

13 December 1999

Mr. Mike Jansen
Office of Gas Access Regulation
Level 6, Governor Stirling Tower
197 Georges Terrace
PERTH WA 6000

Dear Mr Jansen

PROPOSED TUBRIDGI PIPELINE SYSTEM ACCESS ARRANGEMENT

I am writing to you as Operator of the Griffin Joint Venture. We wish to respond to OffGAR's invitation to comment on the proposed Access Arrangement and Access Arrangement Information for the Tubridgi Pipeline System ("Proposed Arrangement").

We have considered the issues addressed in the Issues Paper dated October 1999 issued by OffGAR to assist with submissions on the Proposed Arrangement. We wish to offer comments on a small number of the issues highlighted by OffGAR. In order to assist you in reviewing the submission we have addressed the issues in the order they appear in the Issues Paper. The bracketed numbers refer to the section numbers in the Issues Paper.

1. **Reference Services (3.1(a)):** The proposed Reference Service consists of a forwardhaul service. We understand that there may be a market for a backhaul service. Given the small number of parties that comprise the total market, we suggest that a reasonable interpretation of the requirement in 3.2(a)(ii) that the Proposed Arrangement should include this service.
2. **Terms and Conditions Other Than Price (3.5):**
 - a) The General Terms and Conditions relating to Capacity Management (Clause 3) and Overrun charges (Clause 4) appear to be onerous. In particular, the proposal to reset the Pipeline User's MDQ in the case where MDQ is exceeded is, particularly in the absence of any gas balancing service, unreasonably harsh.
 - b) We note that the Pipeline User is required to provide continuous and instantaneous Metering Equipment at each Receipt Point (Clause 5.1) and provide remote access to this equipment (Clause 5.2). Similarly the Service Provider is required to provide continuous and

instantaneous measurement at the User Delivery Point (Clause 6.1). This being the case, the proposal to provide this information with the invoice each month is restrictive as, in the absence of at least the end of Gas Day custody quantity, it restricts Pipeline Users' ability to deal with the gas. We submit that the Reference Service should give Pipeline Users access to this information daily and as close to the end of the Gas Day as possible. In addition the Reference Service should provide for Pipeline Users to be given remote access to the measurements and readings taken at the Delivery Point Meters.

3. ***Initial Capital Base (3.7(a))***: The calculation of the Initial Capital Base is based on a DORC methodology with little consideration given to other approaches outlined in section 8.10 of the Code.
 - a) The Code specifically requires that for an existing pipeline the service Provider consider the "...accumulated depreciation for those assets charged to Users (or thought to be charged to Users) prior to the commencement of the code" (8.10(a)) and "...the basis on which Tariffs have been (or appear to have been) set in the past, the economic depreciation of the Covered Pipeline, and the historical returns to the Service Provider from the Covered Pipeline" (8.10(f)). As the pipeline system was built for the Tubridgi and Griffin fields, both of which had a relatively short life compared with the potential physical life of the pipeline it is appropriate for the Proposed Arrangement to consider past charges to existing users. The owners and financiers of pipeline system will have required a revenue stream consistent with the projected life of the Griffin and Tubridgi gas fields at the time they were commissioned. The Service Provider appears to have calculated the Initial Capital Base assuming an economic life of 80 years. There is no indication that past charges have been considered in this calculation. The Regulator should be satisfied that value of past charges to users is appropriately incorporated into the calculation of the Initial Capital Base.
 - b) The Initial Capital Base of \$22.7 million based on DORC valuation appears to be excessive. The assumption of an 80 year economic life is not justified in the circumstances. We would expect an economic life closer to the expected life of these fields plus some allowance for potential development in the region (as identified in submissions, including the Griffin Parties' submission regarding the application for revocation of coverage of the Tubridgi Pipeline). We would expect an economic life of between 15 and 20 years. The choice of such a long economic life and the resulting high Initial Capital Base means that the annual amount included as return on capital base used in the calculation of total revenue requirement is excessive.
 - c) The information provided is insufficient to determine the validity of the DAC valuation. The Regulator should seek sufficient information to enable it to form the view that the DAC valuation is the actual cost of the pipeline.
 - d) The information provided is insufficient to justify the use of the current system capacity as the optimised system capacity for the purpose of the DORC valuation. While there is scope for growth in the usage of the pipeline, (as reflected in the NCC recommendation and the determination of the WA Minister) the unused capacity in the system is substantial. The present system does not, in our opinion, represent an optimised system. The forecast used in determining the revenue requirement shows significant and increasing unutilised capacity will

exist in the system. We would therefore expect the DORC valuation to be significantly lower than the DAC valuation.

- e) The choice of DORC based on an 80 year life and without adequate consideration of the historical returns on the pipeline means that the Users will be charged against capital on which the Service Provider has already made some return. In the circumstances we submit that the Regulator should not form the view that the proposed Arrangement complies with the Reference Tariff Principles described in section 8 of the Code.
4. **Regulatory Rate of Return (3.7(b)):** We note that the WACC of 8.75% used in the calculation is high compared to others and in particular the ORG/ACCC estimate of a WACC of 7.75% for the Victorian Gas Distributors.
5. Economic Depreciation of Assets (Return of Capital) (3.7(e)):
- a) The use of accelerated Depreciation based on 15-20 year asset life for the determination of total revenue requirement is, in our view, a realistic timeframe. However, this is not consistent with the assumptions used to determine the Initial Capital Base. The assumption of an 80 year life to arrive at an initial capital base of \$22.7 million at the beginning of the Access Arrangement Period increases the return on capital required during the Period. The use of accelerated depreciation within the Access Arrangement Period increases the depreciation component of the revenue requirement. In combination these assumption have the effect of unnecessarily increasing the revenue requirement.
 - b) The depreciation methodology should be explained, particularly as depreciation schedule shows depreciation amounts continually increasing in nominal terms over the access period. The Regulator should require a consistent treatment of depreciation, and require that the Service Provider use an industry accepted depreciation methodology.
6. **Methodology for Determining Total Revenue (3.7(g)):** The use of the cost of service methodology is acceptable provided the various components are based on the application of consistent and reasonable principles in determining the cost. We have shown that there are inconsistencies between the methodology used to calculate the Initial Capital Base and hence the revenue required to provide a return on capital base, and the accelerated depreciation schedule over the Access Arrangement Period. This inconsistency tends to increase the revenue requirement and hence the tariff. The Regulator must be satisfied that this total revenue reasonably represents the cost of providing the service. On the basis of the issues raised above, we do not believe that the Regulator can draw this conclusion.
7. **Information Disclosure (4):** While the Service Provider has referred to the elements required in Attachment A of the Code, the level of information provided does not, in our view allow users to form an opinion as to the compliance with the provisions of the Code. As noted above, in many key areas, we believe the Regulator would be unable to conclude that the level of information is provided sufficient to justify the choices made by the Service Provider.

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In view of the concerns listed above, we submit that the Regulator should conclude that the Proposed Arrangement does not fully satisfy the principles set out in sections 3.1 to 3.20 of the Code. We therefore submit that the Regulator should not approve Proposed Arrangement as submitted.

Yours sincerely

W. R. MCHOLICK
VICE PRESIDENT AUSTRALIAN OPERATED
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