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MINARA RESOURCES

29th May 2009

Goldfields Gas Pipeline, Gas Access
Economic Regulation Authority
PO Box 8469
Perth BC WA 6849

Via email: ggp@era.wa.gov.au

Re: Goldfields Gas Pipeline Proposed Revisions to Access Arrangement

Dear Sir

We attach a review of the proposed revisions to the Goldfields Gas Pipeline Access Arrangement prepared at our request. The review raises significant concerns regarding the content of the proposed Access Arrangement revisions and the implications for third party access.

Indeed, as a third party user of the Goldfields Gas Pipeline we are concerned that, if the methodology proposed and the amendments put forward to the Goldfields Gas Pipeline Access Arrangement are adopted, the regulatory process will cease to have value to third party and prospective third party users of the Goldfields Gas Pipeline.

We already have reason to be concerned that, as third party users of the Goldfields Gas Pipeline, we are worse off today than we would have been if the Goldfields Gas Pipeline Agreement Act were still to govern third party access to the pipeline. We expect to receive an analysis of that scenario shortly.

We commend the attached report to you and look forward to the opportunity to consider the Authority's draft decision concerning this matter.

Yours faithfully

Mark Dominy
Acting Supply and Logistics Manager
Murrin Murrin Operations Pty Ltd

Review of Proposed Revisions to Goldfields Gas Pipeline Access Arrangement and Access Arrangement Information

Prepared for

Apex Minerals NL
Jabiru Metals Limited
Murrin Murrin Operations Pty Ltd
St Barbara Limited
Xstrata Nickel Australasia Pty Ltd

by

Project Consultancy Services Pty Limited

May 2009

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Review of Proposed Revisions to Goldfields Gas Pipeline Access Arrangement and Access Arrangement Information

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Review of Proposed Revisions to Goldfields Gas Pipeline Access Arrangement and Access Arrangement Information

1. BACKGROUND

On 23 March 2009, Goldfields Gas Transmission Pty Ltd (**GGT**) submitted proposed revisions to the access arrangement for the Goldfields Gas Pipeline (**GGP**) for approval under the National Third Party Access Code for Natural Gas Pipeline Systems (the **Code**). On 21 April 2009, GGT provided a public version of further supporting information which was released by the Economic Regulation Authority (**ERA**) with its Goldfields Gas Pipeline - Issues Paper on the Proposed Revisions to the Access Arrangement.

The GGP consists of the gas pipeline system as described by the Western Australian Pipeline Licence WA: PL 24. The pipeline system comprises 1378 km of high pressure gas pipeline extending from Yarraloola in the Pilbara region of Western Australia to Kalgoorlie in the Eastern Goldfields. The GGP is interconnected with the Dampier to Bunbury Natural Gas Pipeline (**DBNGP**) and receives gas both from the DBNGP and directly from the Varanus Island gas processing facilities.

We understand that the Code is expected to be replaced by a new national gas law (**NGL**) but that, given the NGL is not yet law, the ERA expects to deal with proposed access arrangement revisions under the Code until there are future revisions to that access arrangement.

Project Consultancy Services Pty Ltd has been asked by a number of its clients to review the proposed GGP access arrangement revisions and to prepare a critique of major concerns therewith. Those clients include:

- Apex Minerals NL, the owner and operator of the Wiluna gold mine and a User of the GGP;
- Jabiru Metals Limited, the owner and operator of the Jaguar copper mine and a User of the GGP;
- Murrin Murrin Operations Pty Ltd, the manager and operator of the Murrin Murrin nickel mine and a User of the GGP;
- St Barbara Limited, the owner and operator of the Gwalia gold mine and a User of the GGP; and
- Xstrata Nickel Australasia, the owner and operator of the Cosmos and Sinclair nickel mines and a User of the GGP.

Together these entities account for a significant proportion of the capacity of the GGP and for a major portion of the use of the GGP by third parties.

It is not the purpose of the review to examine the minutiae of the proposed GGP access arrangement revisions but to focus on the more important concerns of third party users of the GGP.

2. DATA PROVIDED

The data used to prepare this submission include the:

- Proposed Revisions to Access Arrangement 23 March 2009;
- Appendix 1 Definitions and Interpretation - Proposed Revisions to Access Arrangement:
- Appendix 2 Forms - Proposed Revisions to Access Arrangement;
- Appendix 3 General Terms and Conditions;
- Access Arrangement Information 23 March 2009;
- Regulatory Tariff Model 21 April 2009; and
- Goldfields Gas Transmission Pty Ltd Letter - Goldfields Gas Pipeline Proposed Revised Access Arrangements.

Less emphasis has been given to the Supporting Information to Proposed Revised Access Arrangement 21 April 2009, including:

- Attachment 1 Proposed Inflation Forecast - Synergies Economic Consulting Pty Ltd March 2009;

- Attachment 2 Proposed Cost of Debt - Synergies Economic Consulting Pty Ltd March 2009;
- Attachment 3 Ongoing Debt and Equity Raising Costs - Synergies Economic Consulting Pty Ltd March 2009;
- Attachment 4 Equity Beta Analysis - Synergies Economic Consulting Pty Ltd March 2009; and
- Attachment 5 Asymmetric Risk - The Importance of Recognition and Compensation - Synergies Economic Consulting Pty Ltd March 2009,

as it is not intended that these documents form part of the Access Arrangement Information

2.1 Key Issues

2.2 Services and Regulated Services

2.2.1 Stapled Services

The only Reference Service which is currently offered, or proposed to be offered under the revised Access Arrangement, by GGT, is a Firm Service. However the GGT service agreement provides that any User with a firm service agreement is entitled to certain services which are stapled to the Firm Services Agreement, namely:

- an Authorised Overrun Service;
- an Authorised Over-delivery Service;
- an Authorised Imbalance Service; and
- by implication, a suite of Unauthorised Services.

Some or all of these services will be, at some time and in some cases quite often, requested and relied upon by all Users of the GGP. However, the proposed Access Arrangement revisions do not suggest that the services stapled to the Firm Service Agreement are Reference Services and nor does the revised Access Arrangement:

- allocate a share of GGP costs to these stapled services;

- set out a tariff setting method for these services;
- set out a Reference Tariff for these services; or
- how revenue from these services will be treated when setting the Reference Tariff.

In considering the Access Arrangement revisions the ERA should consider and clarify the status and appropriate treatment of these stapled services under the Code.

2.2.2 Negotiated Services

The ERA contends that the capacity of the GGP described by GGT as "covered capacity" is used to provide Negotiated Service and Reference Services. The ERA asserts further that "(T)he balance of covered capacity is for negotiated services" whatever that is to be taken to mean under the Code. Further, the Service Agreement submitted by GGT contends it (the Service Agreement) relates only to the Reference Services and would appear not to apply to Negotiated Services.

The ERA position is worrying in that it suggests that GGP capacity which forms part of the covered pipeline (whether that is 108 tJ per day or 167 tJ per day) may not be captured under the umbrella of the Access Arrangement since, in GGT's language, Negotiated Services are not subject to the Service/Access Arrangement.

More worrying is the fact that the GGP is defined by GGT as comprising three separate pipelines in one, namely;

- covered Firm Service capacity;
- covered Negotiated Service capacity; and
- uncovered Negotiated Service capacity.

Three pipelines and one cost base. This characterisation of the GGP raises substantial uncertainty regarding:

- the status of Negotiated Services (whether provided using covered or uncovered GGP capacity) vis-à-vis the Reference Service and the Code;

- the terms on which Negotiated Services are offered (the treatment of Negotiated Services by GGT is not necessarily consistent with the treatment set out in the Access Arrangement);
- the allocation of GGP costs between Reference Services and Negotiated Services; and, or
- the method whereby revenue from these services will be treated when setting the Reference Tariff.

In considering the Access Arrangement revisions, the ERA should consider and clarify the status and appropriate treatment of Negotiated Services under the Access Arrangement and the Code.

2.2.3 Interruptible Service

With recent trends to:

- increased liquidity in the Western Australian gas market; and
- increased capacity utilisation/load factors on the GGP,

Users of the GGP will be required to, or plan to, exploit gas market liquidity to optimise their gas procurement arrangements. In these circumstances there is a prima facie case that the Interruptible Service for GGP capacity should be defined as a Reference Service.

In considering the Access Arrangement revisions the ERA should consider wether the Interruptible Service for GGP capacity should be a Reference Service and or whether:

- a share of GGP costs should be allocated to Interruptible Services; or
- revenues from Interruptible Services should be brought to account when setting the Reference Tariff for the Firm Service..

2.3 Capacity and Regulated Capacity

The ERA indicates that the capacity of the GGP after the current capacity expansion will be in the order of 167 tJ per day. However, GGT suggest that only 108 tJ per day of this capacity is actually subject to regulation and that only 4.12 tJ of that regulated capacity is currently available to offer to third paries.

In the previous regulatory review of the GGP the ERA cites evidence which suggests that, as a minimum, nearly 80% of the "regulated" 108 tJ per day of capacity is contracted under long term contracts through until 2013/16. However, in the previous access review growth under "existing contracts" was expected by ACIL to increase by 30 tJ per day meaning that, on the limited information publicly available 100% of the purported 108 tJ per day of regulated capacity of the GGP may be locked into contracts controlled by the owners of the GGP.

The ERA implies that the GGT assessment of regulated capacity of the GGP is apparently validly based upon GGT's right to elect to exclude capacity expansions from regulation.

2.3.1 Narrowing the Focus of the Access Arrangement

The GGT approach of proposing that the amended Access Arrangement applies only to 4 tJ of GGP capacity raises questions regarding the application of the Code and revised Access Arrangement to all of the covered capacity of the GGP (irrespective of whether the covered capacity is determined to be 108 tJ per day, 167 tJ per day or any other measure of capacity). The Code clearly requires that the regulatory process applies to the whole of the covered pipeline and does not contemplate that the covered pipeline will be broken up into multiple independent elements and each different element will subject to access regulation at different times.

Approval of an Access Arrangement that applies to only 4 tJ of GGP capacity will simply confuse, frustrate and diminish the regulatory process.

This whole problem of narrowing the scope of regulation is problematic when ACIL's advice that growth under "existing contracts" is expected to rise substantially over time. Depending on the term and ownership of these contracts it is very easy to contemplate a situation where capacity "committed" to the owners of the GGP represents all of the regulated capacity of the GGP and third parties are left to deal with unregulated capacity. This is a most interesting outcome to contemplate for a third party access regime.

2.3.2 The Value of Regulation and Relevant Information

If the GGT position on the extent of regulated GGP capacity is accepted by the ERA it will transpire that regulation of third part access to the capacity of the GGP will be marginalised. From the Access Arrangement revisions it is impossible to properly quantify the extent of regulated capacity (if any) beyond the current 4 tJ per day tranche that will be available to third party access and when that capacity might become available and offered to the market.

From a third party access perspective this is a retrograde and perverse outcome compared with the position under the Goldfields Gas Pipeline State Agreement where 100% of the capacity of the GGP was subject to third party access regulation.

Indeed, if the GGT position is accepted, there is little value for third parties in there being any regulation of the GGP.

2.3.3 Double Dipping Capacity Expansion Costs

It is the case that the Code permits a Service Provider to elect to exclude expanded capacity from regulation but it is difficult to argue at what point the election contradicts the Reference Tariff Policy. For example when the:

- cost of expanding capacity is included in the Capital Base used for setting the Reference Tariff; and
- Reference Tariff gives a throughput incentive to GGT up to 31 December 2009 and by implication resets the tariff based on actual outcomes at the time of the 2009 access arrangement review.

GGT explicitly included the cost of capacity expansion in the Capital Base under its current Access Arrangement. The ERA suggests that GGT has not proposed to include the cost of current capacity expansions in setting the Reference Tariff under the Access Arrangement revisions. However, the revised Access Arrangement Information provides for an increase in compression capital which would suggest otherwise. In considering the Access Arrangement revisions the ERA should carefully scrutinise the validity of GGT's assertion that there is no provision for capacity expansion in its revised Access Arrangement.

Further, GGT has had the benefit, under its current Access Arrangement and Reference Tariff Policy, of throughput and capacity contracts far greater than those forecast by GGT in its Access Arrangement. The proposed Access Arrangement revisions do not limit these benefits to 31 December 2009 but perpetuate these benefits until such time as GGT elects to surrender them. Clearly this proposition, at least makes a mockery of, and is at worst inconsistent with, GGT's Reference Tariff Policy.

Whilst the Code clearly contemplates that GGT might exclude expanded capacity from regulation that election must clearly be consistent with the Reference Tariff Policy as a whole. The ERA, in considering the Access Arrangement revisions, should consider:

- the validity of the election by GGT to exclude expanded capacity from regulated capacity in the context of GGT's behaviour and its own Reference Tariff Policy; and
- the role of expansion capital from 2006 to 2010 and after 2010 in setting tariffs.

2.3.4 Mechanisms for Releasing Regulated Capacity

Should the ERA accept GGT's proposition that a minimal and diminishing portion of GGP capacity is subject to regulation it is inappropriate for third parties to be blind to:

- the actual extent of that capacity;
- when that capacity will become available to the market; and
- means whereby that capacity will be offered to the market.

For example, in the Access Arrangement revision, GGT purports that 4 tJ of regulated capacity of the GGP is currently available. The question becomes, how is it available and how will the ERA ensure that this capacity is offered to, and placed in, the third party market at the Reference Tariff. More generally, what is the process by which regulated capacity turns over from time to time.

In considering the Access Arrangement revisions the ERA should consider and clarify the process by which regulated GGP capacity is turned over under the Access Arrangement and the Code as pre existing contracts terminate.

2.3.5 Allocation of Costs to Covered and Uncovered Capacity

GGT appears to take its forecast non-capital costs and the GGP's 2006 Capital Base (updated for depreciation and capital expenditure since 2006) and allocates approximately four percent of those costs to the currently available regulated GGP capacity. Putting aside for the moment the question of whether the inclusion of any GGP expansion capital is valid, it is now the case that these costs will service 167 tJ per day of capacity from 2010. Clearly, the allocation of GGP capital and non-capital costs across all pipeline capacity use needs to be carefully scrutinised in the Access Arrangement revisions and allocated across all GGP capacity.

2.4 Reference Tariffs and Reference Tariff Policy

2.4.1 Return On and Of Capital

GGT proposes to increase the return on, and of, capital by nearly 25% in 2010. This increase is largely attributable to GGT's proposed increase in the regulated rate of return. This increase in the regulated rate of return reflects the net outworking of a number of fundamental structural changes in finance markets and in their treatment of pipeline investments described by GGT. Principal among these changes is a substantial shift in the appropriate equity beta, risk free rates of return, risk margins and debt margins.

Whilst it is the case that conditions in finance markets have changed since 2006, it is not clear that key structural relations have changed as suggested by GGT. However, it is inappropriate that all parties motivated to comment on GGT's Access Arrangement revisions should commission reviews of GGT's assessed finance market changes. It is incumbent on the ERA to scrutinise GGT's assessed finance market shifts since 2006 and to reflect the result of that assessment in its draft decision.

2.4.2 Non-capital Costs

Given that GGT's non-capital costs are not disclosed it is difficult to make meaningful comment. However, a simple examination of GGT's annual non-capital costs reveals that these costs rise by 32% in 2010 and vary by between 2.2% and 9.6% annually thereafter. These increases are well above the assumed level of inflation and are difficult to understand since they purportedly apply to a constant 108 tJ of capacity. Whilst these increases may be realistic, it is essential that the assumptions behind these estimates are thoroughly tested.

2.4.3 Allocation of Costs

In any Access Arrangement one of the key Reference Tariff Policy elements is a clear statement of how pipeline capital (historical and prospective) and non-capital costs are shared across each of the Reference Services and between Reference Services and non-reference, or in this case, Negotiated Services. Unfortunately, there does not appear to be such a statement in the proposed GGP Access Arrangement revisions.

It would assist in efforts to evaluate the proposed Access Arrangement revisions if there were a clear statement setting out the total capital and non-capital for the whole of the system used to supply:

- covered Reference Services;
- covered Negotiated Services (if that concept can be shown to have a meaning and purpose under the Code);
- uncovered Negotiated Services; and
- all other unregulated services,

and an allocation of those costs between each of those service groups. Alternatively, if the system costs are all or disproportionately allocated to the Reference Services, a statement of how revenue from the services which are favoured by the cost allocation will be treated under the Reference Tariff Policy is essential.

It is impossible, from the information provided by GGT, to ascertain the extent to which the various GGP services draw on the capital base, or add to the non-capital cost of, the GGP and, or, to determine how GGP costs have been allocated between Reference Services and non-reference services.

2.4.4 Annual or Quarterly Modelling

The proposed move from quarterly modelling to annual modelling will deliver a one-off windfall gain to GGT unless a specific correction is made to offset that windfall gain.

That is to say, a quarterly cash flow, which is summed and analysed annually, can be expected to understate the implicit rate of return and favour of GGT with a higher Reference Tariff. This result is reflected in the ERA's own assessment of the changed methodology. To adopt an annual approach to modelling GGT's proposed Access Arrangement revisions will deliver a windfall gain/shift to GGT relative to its current Access Arrangement. The change to annual modelling should not be adopted without an explicit correction to offset this windfall gain.

2.4.5 Tariff Variation Method

Whilst interpreting the proposed revised Access Arrangement method for tariff adjustment is difficult, to say the least, it appears to provide that the Reference Tariff will be adjusted:

- quarterly, in line with 100% of the movement in the Consumer Price index; and
- on an ad hoc basis for changes in Imposts (broadly defined); and
- annually in line with 100% of the movement in the Consumer Price index with a turbo charged:
  - 2% booster for no stated reason;
  - "x" factor provision which is set at zero but included because at some time it is anticipated to non-zero; and
  - Regulatory Cost factor (Regulatory Costs are again broadly defined and perhaps included already in Imposts).

This methodology is defined by GGT as a tariff basket price cap methodology.

GGT also proposes that the process of review and approval of Reference Tariff variations, as set out in clauses 8.3B to 8.3H of the Code, no longer apply.

Hopefully it is correct to assume that GGT is not proposing to adjust prices twice in any year. Hopefully also it can be assumed that GGT does not intend to turbo charge its CPI tariff adjustments.

On the basis that the above assumptions are correct, it would seem that the principal purpose of the proposed revised tariff review mechanism is for GGT to recover a swathe of regulatory costs associated with operating the GGP. The difficulty with this proposal is that Users of the GGP become de facto pipeline owners and bear the cost of a wide range of regulatory actions when GGT is the one party able to manage those costs. Further, this proposal would frustrate government policy where it is clearly the intention of that policy to impact upon, and change the behaviour of, a pipeline operator.

This proposed Access Arrangement revision should be rejected because:

- it is not a tariff basket price cap methodology because clearly there is no cap to be seen;
- the costs which GGT seeks to pass on to Users are unbounded and there is no incentive on GGT to mitigate these costs, indeed in some situations it is in GGT's interest to expend vast sums of money to fight regulatory measures;
- Users have no way of mitigating or managing the cost risk introduced by the proposed mechanism;
- it may be a matter of public policy that some of costs included as Regulatory Costs are intended to be borne by the person upon whom they are imposed; and
- the role of the ERA pursuant to clause 8.3 to 8.3H of the Code should not be discontinued.

Should GGT have real concerns in regard to its exposure to regulatory costs perhaps it would be more appropriate that the definition of Imposts be expanded and the process set out in GGT's current Access Arrangement, which calls clause 8.3 to 8.3H of the Code into play, should apply to the recovery of any such costs.

3. TERMS AND CONDITIONS

3.1 Appendix 1

3.1.1 Definition of "Change in Imposts"

Note that this definition has been amended so that it only applies to deliver upward movements in price. It is difficult to justify this change to a one-way upward ratchet I price when the risk of Impost changes is passed on to users of the GGP. Such risk transfer should be symmetrical.

3.1.2 Definition of "Imposts"

This definition overlaps with GGT's proposed tariff variation method. See comments above on tariff variation method.

3.1.3 Definition of "Interest Rate"

This change needs to be justified above and beyond GGT's proposed Capital Base, working capital provision.

3.1.4 Definition of "Regulatory Change Event"

See comments above on tariff variation method.

3.1.5 Item 27 of Enquiry Form

The phrase "[to be Completed by GGT]" has a chicken and egg problem in that the prospective user can not lodge the form without this information.

3.2 Appendix 3

3.2.1 Clause 5

It would assist if these clauses were conformed to GGT's current nomination methods and practices.

3.2.2 Clause 6.4

Base level Outlet Point temperature and pressure levels should be set out in the Terms and Conditions to allow proper planning and design of facilities (See clause 6.3).

3.2.3 Clause 6.6, 6.7 and 11.2

These clauses confuse or contrive to give GGT the exclusive role as provider of Outlet Facilities for Users. The extension of GGT's monopoly position should not be extended by its Terms and Conditions.

3.2.4 Clause 7.5, 9.4 and 9.6

The imposition of a variance charge is extremely concerning to third party users of the GGP. GGT is the beneficiary of a take or take style contract and wishes to penalise users should they incorrectly estimate their gas usage on a day. There are two concerns with the imposition this charge:

- first, users are paying for the right to use capacity, even if they don't use it, and then paying should their forecast use be in error (but below MDQ); and
- user's gas demand is subject to weather conditions, plant availability and a variety of other factors that change from day to day and moment to moment.

If a user of the GGP is paying for the privilege of using GGP capacity (whether it uses the capacity or not) surely there should be no additional charge for inaccuracy of nominations.

The justification of this charge on grounds of "safety and efficiency" by lumping this charge in with other variance charges substantially overstates the case.

3.2.5 Clause 9.8

As with Imposts this clause is proposed to be changed to ratchet up only. Asymmetrical transfer of risk in this manner can not be justified on commercial grounds.

4. COMPARISON WITH STATE AGREEMET REGULATION OF THIRD PARTY ACCESS

Project Consultancy Services Pty Ltd has been asked to prepare a comparison between the current third party tariff structure on the GGP and the tariff structure which might be expected to apply to the GGP under the Goldfields gas pipeline State Agreement Act. Time has not permitted the preparation of this comparison in time for inclusion in this report but further advice will be provided to the participants in this review setting out that comparison shortly.

5. SUMMARY AND CONCLUSION

The proposed GGP Access Arrangement provisions are of concern at three levels, namely because:

- the approach taken to defining covered capacity and third party access rights marginalises third party access;
- the approach taken to defining services is confusing and obfuscates the rights of all GGP users;
- certain specific proposals and the arithmetic content of the proposed revises Access Arrangement and Access Arrangement Information.

Acceptance of the proposed Access Arrangement revisions would act to bring and end to regulated third party access to the GGP.