’s Draft Decision Amendment 15, if implemented, would give the gas producers a commercial advantage and the ability to avoid a negotiated outcome.
  - (m) In CSBP’s view, there is a real risk that Draft Decision Amendment 15 may place DBNGPT in a position where it will be in breach of contractual commitments – it will be in a position where it needs to choose which contractual commitment it breaches (ie. the obligation to take broader specification gas at an inlet point or the obligation not to supply out of specification gas at an outlet point under an existing contract). This is a position that CSBP as a customer does not wish its supplier to be placed in. In CSBP’s view it is entirely inappropriate for the ERA to possibly erode existing contractual interests by requiring DBNGPT to enter into contracts which may result in DBNGPT being unable to comply with existing contractual commitments to other shippers.
  - (n) Further, CSBP is concerned that Draft Decision Amendment 15 will not only give shippers a right to broader specifications under new Standard Shipper Contracts, but may also adversely affect DBNGPT’s rights under clauses similar to clauses 7.10 and 7.14 of the Standard Shipper Contract which appear in existing shipper contracts. In CSBP’s view, it is not the role of a Relevant Regulator in exercising powers and performing duties under the Code to affect existing contractual interests of shippers and the pipeline owner in this manner without adequate compensation to those adversely affected. In CSBP’s view, this form of regulatory intervention is likely to adversely affect the view of risk relating to investments in regulated assets in the State of Western Australia.
- 1.3 On this basis, CSBP submits that Draft Decision Amendment 15 is inappropriate and that the provisions in the Standard Shipper Contract proposed by DBNGPT in its proposed revised Access Arrangement should instead apply as these provisions adequately address the interests of all relevant parties in relation to the issue of gas specifications.

## **2. Rebatable Revenue**

- 2.1 In CSBP’s Initial Submission, CSBP made a submission that “penalty revenue”<sup>2</sup> should be rebated to shippers (Section 5 of CSBP’s Initial Submission). The ERA has not required DBNGPT to adopt a rebatable revenue scheme. Without prejudice to CSBP’s rights to make submissions in the future on the issue of rebatable revenue in relation to any revisions or access arrangements proposed from time to time, CSBP does not propose to press these concerns further at this stage.

## **3. Incentive Mechanisms**

- 3.1 In CSBP’s Initial Submission, CSBP made the following submissions:

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<sup>2</sup> That is, all overrun charges, imbalance charges, peaking charges and nomination surcharges derived under capacity contracts and in excess of the costs incurred as a result of the matters giving rise to those charges.

- (a) the Operator should share the relevant cost savings as referred to in the incentive mechanism with shippers during the 2011-2015 period (paragraph 3.5 of CSBP's Initial Submission);
- (b) the Operator should be allowed to carry forward only those cost savings which continue to be realised; (paragraph 3.3 of CSBP's Initial Submission) and
- (c) as the allocation of costs between services may be determined on a different basis in future access arrangement periods, the incentive mechanism should be amended so as to make it clear that only that portion of the relevant cost savings that relates to that portion of the Total Revenue used to derive the relevant Reference Tariff for a particular Reference Service may be added to the relevant Total Revenue figure when deriving such Reference Tariff (paragraph 3.8 of CSBP's Initial Submission).

CSBP submits that unless the amendments in paragraphs (b) and (c) above are made, the Operator is receiving a commercial benefit that is not commensurate with the actual costs savings at the expense of shippers.

3.2 CSBP submits that these changes should be made to the proposed revised access arrangement.

#### **4. Fixed Principles**

4.1 The third fixed principle proposed by DBNGPT operates to prevent the ERA from taking into account any revenue that may be earned in excess of the revenue that would have been earned had the services been sold for the T1 Reference Tariff. The ERA in its Draft Decision states that the third fixed principle proposed by DBGNPT is acceptable. Accordingly, the ERA rejects (implicitly, not expressly) a number of CSBP's submissions in relation to the third fixed principle, including that the third fixed principle ought to have a "flip side". That is, CSBP submitted that, in order to operate fairly, the third fixed principle should also preclude the ERA from taking into account the fact that the Operator may receive lower revenues than the revenues it would have received had the services been sold for the T1 Reference Service Tariff (paragraph 6.5 of CSBP's Initial Submission). This is consistent with section 2.50 of the Code which indicates that nothing in an Access Arrangement except for the Queuing Policy limits the terms and conditions (including tariffs) that can be agreed between a Service Producer and a User or Prospective User. Obviously, it was and is open for the Operator to negotiate higher tariffs with some Users and lower tariffs with other Users. CSBP submits that, for the third fixed principle to operate fairly, any shortfall between the revenue actually earned and the revenue that would have been earned had the services been sold for the T1 Reference Tariff should be disregarded, in the same manner as any excess of the revenue actually earned over the revenue that would have been earned had the services been sold for the T1 Reference Tariff will be disregarded.

4.2 CSBP submits that the third fixed principle in the proposed revised access arrangement should be amended in this manner.

Please let me know if you require clarification of any matters raised in this submission.

Yours sincerely,

CSBP Limited



Ian Hansen

General Manager – Chemicals