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Anaconda

Anaconda Response to GGT submission on Offgar Draft Decision

1. That the price of delivered gas is independent of geographical location or specific pipeline design.

i) A pipeline supplying a smaller market place will probably not enjoy the economics of scale of a pipeline servicing a larger market. However it has probably been developed at a lower capital cost, and faces less competitive risk. The economics of scale issues varied are already reflected in the regulated tariff to Kalgoorlie of about $2.00 versus the regulated tariff for a pipeline that enjoys economics of scale, the DBNGP, where tariffs have recently been assessed at approximately $0.75 for a similar distance.

ii) We would be prepared to acknowledge aspects of this argument if there were some attempts to quantify the cost penalty. It should be noted that the majority of gas in the GGT is delivered to the lower third of the line, and well beyond its telescoping from 400mm to 350mm.

Any cost penalties associated with this issue have clearly already been built into the tariffs through operating and capital cost considerations.

iii) The tariffs were initially structured to achieve a price slightly less than the alternative diesel cost. That does not make the pricing correct or fair and reasonable.

We would be interested in the view of the State Government about "stepping in" to the process. We understand that they sponsored and facilitated the development of this pipeline. Indeed we understand the reverse is true – there were a substantial number of tenderers who were not afforded a level playing field as the Mine owners, some of whom were also the owners of the gas resource, would not contemplate third party ownership. As it turned out this decision was correct as it allowed the receipt of Federal Government Infrastructure Bonds, in turn providing substantial extraordinary profits to the proponents, which have never been brought to account in conjunction with the tariffs.

We have more detail in the main body of our document about the spurious argument on the additional capital cost incurred by the owners at the Government's insistence. it is well accepted in the pipeline industry that a pipeline should be designed for free flow capacity for the initial throughput. the GGT was initially designed with two initial compression stations. Murrin Murrin, as the next major user, was put under significant financial pressure to assist with the next compressor station, only averted through the agreed reduction in capacity booking by the initial sponsors.

That third compressor has since been built, with some pressure on Anaconda to assist the fourth. Whilst it suited the then sponsors, and the new owners, to claim financial distress as a result of Government demands, it would assist the public's assessment of this issue if there was more information about how the line would have been constructed and the associated capital operating and tariff structures.

More importantly we note that the existing consortium owning the pipeline (with the probable exception of Duke Energy) had the choice of offering a lower amount of money. The issue as to pipeline size should not be a concern to the new owners, other than that they should be grateful that it has suitable capacity.

We note that there is much made of the initial increased capital cost as a result of the Government's demands, but little made of the reduced operating costs associated with the better flow through.

Load Side

We agree with the GGT's position that "until both of these determinants are known, any resulting new tariffs can only be estimated". However the level of accuracy in that estimation is extremely high.

We have already addressed the GGT's Economic Development Tariff approach. To lead to the conclusion that gas demand in the Goldfields is highly price inelastic is, at best, self serving. A gold or nickel mine will consume energy near the orebody. The economics of metal production will always outweigh the economics of energy consumption.

The equation is not inelastic. We note that the Granny Smith and Sunrise Dam gold mines near Laverton, even after combining forces, have chosen diesel powered generation over gas.

2. Loading – The relative impact of the transportation component in the delivered cost of gas.

The relative impact of the transportation component in the delivered cost of gas versus the total cashflow of the corporate customer is an irrelevant indicator.

We have some sympathies for domestic consumers, but do not pretend to understand the economics of reticulation and note that the issue has no great import on the overall tariff economics.

3. That reducing the cost of transporting gas will have any significant effect on the development of new business.

We accept that offering to transport gas for free is not a commercially viable option.

However Anaconda totally rejects the assumption that there are no new projects on any scale for which the cost of gas transportation is a critical determinant of viability. We will acknowledge that our proposed new nickel projects are less dependant on gas price as they are on perhaps capital cost, or delivered sulphur prices. However, that is no excuse for high tariffs, and gas prices remain an important component of every project's overall viability.

Further, Anaconda has studied non metal projects which are extremely sensitive to gas prices, such as the Mt Weld Phosphate Project where gas prices are approximately 20% of the overall cost. The Mt Weld Phosphate Project requires an ammonia plant where 95% of the operating costs are gas. We have then considered increasing the ammonia plant capacity to allow production of ammonium nitrate, sodium cyanide and urea, all of which show positive returns – subject to gas price.

Indeed ICI (now Orica) had considered a cyanide plant in Kalgoorlie but were unable to achieve sensible gas prices. The opportunity was lost.

4. That the mandating of reductions in tariffs on the GGP will be conducive to development of other business or serve to promote economic prosperity.

It is noted that the new GGT owners acquired the asset in 1999 at a time when Western Australia's regulatory process was well in train. It is difficult to have sympathies with their arguments which we would suggest are best addressed directly to the State Government rather than through Offgar anyway.

None the less, we note the Goldfields Gas Pipeline Agreement Act 1994 requires the Joint Venturers to "… incorporate tariffs that are fair and reasonable". The Draft Decision by Offgar provides for tariffs that provide a premium rate of return relative to other pipelines in Australia with a larger customer base. It is difficult to argue that that is not a fair and reasonable approach.

5. That any significant reduction of tariffs and hence revenue to GGT is economically sustainable.

We note that there were economic justifications other than revenue for the investment that have not been taken into account by the regulator. These include:-

- Alternative cost of fuel
- Development of East Spar Gas Field
- Infrastructure Bonds

The Pipeline clearly was not built on the basis of the revenue stream, as the revenue stream initially agreed provided for a rate of return substantially higher than any other Pipeline in Australia and probably the rest of the developed world.

The revenue stream was more a function of what the Joint Venturers could “get away with” at that point in time.

Conclusion

If logic can be fallacious we expect it results in the outcome that the tariff reductions are more likely to result in a stifled investment and sustained economic downturn.

Regional resources such as gold, or nickel from nickel sulphides, may well still be developed virtually regardless of energy costs. Many other regional resources, such as the Mt Weld Phosphate Project, will be particularly sensitive to gas costs. Anaconda is also considering means of extracting magnesium from its tailing streams in an opportunity particularly sensitive to energy costs.

We do not see how the Regulator is expected to re-evaluate the basis upon which he has formed his initial view which, in our detailed response tot the Draft Decision, we suggest continues to err on the side of generosity to the GGT JV owners. The Regulator’s role is to set tariffs in accordance with the National Gas Access Code provisions as adapted for Western Australia.