DBNGP - Trouble In The Pipeline

Epic Energy has claimed victory in the first stage of its legal action that challenges the draft regulatory decision of Dr Ken Michael, the Western Australian independent Gas Access Regulator (OffGAR), on the Dampier to Bunbury Natural Gas Pipeline (DBNGP).

On August 29th 2001, the West Australian Supreme Court ruled Epic has an arguable case against the Regulator's draft decision. The action will now be referred to a full court hearing in the Supreme Court, where Epic will seek to have OffGAR's decision quashed.

Epic Energy's General Manager of Corporate Services, David Williams, said, "Epic Energy is arguing that the Regulator erred at law in his draft decision by failing to balance the various interests he is required to, including the service provider and potential users."

The 1,530 km DPNGP supplies around 200,000 TJ of natural gas to industrial, commercial, rural and residential customers of Western Australia every year. Epic purchased the pipeline from the West Australian State government in 1998 for A$2.407 billion. Their bid was based on tariffs of $1/GJ to Perth and $1.08/GJ to the south of Perth.

But the draft decision, issued by OffGAR on June 21st 2001, recommended transportation tariffs of 75c/GJ to Perth and 85c/GJ to the south of Perth. The regulator determined the tariffs through a complicated, but standard economic model that considers a number of elements, including the initial capital base value of the pipeline, which is usually between the depreciated actual cost (DAC) and the depreciated optimised replacement cost (DORC).

The regulator's decision valued the DBNGP at between approximately A$1 billion (DAC) and A$1.2 billion (DORC), resulting in the lower-than-expected tariffs that, if enforced, will see Epic recover only half the price they paid for the pipeline, throughout its economic life.

Epic's preferred tariffs were not made explicit in a legal contract with the government, but they argue that an understanding, known as a regulatory compact, exists between the two parties. This agreement was never in writing, despite there being extensive uncertainty surrounding new policies and procedures being drawn up to cover all natural gas pipelines in Australia.

At the time the pipeline deal was under negotiation, the National Third Party Access Code for Natural Gas Pipeline Systems - the legislation governing gas pipelines in Western Australia - was being developed. The government was preparing to engage a regulator to oversee the application of the Code to gas pipelines

Epic was aware the final decision on tariffs would be made by an independent third party, but argue that they were led to believe the regulatory compact would still apply and maintain they are entitled to the tariffs that were outlined at the time of the sale of the pipeline. Epic argues that they would never have paid so much for the DBNGP if they did not believe the tariffs set out in their bid would apply.

The Epic point-of-view is that the tariffs recommended in the draft regulatory decision contravene the understanding between Epic and the government to an extent that could have serious consequences for Epic Energy's financial viability.

Epic Energy's Chief Executive Officer, Sue Ortenstone, said that OffGAR's proposed pricing structure may seem attractive but, if implemented, it would create a barrier to competition for new entrants who may be forced to pay more for incremental capacity in the pipeline than existing customers.

She said that Epic's proposed rates were non-discriminatory and applied to all potential and existing customers. Epic's pricing structure also had limits placed on future escalation, continuing real reductions in gas transportation tariffs over time.

According to Epic, a new customer requiring a 50 TJ/day load in Perth, such as a new 280 MW combined cycle power station, would need a tariff of at least $1.32/GJ, compared to the Regulator's proposed 75c/GJ. This situation would make it difficult for new entrants to compete in areas such as power generation.

If the draft decision is implemented, Epic maintains it would no longer be bound by any commitments to expand the capacity of the pipeline by $800 million over the next ten years, and any future projects, such as an extension of the DBNGP into Albany or Esperance would be placed at risk.

Epic is also arguing that the lower tariffs would be a dis-incentive to invest in pipelines. Ortenstone said a move to ensure lower short-term tariffs to existing customers at the expense of future, longer term, pricing policies would also discourage infrastructure investment in Western Australia.

"One of the issues associated with the California energy crisis can be attributed to a lack of infrastructure development", she said. Ortenstone said that consumers would see little, if any, direct benefit from the lower tariff. Epic has reduced tariffs by more than 20% since purchasing the pipeline in 1998, with tariffs to Perth falling from $1.18/GJ to $1/GJ but, to date, residential customers have not seen any of these savings. Customers using the pipeline, including Alinta Gas, which was privatised after negotiations for the sale of the pipeline occurred, enjoy the benefits of lower tariffs, which boost share value.

Epic's legal action, filed in the Supreme Court, will challenge the Regulator's draft decision on six points that essentially argue that the regulator made a decision that no reasonable regulator would make.

"We believe the Regulator, in his draft decision, has failed to take into account the vested interests of all parties, particularly the service provider and potential users", Ortenstone said.

Standing charges, service charges and consultants used by OffGAR in the regulatory process have so far cost Epic in the region of $2 million, under the requirement that pipeline companies fund the costs associated with running the Regulators office. Epic said this had had a major economic impact on the company's financial position and ability to grow its business in the State.

Epic's Bids for the DBNGP

The Liberal State Government conducted a competitive bid sales process which sought to achieve three public policy objectives:

- a reduction in transportation tariff to around $1/GJ to Perth from the 1997 rate of $1.27;
- the maximum sustainable sales price for the pipeline; and
- a commitment to expand the capacity of the pipeline.

Epic Energy made two alternative bids for the purchase of the DBNGP. The successful $2.407 billion bid was based on a tariff price of $1/GJ to Perth, meeting the government's objectives, and $1.08/GJ to the south of Perth. The second bid was based on a lower tariff of less than $1/GJ, with an associated lower sales price. Neither of these rates incorporated an attempt to recover the $2.4 billion purchase price.

The State Government selected the higher tariff, higher sales price bid as their preferred option.

The economic benefits of the current situation are twofold for the government; in addition to a premium purchase price, government utilities such as Western Power now benefit from lower costs associated with using the pipeline.

However, without proof that a regulatory compact exists between the concerned parties, the Regulator has followed the Code requirements in making his draft decision. A decision that, if finalised, could lead to a stagnation of gas transportation infrastructure in Western Australia.

Epic is seeking an early decision on the issue, with the case set to be heard in the Supreme Court in November 2001.