Public Submission

By BHP Billiton

In Response to the Proposed Revisions to the Goldfields Gas Pipeline Access Arrangement and Access Arrangement Information

30 June 2009

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PART A - INTRODUCTION

1 Background

On 23 March 2009, Goldfields Gas Transmission Pty Ltd (**GGT**) submitted proposed revisions to the access arrangement (**Proposed Access Arrangement**) for the Goldfields Gas Pipeline (**GGP**) for approval under the National Third Party Access Code for Natural Gas Pipeline Systems (**Code**).[1]

On 23 March 2009, GGT provided Supporting Information to the Proposed Access Arrangement (**GGT's Further Supporting Information**) to the Economic Regulation Authority (**Regulator**) which the Regulator released to the public, along with an Issues Paper prepared by the Regulator on the Proposed Access Arrangement, on 22 April 2009.

On 2 April 2009, the Regulator invited submissions from interested parties on the Proposed Access Arrangement, to be submitted by 29 May 2009.[2] On 29 May 2009, BHP Billiton Nickel West Pty Ltd made a submission on the Proposed Access Arrangement, and on 29 May 2009 (confirmed in writing on 2 June 2009) received an extension of time to make a further submission in respect of the Proposed Access Arrangement to 30 June 2009.

2 Introduction

This Submission is made by BHP Billiton (**BHPB**) in relation to the Proposed Access Arrangement and related material including:

(a) the Access Arrangement Information lodged with the Proposed Access Arrangement (**AAI**);

(b) GGT's Further Supporting Information;

(c) the Issues Paper on the Proposed Revisions to the Access Arrangement prepared by the Regulator dated 22 April 2009 (**Issues Paper**); and

(d) the Response to the Issues Paper from Goldfields Gas Transmission Pty Ltd (**GGT**) dated 29 May 2009 (**GGT Response**).

3 Structure

This Submission is structured to focus on the following four areas:

(a) Part A - Introduction

(b) Part B - Coverage

(c) Part C - Reference Tariffs

(d) Part D - Other Issues

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1 Contained in Schedule 2 of the *Gas Pipelines Access (Western Australia) Act 1998* (WA).

2 Economic Regulation Authority, 2 April 2009, "Notice - Revisions to Goldfields Gas Pipeline Access Arrangement and Access Arrangement Information Invitation for Public Submissions"

Unless otherwise defined, words and expressions used in this Submission have the meaning given in the *National Third Party Access Code for Natural Gas Pipeline Systems* contained in Schedule 2 of the *Gas Pipelines Access (Western Australia) Act 1998* (WA) (**Code**).

4 Executive Summary

4.1 Coverage

GGT has indicated in the Proposed Access Arrangement that the Capacity created by future expansions to the GGP is to be treated as "uncovered capacity" and therefore will not fall within the scope of the Proposed Access Arrangement.

BHPB submits that all Capacity that is, or becomes, available on the GGP which is provided by means of the infrastructure comprising the Covered Pipeline should be dealt with under the Access Arrangement on the basis that the Code does not contemplate the concept of "uncovered capacity". While it is possible under the Code to exclude from a Covered Pipeline parts of gas infrastructure forming part of that Pipeline that is capable of providing a Service (subject to clauses 1.9, 1.31 and 1.36 of the Code), BHPB submits that it is not possible to exclude part of the Capacity within that Covered Pipeline.

As a result of the above, and in any event, the Code requires allocation of the Capital Base and other costs between all Services which are provided by means of the Covered Pipeline, including those Services purporting to utilise the "uncovered capacity".

4.2 Reference Tariffs

BHPB submits that the Reference Tariff proposed by GGT in the Proposed Access Arrangement is inflated because:

(a) certain assumptions concerning the current risks facing the GGP and its owners relied on by GGT when determining the Reference Tariff are erroneous. These erroneous assumptions are:

 (i) the effects of the Global Financial Crisis;

 (ii) the increased insolvency risk from smaller mining companies; and

 (iii) the availability of alternative fuels as competition to pipeline access;

(b) the Rate of Return used by GGT when determining the Reference Tariff was inflated due to the use of the following inaccurate parameter values:

 (i) equity beta and asset beta;

 (ii) market risk premium;

 (iii) credit rating;

 (iv) asymmetric risk;

 (v) gamma; and

 (vi) cost of raising debt; and

(c) a number of other inputs in the Reference Tariff calculation need careful consideration.

BHPB submits that the appropriate parameters are as follows:

WACC parameters	GGP 2010 Proposed	Submission
Market Risk Premium	7.00%	5.75%
Equity Beta	1-1.8	0.7
Cost of debt margin	3.60%	3.2%
Cost of raising debt	0.125%-0.3%	0%
Franking credit value (gamma)	20%	50%-65%
WACC	10.7-13.8%	8.2% to 8.4%
Credit Rating	BBB-	BBB+

4.3 Other Issues

BHPB also raises the following objections in relation to the Proposed Access Arrangement:

(a) BHPB has already made a submission to the Regulator regarding its objections to the proposed increase in the minimum gross heating value. In addition, BHPB submits that this proposed increase should be carefully considered in light of the *Gas Supply (Gas Quality Specification) Bill 2009* (WA) which is soon to be released for public comment.

(b) BHPB would request that any of the proposed changes to the General Terms and Conditions that do not have supporting information provided by GGT should be declined unless GGT are able to provide the information substantiating the need for change.

(c) The proposed 3% increase to the interest rate on late payments is unreasonable and unjustified.

(d) The proposed removal of the obligation on GGT to return 95% of the quantity variation charges to the non offending shipper should be declined. This type of charge should not appropriately be revenue to a pipeline operator.

(e) The proposed pass through of all imposts including carbon taxes should be declined. As currently contemplated, BHPB submits that carbon tax is a tax on the asset owner, not the end user, and is aimed as a behaviour modifier for the asset owner. The simplistic pass through contemplated by GGT is inconsistent with the aim of the carbon tax, and in any event may result in double counting through application of the escalation factors. Further work is required on this concept to ensure that GGT remains responsible for the efficient operation of the GGP and motivated to minimise emissions.

(f) The amendments in clauses 6.6, 6.7 and 11.2 of the General Terms and Conditions which provide GGT with the exclusive right to provide Outlet Facilities should be declined. BHPB submits that there is no reasonable justification for GGT to extend its monopoly position.

(g) The proposed amendment in clause 9.8 of the General Terms and Conditions to limit the effect of CPI changes so that reduction is not possible should be declined. BHPB submits there can be no reasonable justification for this amendment.

(h) BHPB submits that there is no justification for the inclusion of other escalation factors in the Reference Tariff calculation other than CPI.

(i) BHPB submits that it does not have an in principle issue with moving to annual modelling. However, BHPB submits that the Regulator should consider the potential impact of this change to ensure that it does not have a negative impact on the Reference Tariff or shippers generally.

PART B - COVERAGE

5 Coverage of Capacity

5.1 Issue

In the Proposed Access Arrangement, GGT has indicated that the Capacity created by future expansions to the GGP will be treated as "uncovered capacity" and therefore not fall within the scope of the Proposed Access Arrangement.

5.2 Summary - BHPB position

BHPB submits that all Capacity that is, or becomes, available on the GGP which utilises the infrastructure comprising the Covered Pipeline (i.e. flows molecules of gas through that pipeline) should be dealt with under the Access Arrangement on the basis that the Code does not contemplate the concept of "uncovered capacity" of the nature proposed to be created by GGT. The Code differentiates between Covered and Uncovered Pipelines but not the covered nature of Capacity within a Covered Pipeline.

While it is possible under the Code to exclude from a Covered Pipeline parts of gas infrastructure forming part of that Pipeline that are capable of providing a Service (subject to clauses 1.9, 1.31 and 1.36 of the Code), it is BHPB's position that it is not possible to exclude part of the Capacity within that Covered Pipeline. Capacity is represented by a service provided by means of a Covered Pipeline.

BHPB's position is that the Regulator is not empowered under the Code to approve the Proposed Access Arrangement in its current form with any differentiation between covered and uncovered Capacity. In relation to the previous compressor expansions of the GGP, it is BHPB's position that they are not properly capable of exclusion and so must be brought back into the Covered Pipeline with consequential effects on the Proposed Access Arrangement and Reference Tariff calculation.

5.3 The object of the Code and Coverage

The objective of the Code is to establish a framework for third party access to gas pipelines that, among other things:

(a) prevents abuse of monopoly power;

(b) promotes a competitive market for natural gas; and

(c) provides rights of access to natural gas pipelines on conditions that are fair and reasonable for both service providers and users.

This objective is achieved by means of the "Coverage" of a Pipeline that meets all of the criteria set out in clause 1.9 of the Code.

One of the criteria is that access (or increased access) to Services provided by means of the Pipeline would promote competition in at least one market other than the market for the Services provided by means of the Pipeline.

This criterion involves an assessment of whether the Service Provider has power in the market for gas transmission which could be used to adversely affect competition in the upstream or downstream markets.

As a result, a Reference Tariff and Reference Tariff Policy is to be designed with a view to achieving the objectives set out in clause 8.1 of the Code, including the replication of the outcome

of a workably competitive market. That is, the objective is to replicate what would be the outcome if there were competition for the transportation of gas by the Pipeline, even though it is the premise of the Code that the Pipeline is in a natural monopoly situation and it would be uneconomic to construct another.

Accordingly, “Coverage” is an expression intended to describe a Pipeline that meets all the criteria in clause 1.9 of the Code; that “Coverage” being necessary to ensure that the operation of the Pipeline, and the Services provided by means of it, replicate a workably competitive market.

5.4 The distinction between Coverage of a Pipeline and Services

It is important to draw a distinction between the Coverage of the Pipeline and the Services provided by means of that Pipeline.

In particular, of fundamental significance in the context of the Proposed Access Arrangement, is the correct application of the principle under the Code that Coverage does not relate to a Service provided by means of a Pipeline or any part of the capacity of a Pipeline; it relates to the Pipeline itself.

In essence, the Pipeline is the facility by means of which various Services are, or can be, provided. A Service is something separate and distinct from a facility such as a Pipeline.

It has been established for some time that one facility may provide a number of different kinds of Services as well as a number of different instances or occasions of the same kind of service.[3] Therefore, more than one Service can be provided by means of a Covered Pipeline, with the terms and conditions upon which each such Service is provided, being determined on a fair and reasonable basis as between the Service Provider and the users of each Service.

If a Pipeline is Covered under the Code, each service provided by means of that Covered Pipeline must be addressed and determined by reference to the Code. Only once it has been determined that a Pipeline is to be Covered, are the terms and conditions upon which Services are to be provided by means of that Covered Pipeline to be considered.

As a result, the concept of “Coverage” necessarily applies to a Pipeline, not to services or potential services provided by means of a Pipeline.

This is inherent within and throughout the Code as it is the underpinning by reference to which the fundamental object of the Code, to replicate workably competitive outcomes in a natural monopoly context, is based.

In addition, this is the irresistible conclusion to be drawn from the terms of the Code. For example:

(a) “Coverage/Covered” is defined “in relation to a Pipeline or part of a Pipeline”.

(b) “Pipeline” is defined in the Gas Pipeline Access Law as “a pipe, or system of pipes, or part of a pipe, or system of pipes, for transporting natural gas, and any tanks, reservoirs, machinery or equipment directly attached to the pipe, or system of pipes.”

(c) “Covered Pipeline” is defined as “the whole or a particular part of a Pipeline or proposed Pipeline which is Covered and any extension to, or expansion of the Capacity of, that Covered Pipeline which is to be treated as part of the Covered Pipeline in accordance with the Extensions/Expansions Policy contained in the Access Arrangement for that Covered Pipeline”.

[3] *Hamersley Iron Pty Ltd v National Competition Council* (1999) ATPR ¶41-705; *Rail Access Corporation v New South Wales Mineral Council Ltd* (1998) ATPR ¶41-663.

(d) "Service" is defined as meaning "a service provided by means of a Covered Pipeline" including "haulage services (such as firm haulage, interruptible haulage, spot haulage and backhaul)".

Each such reference would be a separate Service provided by means of the Covered Pipeline.

(e) Section 1 of the Code generally refers to, and regulates, Coverage of a Pipeline, including recommendations by the National Competition Council (**NCC**), and decisions by the Relevant Minister, that a Pipeline be Covered.

The Preamble to Section 1 of the Code (Coverage) provides expressly for Coverage of a Pipeline and the right of any person to seek Coverage of the Pipeline in accordance with the terms of the Code:

> *"1. COVERAGE*
>
> *This section of the Code describes **the kinds of gas infrastructure** which are subject to the Code and the basis on which particular infrastructure is or may become subject to the Code.*
>
> *In relation to the first issue, **the scope of the Code is limited to Pipelines** used for the haulage of Natural Gas. The definition of Pipeline includes gas transmission pipelines and distribution networks and related facilities, but excludes upstream facilities."*

Although the term '*gas infrastructure*' is not defined in the Code, the use of these words in the first paragraph suggests that the Code does not contemplate Capacity (which is essentially a measurement of the potential performance of a Pipeline) as a kind of gas infrastructure that is 'subject to the Code'.

In the second paragraph, the scope of the Code is expressly limited to "*Pipelines used for the haulage of Natural Gas*".

(f) The provisions of the Code relating to revocation of Coverage relate expressly to the revocation, or a request for the revocation, of Coverage of a Covered Pipeline. There is no reference to, or contemplation of, revocation of Coverage of Capacity.

5.5 Coverage and Capacity

Coverage does not relate to Capacity or to a particular Service provided by means of a Pipeline.

It follows that the Code does not contemplate:

(a) a concept of "uncovered Capacity";

(b) a service provided by means of a Covered Pipeline not being subject to the Code; or

(c) a Service Provider having a unilateral right to determine whether a service provided, or to be provided, by means of a Covered Pipeline is to be subject to the Code.

This conclusion must be self-evident for the following reasons:

(a) Given the principles and policy underlying the basis upon which a Pipeline is to be Covered (i.e. to replicate outcomes in a workably competitive market so as to ensure fair and reasonable terms of access between ***all*** users of services provided by means of a Covered Pipeline), it would be inconsistent for a Service Provider to determine unilaterally

whether particular services provided by means of that Covered Pipeline fall within the Code.

(b) Capacity or Spare Capacity in relation to a Covered Pipeline relates to services provided by means of that Covered Pipeline. For example, if a Covered Pipeline has spare capacity, that spare capacity will be represented by a service provided by means of that Covered Pipeline to users (or potential users) of that spare capacity.

This is reinforced by the definition of "Capacity" in the Code. "Capacity" is defined as "the measure of the potential of a Covered Pipeline as currently configured to deliver a particular Service between a Receipt Point and a Delivery Point at a point in time." There is a clear and direct connection in this definition between Capacity and the delivery of a Service from point A to point B along a Pipeline.

(c) The concept of Coverage applies to the criteria set out in clause 1.9 of the Code and is designed to identify those Pipelines that have natural monopoly characteristics. The concept of "Coverage" has no application to Capacity; it applies to the facility itself, not services or potential services provided by means of that facility.

(d) An object of the Code is to ensure that all Services provided by means of a Covered Pipeline are subject to, and are regulated by, the Code. As the preamble to Section 2 of the Code provides:

> *"Where a Pipeline is Covered, this section of the Code requires a Service Provider to establish an Access Arrangement to the satisfaction of the Relevant Regulator for that Covered Pipeline. An Access Arrangement is a statement of the policies and the basic terms and conditions which apply to third party access to a Covered Pipeline. The Service Provider and a User or Prospective User are free to agree to terms and conditions that differ from the Access Arrangement … . If an access dispute arises, however, and is referred to the Relevant Regulator, the Relevant Regulator (or any other Arbitrator it appoints) must apply the provisions of the Access Arrangement in resolving the dispute."*

(e) An Access Arrangement applies to all Services to be offered by the Service Provider in relation to the Covered Pipeline (including, but not limited to, a Reference Service). A Reference Tariff relates to a Reference Service, but other Services provided by means of the Covered Pipeline also have the protection of the Code (and the dispute resolution processes under the Code) and can take advantage of the concept of an "Equivalent Tariff" as defined in the Code.

5.6 Extensions/Expansions Policy

Section 3.16(a) of the Code provides that an Access Arrangement must include an Extensions/Expansions Policy which sets out, among other things:

> *"(a) the method to be applied to determine whether any extension to, or expansion of the Capacity of, the Covered Pipeline:*
>
> *(i) should be treated as part of the Covered Pipeline for all purposes under the Code; or*
>
> *(ii) should not be treated as part of the Covered Pipeline for any purpose under the Code;*
>
> *(for example, the Extensions/Expansions Policy could provide that the Service Provider may, with the Relevant Regulator's consent, elect at some point in time whether or not an extension or expansion will be part of the Covered Pipeline or will not be part of the Covered Pipeline); … ."*

Clause 1.40 of the Code provides as follows:

> *"An extension to, or expansion of the Capacity of, a Covered Pipeline shall be treated as part of the Covered Pipeline for all purposes under the Code if the Extensions/Expansions Policy contained in the Access Arrangement for that Covered Pipeline provides for that extension or expansion to be treated as part of the Covered Pipeline."*

Although clauses 3.16(a) and 1.40 of the Code refer to an "extension to, or expansion of the Capacity of, a Covered Pipeline", it is clear that an Extensions/Expansions Policy must apply to an extension to, or an expansion of, a Covered Pipeline in order to create additional Capacity. It is only by means of the extension to, or expansion of, the Covered Pipeline that any additional Capacity can be created. This construction is consistent with the reference to such an extension or expansion being "treated as part of the Covered Pipeline".

As set out above, "Pipeline" has the meaning given to that expression in the Gas Pipelines Access Law. It is defined as "a pipe, or system of pipes, or part of a pipe, or system of pipes, for transporting natural gas, and any tanks, reservoirs, machinery or equipment directly attached to the pipe, or system of pipes … ".

"Capacity" is not capable of being "treated as part of the Covered Pipeline"; it is only the pipes or the machinery or equipment directly attached to the pipes that is capable of being "treated as part of the Covered Pipeline".

It has been held that in interpreting the Code, a purposive interpretation is to be preferred to any other:[4]

> *"By virtue of the special interpretative provisions consideration may be given to extrinsic material if a provision of the Code is ambiguous or obscure or if the ordinary meaning leads to a result that is manifestly absurd or unreasonable. Extrinsic material may also be used to confirm that the meaning of a provision is the ordinary meaning. In determining the ordinary meaning regard would normally be had, of course, to the ordinary meaning conveyed by a provision having regard to its context and to the scope and purposes of the Code."*

Taking these principles of interpretation into account, an Extensions/Expansions Policy must relate to an extension to, or expansion of, a Covered Pipeline.

Consistent with this construction, a review of the information available about the Code on the websites of the Australian Energy Regulator, NCC and the Australian Competition and Consumer Commission (**ACCC**), did not reveal any consideration of 'Coverage' under the Code being related to anything other than Pipelines. In particular, the NCC's website contains a number of issues papers and past submissions the NCC has prepared or received in connection with recommendations it has made to cover or revoke coverage of particular Pipelines. It does not appear that the NCC has ever received a submission discussing the concept of "covered" or "uncovered" Capacity let alone endorsed such a distinction.

5.7 An Extension to or Expansion of a Covered Pipeline

It is acknowledged that Coverage under the Code can apply to the whole of a Covered Pipeline or to a part of a Pipeline. As the preamble to Section 1 of the Code provides:

> *"The term "Pipeline" is defined in the Gas Pipelines Access Law to include part of a Pipeline. Consequently, an application can be made for the Coverage of the whole or any part of a Pipeline provided the Pipeline or the relevant part of the Pipeline is owned or operated by the same Service Provider or group of Service Providers."*

[4] *Re: Dr Ken Michael AM; Ex Parte Epic Energy (WA) Nominees Pty Ltd* (2002) ATPR ¶41-886 at [87].

Similarly, an application for revocation of Coverage of a Covered Pipeline can be an application for revocation of part of the Covered Pipeline. Further, the NCC recommendation and the decision of the Relevant Minister, permits revocation "to a greater or lesser extent than requested by the applicant if, having regard to the part of the Pipeline that is necessary to provide Services that Prospective Users may seek, the Relevant Minister considers it appropriate".

However, the relevant reference is to part of a Pipeline or Covered Pipeline (as the case may be), not to part of the Capacity of a Pipeline or Covered Pipeline.

An example of revocation of part of a Covered Pipeline is the decision made on 19 November 2003 for revocation of coverage of that part of the Moomba to Sydney Pipeline "from the exit flange at the Moomba processing facility to immediately upstream of the off-take point of the Central West Pipeline at Marsden, New South Wales". However, coverage has been retained for that part of the Moomba to Sydney Pipeline "from the off-take point of the Central West Pipeline at Marsden to the Sydney city gate at Wilton, New South Wales".

As this example illustrates, Coverage of part of a Pipeline, or revocation of Coverage of part of a Pipeline, relates to physical and separate elements of a Pipeline or Pipeline system, not either:

(a) the Capacity or potential Capacity of a Pipeline; or

(b) physical elements of a Pipeline that form an integral and inseverable part of that Pipeline (or the operation of that Pipeline).

As with the Moomba to Sydney Pipeline example, it is only if the Service Provider can achieve revocation of coverage of a Covered Pipeline or part of a Covered Pipeline that any Service provided by means of the Pipeline or part of the Pipeline in relation to which coverage has been revoked, can fall outside the Code.

As discussed above, the Extensions/Expansions Policy under the Code also contemplates an extension to, or expansion of, a Covered Pipeline not forming part of that Covered Pipeline. However, the question of whether such an extension to, or expansion of, a Covered Pipeline is to form part of that Covered Pipeline must be determined by reference to the criteria in clause 1.9 of the Code. In addition, if any such extension or expansion is not to form part of the Covered Pipeline, that extension or expansion must be capable of providing a relevant service or services to users and prospective users in its own right. Otherwise, to identify and describe a piece of gas infrastructure as "uncovered" is meaningless if it is incapable of providing such a relevant service or services.

As illustrated by the Moomba to Sydney Pipeline example, a meaningful "uncovered" Pipeline (or part of a Pipeline) is a separate section of a Pipeline by means of which Services can be provided from Point A to Point B.[5]

The relevant question in this respect is to determine whether an extension to, or expansion of, a Covered Pipeline (which creates additional Capacity) is capable of providing a relevant Service (such as a haulage Service for the additional Capacity created by that extension or expansion).

The addition of a compressor to an existing Covered Pipeline may have the result of expanding Capacity, but it would not be a "Pipeline" capable of providing a Service in its own right (being a service of the kind contemplated by the Code). Rather, it is an integral and inseverable part of the Covered Pipeline that facilitates pressure being maintained or enhanced along that Covered Pipeline. It is the Covered Pipeline (as extended or expanded by such a compressor) that would

[5] Reference can be also made to the final recommendation of the NCC in the Application for Revocation of Coverage of the Moomba to Adelaide Pipeline System (14 December 2005) in which "uncovered" sections of that Pipeline (prior to revocation) arising from new facilities developed under the Extensions/Expansions Policy were identified principally as a series of laterals (paragraph 3.9).

continue to provide the relevant Services. From a technical perspective, a compressor simply increases the pressure in a Pipeline which corresponds to an increased flow rate (throughput capacity). The Service provided by means of the Pipeline, that is, the haulage of gas, remains the same whether a compressor is present or not.

In this regard, it is relevant to recognise each of the following:

(a) If part of a Pipeline is to be "uncovered", such a result can apply only if one or more of the criteria set out in clause 1.9 of the Code is not satisfied in respect of a Service to be provided by means of that part of the Pipeline.

That assessment can be made ***only*** by reference to the Services provided (or capable of being provided) by means of that part of the Pipeline. In the Minister's Statement of Reasons in relation to the Applications for Revocation of Coverage on Certain Portions of the Moomba to Sydney Pipeline System, it was noted as follows:[6]

> *"Much of the debate on access regulation (coverage) tends to focus incorrectly on the perceived monopoly characteristics of the pipeline as a physical asset, not whether the services provided by means of the pipeline in question are being provided in a monopoly fashion."*

Each of the criteria set out in clause 1.9 of the Code relates to the Services provided by means of the Pipeline. Accordingly, if a piece of gas infrastructure added to a Covered Pipeline is an integral and inseverable part of the Covered Pipeline and is incapable of providing a relevant Service in its own right, it is also incapable of assessment for the purposes of clause 1.9 of the Code. As a result, it is incapable of being an "uncovered" part of a Covered Pipeline.

(b) The NCC has discussed the concept of "Services provided by means of the Pipeline" on several occasions. It has maintained the following: [7]

> *"Reflecting the approach of the Australian Competition Tribunal ... the Council adopts a point-to-point approach to defining the services provided by the pipeline when considering coverage and revocation applications."*

This reference to the Australian Competition Tribunal is reference to its decision in *Duke Eastern Gas Pipeline Pty Ltd* in which it was observed by the Tribunal:[8]

> *"The pipeline operator sells a (haulage) service consisting of the transport of gas from Point A to Point B. ... Every haulage service will of necessity be from one point to another. That is the commercial service actually provided by the pipeline operator to its customers. That service may be of different use to the producers in the origin market or to the customers in the destination market, but it is the same service."*

Accordingly, the NCC has regularly identified the principal Service provided by a Pipeline as a gas haulage service from one point to another point serviced by that Pipeline. Obviously, a Pipeline is capable of providing a gas haulage service to different points along the Pipeline. For example, in its Final Recommendation in relation to the Application for Coverage of the Dawson Valley Pipeline, the NCC identifies the following principal service: [9]

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[6] Minister for Industry, Tourism and Resources, the Hon. Ian Macfarlane, 19 November 2003, "Applications for Revocation of Coverage on certain portions of the Moomba to Sydney Pipeline System, Statement of Reasons", at [10].

[7] National Competition Council, 27 February 2006, "Application for Revocation of Coverage of the Tubridgi Pipeline System under the National Gas Access Regime", at [4.2].

[8] (2001) ATPR •41-821 at [68] and [69].

[9] National Competition Council, August 2005, "Application for Coverage of the Dawson Valley Pipeline under the National Gas Code, Final Recommendation", at [5.6].

"… the principal service provided by the DVP is the haulage of natural gas from the Dawson Valley gas fields to the QGP ***and all points in between****." (emphasis added).*

5.8 The GGP Extensions/Expansions Policy

However, the existing Goldfields Gas Pipeline Access Arrangement (and the Proposed Access Arrangement), provide for an Extensions/Expansions Policy that relates to Capacity, not the extension to, or expansion of, the Covered Pipeline itself. It is respectfully submitted that this is a misconstruction and misapplication of the Extensions/Expansions Policy provisions of the Code.

If an Extensions/Expansions Policy under the Code were to relate to additional Capacity of a Covered Pipeline, it would be inconsistent with the underlying objectives of the Code. In particular:

(a) It would ignore the fundamental requirement under the Code for the determination of the question of whether an extension to, or expansion of, a Covered Pipeline is itself capable of being "uncovered". As discussed above, this requires an assessment of the gas infrastructure represented by such an extension or expansion, whether it is capable of providing any relevant Service under the Code in its own right and if so, whether that Service falls within the criteria set out in clause 1.9 of the Code.

(b) It would have the effect of allowing the Service Provider to identify Services to be provided by means of a Covered Pipeline as falling outside the operation of the Code. Any additional Capacity of a Covered Pipeline must represent a Service or potential Service that is to be provided by means of the Covered Pipeline. All Services provided by means of a Covered Pipeline fall within the Code (including, but not limited to, the dispute resolution procedures in the Code).

(c) If a Pipeline is Covered, it means that the Pipeline has the characteristics (in particular, the natural monopoly characteristics) required under clause 1.9 of the Code. Coverage is necessary to reflect outcomes in a workably competitive market and to ensure that all users have access to all Services provided, or to be provided, by means of the Covered Pipeline on fair and reasonable terms.

The Code does not contemplate "uncovered capacity" of a Covered Pipeline. It only contemplates (by way of exclusion) services that are to be provided by means of an uncovered Pipeline or part of a Pipeline. This is made clear by clauses 1.31 and 1.36 of the Code which provides that the NCC cannot recommend, and the Relevant Minister cannot decide, revocation of Coverage of a Covered Pipeline to the extent that the NCC or the Relevant Minister (as the case may be) continues to be satisfied of all of the matters set out in clause 1.9 of the Code.

Further, by identifying the Extensions/Expansions Policy in the Proposed Access Arrangement by reference to Capacity, the Service Provider (GGT) is purporting to confer upon itself an election as to how it will treat the "expanded capacity", including an election "that the expansion will not be covered, subject to GGT notifying the Regulator of this fact prior to the expansion coming into operation".

Such a proposal is inconsistent with the Code. A Service Provider cannot unilaterally "opt out" of the Code in respect of a Service to be provided by means of a Covered Pipeline arising from an increase in Capacity by reason of an extension to, or expansion of, that Covered Pipeline. As discussed above, it would undermine the requirements of, and policy that underlies, the Code. In addition:

(a) It purports to pre-empt (if not fetter) the future administrative functions and duties of the Relevant Regulator under the Code. Clause 3.16(a) of the Code provides by way of example that the Service Provider can only make an election whether or not an extension or expansion will be part of the Covered Pipeline "with the Relevant Regulator's consent".

This consent could be only given if the proposed "uncovered" extension or expansion meets the requirements of the Code in relation to a "Pipeline", a Service is provided by means of that "Pipeline", and such a Service does not meet any of the criteria set out in clause 1.9 of the Code.

(b) The Government of Western Australia, as part of the *Goldfields Gas Pipeline Agreement Act* 1994 stipulated the minimum size of the Goldfields Gas Pipeline and "that the capacity of the pipeline should be able to be expanded by a minimum of 50% of the initial committed capacity". It was stated that this was "to ensure that the pipeline had the capacity to carry gas to third parties and that the pipeline size was not restricted to the capacity of the existing market (which was represented by the owners)". [10]

Accordingly, for GGT to suggest in the Proposed Access Arrangement that future expansions of Capacity of the Covered Pipeline created by an extension to, or an expansion of, the Covered Pipeline may, at the option and discretion of GGT, fall outside the Code, appears to be inconsistent with the original requirements and policy of the Government of Western Australia.

(c) In its Final Approval of the GasNet Revised Access Arrangement, the ACCC required GasNet to amend its proposed Extensions/Expansions Policy to read as follows: [11]

> *"An expansion required to increase withdrawals at Culcairn over and above the current capacity of 17TJ/day will be covered unless the Regulator, before the decision to construct the New Facility is made by the Service Provider, agrees that it should not be covered."*

This provision contemplates an extension or expansion by means of the "New Facility" (i.e. not an extension or expansion of Capacity) and presumes Coverage as part of the Principal Transmission System unless the Regulator agrees otherwise.

Such an approach is consistent with the requirements, objectives and policies of the Code. The Extensions/Expansions Policy as set out in the Proposed Access Arrangement is inconsistent with those requirements, objectives and policies.

As is evident from the discussion in section 5.7, the expansion to the GGP by means of the addition of a new compressor at the Paraburdoo Compressor Station is not an "uncovered" part of that Covered Pipeline. It is an integral and inseverable part of the Covered Pipeline and is incapable of providing any relevant service for the purposes of clause 1.9 of the Code. The relevant services will continue to be provided by means of the Covered Pipeline (as extended or expanded by that compressor), being the haulage of gas between any two points along that Covered Pipeline.

In addition, GGT is not in a position to contend otherwise for the reason that the additional capital costs (in the region of $7 million) for the Paraburdoo Compressor Station have been factored into the tariffs set for the period 2005 to 2009. In addition to the technical, structural, legal and operational reasons for the Paraburdoo Compressor Station (and any other compressor station) forming an integral and inseverable part of the Covered Pipeline, this has been reflected in GGT's tariff calculations for the above period.

It is relevant to note that the assumption that is applied in the Access Arrangement (and the proposed revisions to the Access Arrangement) was queried by the Department of Resources Development, Office of Energy, Treasury of the Government of Western Australia in its submission on the first proposed Access Arrangement for the GGP as follows:

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[10] Department of Resources Development, Office of Energy, Treasury, "Goldfields Gas Pipeline - Submission on Proposed Access Arrangement", page 2.

[11] Australian Competition and Consumer Commission, 25 June 2008, "Final Approval, Revised Access Arrangement by GasNet Australia (Operations) Pty Ltd and Gasnet (NSW) Pty Ltd for the Principal Transmission System", at [2.2.5].

"The proposal appears to circumvent the approval of the Regulator should GGT elect that an expansion or extension not be covered.

The discretion proposed by GGT appears to be derived from sub-paragraph 3.16(a)(ii) of the Code. However, that sub-paragraph could equally be interpreted as requiring the Regulator's consent for an expansion or extension of capacity not to be covered under the Access Arrangement. The Regulator could consider his desired role in monitoring the elections of the service provider whether or not to include extensions or expansions."

It is submitted that this concern was well founded and that the construction of clauses 1.40 and 3.16(a) of the Code as set out in this Submission is to be preferred.

GGT has responded to the Issues Paper released by the Regulator by its letter of 29 May 2009. In particular, GGT contends that the Covered Pipeline "is not used to provide services enabled by the construction of the (uncovered) second compressor set at Paraburdoo Compressor Station or Wyloo West Compressor Station" and that "it is beyond the Authority's power to attempt to allocate any proportion of the costs associated with providing Covered services to the provision of non-covered services".

However, the following comments can be made in relation to these contentions and the reasons given in support of them:

(a) The addition of the compressors to the Covered Pipeline is an integral and inseverable part of the Covered Pipeline as a whole. A compressor set, in isolation, is not capable of providing any Services to a user or prospective user. It is only the whole of the Covered Pipeline (as extended or expanded by the addition of the compressor sets) that can provide Services in relation to the additional Capacity that is available in the Covered Pipeline by reason of that extension or expansion.

(b) It is incorrect to assume that because the Extensions/Expansions Policy as set out in the existing Access Arrangement refers to "expanded capacity", that Extensions/Expansions Policy complies with the Code or that the Regulator is constrained as a result.

(c) As the Covered Pipeline must include the additional compressor sets (which, in isolation, are incapable of being an uncovered part of the Pipeline as they form an integral part of the Covered Pipeline and are incapable of providing any services in their own right separate from the Covered Pipeline as a whole), the expanded capacity of 42TJ/day represents a Service (or a series of different Services) provided by means of the Covered Pipeline as a whole.

(d) The Code does not contemplate "services provided by means of the non-covered capacity".

Accordingly, it is submitted that the Regulator does have power to allocate costs associated with the provision of all Services provided by means of the Covered Pipeline as extended or expanded from time to time and that a Service involving the haulage of "expanded capacity" is, and must be, a Service provided by means of the Covered Pipeline (as extended or expanded).

6 Allocation of costs across "uncovered capacity"

6.1 Issue

Under the Proposed Access Arrangement, GGT contemplates a Reference Tariff determined by sharing the Capital Base, Depreciation and Operating Costs of the Covered Pipeline between Reference and Non-Reference Services but not services arising out of so-called "uncovered

capacity". Effectively, this means that those costs of the Covered Pipeline are not being shared across all of the Services which utilise the Covered Pipeline.

6.2 Summary - BHPB position

As set out in section 5 above, it is BHPB's position that the Code does not allow for an Access Arrangement in respect of a Covered Pipeline to differentiate between Capacity within that Covered Pipeline. All Capacity (including Spare Capacity) of a Covered Pipeline is represented by the provision and delivery, or the potential provision and delivery, of a Service or a series of separate Services.

Accordingly, the Code requires allocation of the Capital Base, Depreciation and Operating Costs between all Services which are provided by means of the Covered Pipeline, including those purporting to utilise the "uncovered capacity". This cost allocation needs to be appropriate and not based on marginal costs.

6.3 "Uncovered capacity" a Service under the Code

The Extensions/Expansions Policy as set out in the Proposed Access Arrangement refers to the "expanded capacity" in the context of the "Covered Pipeline".

As discussed above, although clause 1.40 of the Code provides for an Extensions/Expansions Policy identifying whether a future extension to, or expansion of, a Covered Pipeline is to be treated as part of that Covered Pipeline, if that extension or expansion (either alone or together with the existing Covered Pipeline) satisfies all of the criteria in clause 1.9 of the Code, it is clear that it should be also Covered and form part of the Covered Pipeline (as expanded or extended).

Clauses 1.40 and 3.16 of the Code do not contemplate a Service Provider having absolute discretion in relation to the question of whether an extension to, or expansion of, a Covered Pipeline is to be also Covered. Clearly, the Relevant Regulator must be first satisfied that the requirements and objectives of the Code have been satisfied and, in any event, the Service Provider cannot prevent another person making an application for Coverage.

The Extensions/Expansions Policy for the purposes of the Code contemplates nothing more than the fact that a decision in relation to a future extension to, or expansion of, a Covered Pipeline in respect of Coverage should not be made until the time that extension or expansion is completed and brought into operation and the Relevant Regulator is satisfied of the matters described above.

In any event, as the addition of the compressor at the Paraburdoo Compressor Station must be part of the Covered Pipeline, it must follow that each Service provided by means of that Covered Pipeline (as extended or expanded) falls within the Code.

The only relevance of additional Capacity (or Spare Capacity) for the purposes of the Code is that it represents an addition to existing Services or the introduction of a new Service provided by means of the Covered Pipeline.

To suggest that there is or can be "uncovered capacity" of a Covered Pipeline misstates the concept of a "Service" under the Code.

The Code does not provide for "uncovered capacity" as if any Service provided by means of a Covered Pipeline arising from that "uncovered capacity" can fall outside the Code.

Further, even if the Code did contemplate a concept of "uncovered capacity" in respect of a Covered Pipeline under an Extensions/Expansions Policy as is suggested by GGT, it must still represent a Service provided by means of that Covered Pipeline.

The result must be that:

(a) the capital cost of an extension to, or expansion of, a Covered Pipeline which is to form part of that Covered Pipeline should be included in the capital base for the whole of the Covered Pipeline for the purposes of an Access Arrangement; and

(b) the Capacity (or Spare Capacity) available by reason of such an extension or expansion must form part of, and be aggregated with, the existing Capacity of a Covered Pipeline so that the whole of the Capacity of the Covered Pipeline (as extended or expanded) is taken into account for the purposes of the Access Arrangement and the principles of access (including Reference Tariff principles) to be set out in that Access Arrangement.

The dilemma that would be caused if there were to be a concept of "uncovered capacity" in relation to a Covered Pipeline has been recognised by the Regulator in its Issues Paper on the Proposed Access Arrangement. In particular, the Regulator has noted the following:

> *"(a) Unless costs are correctly allocated to covered and uncovered capacity, this could lead to the situation where users of pipeline services under the access arrangement pay more for these services than should be the case based on a proper allocation of costs between covered and uncovered capacity."*[12]
>
> *"(b) The election to exclude capacity of 42TJ/day from coverage has occurred from 2006 and is forecast to occur in 2009. This election to exclude capacity has the effect of using covered assets to contribute to uncovered capacity. The terms of extensions and expansions policy in the revised access arrangement will affect the extent to which covered assets could be used in the future to contribute to further uncovered capacity."*

Essentially, it is the submission of BHPB that the reference to "uncovered capacity" merely confuses the relevant issues and principles to apply in relation to the allocation of costs. Costs should not be allocated to "covered and uncovered capacity". Costs in relation to the Covered Pipeline as a whole (including extensions or expansions such as new compressor stations) should be applied in a fair and reasonable manner across all Services provided by means of that Covered Pipeline. The Services relate to the whole of the Capacity from time to time of the Covered Pipeline (as extended or expanded from time to time). References to "covered" and "uncovered" capacity should be extinguished as they are apt to mislead and confuse.

Accordingly, BHPB submits that the proposed tariffs do not reflect proper allocation between all Services provided by means of the Covered Pipeline (as extended or expanded) for the following reasons:

(a) They do not evenly allocate capital costs across all Capacity and result in distortions (as the capital cost is only allocated to shippers who have "covered capacity").

(b) They do not equitably allocate depreciation and operating costs across all Capacity (it appears that operating costs are allocated on a marginal cost basis and are not shared equitably).

(c) They do not recognise or incorporate the projected revenue from the "uncovered" capacity.

(d) Different tariff regimes between "covered" and "uncovered" Capacity on a Covered Pipeline are likely to lead to cross-subsidisation at the expense of users of "covered" Capacity.

(e) The rate of return does not reflect returns from the "uncovered" Capacity of the Covered Pipeline.

[12] Economic Regulation Authority, 22 April 2009, "Goldfields Gas Pipeline - Issues Paper on the Proposed Revisions to the Access Arrangement", at [40].

(f) The rate of return does not reflect the returns from the non-Reference Services of the Covered Pipeline. The rate of return assumes that all shippers are on the regulated tariff. It is within the power of the Regulator to confirm that all shippers on the non-Reference Tariff will be paying higher tariffs and thus the GGT rate of return is potentially understated.

In GGT's Proposed Access Arrangement there is already clear evidence of the difficulties created by the concept of covered and uncovered capacity and the potential for cross-subsidisation and inequity. Should the Regulator approve the increase in minimum gross heating value in the gas specification (discussed below in section 16), this will create additional capacity without any expansion. However, is the subsequent increase in capacity to be treated as Covered or uncovered? On the face of the Proposed Access Arrangement, the answer to this question seems to be uncovered given that it does not fit within the fixed volume of Covered capacity. BHPB submits that this is clearly inappropriate given the allocation of capital costs. This is just one example of where GGT's proposal creates conceptual and practical difficulties.

In its submission to the Regulator, GGT asserts that:

> *"Consistent with the nature of shared infrastructure assets, the vast majority of costs are incurred to provide service to all Users. For example, it is not possible to specifically attribute pipeline costs or inlet facilities to particular loads. GGT has developed a causal allocator for shared costs. GGT considers that pipeline costs are driven by a number of clearly identifiable criteria; capacity demanded, which dictates the size of the pipeline in question and the need for compression on that pipeline; and length of haul, which drives the length of the pipeline and the cost of compression. GGT's capital and operating costs have been allocated on the basis of the amount of the GGP being used, and the capital and operating cost of compressors required to "push" the gas further along the GGP. Therefore, shared pipeline and compression costs, opex etc has been allocated between the Reference Service and Negotiated Services on the basis of "capacity kilometres". It is also not possible to directly attribute most of the operating and general and administrative costs to specific services. Therefore, except as described below, these costs have been allocated on the same basis of allocation as the pipeline and operating costs."*

BHPB believes that this is an inequitable method for the allocation of costs across a shared infrastructure asset. The Covered and uncovered Pipelines Capacity should also be considered a shared infrastructure asset as the GGP mainline is a common feature to both.

Consistent with this is the charging of System Gas to the Covered Pipeline shippers. BHPB is currently being charged fuel gas for PAC, Wyloo West and will be charged for the Ned's Creek when completed.

The additional capacity in the GGP created by the installation of one additional compressor (PAC) and two additional compressor stations (Wyloo West and Ned's Creek) is only available by utilising the Covered Pipeline. A compressor without a Pipeline cannot transport gas other than from the inlet of the compressor to the outlet of the compressor and thus the Covered and uncovered Pipeline must be considered a shared infrastructure asset that has costs allocated according to the GGT theory quoted above. The 108TJs of "Covered" Capacity can operate independently of the "uncovered" Capacity. However, the same cannot be said of the "uncovered" Capacity.

This should mean a pro rated allocation of costs across all Services provided by means of the Covered Pipeline (as extended or expanded from time to time). GGT aims to only allocate the marginal costs associated with the additional Capacity created by the addition of the compressor station to the users of the Service that delivers that Capacity. This results in an unequitable distribution of all other costs to the users of all other Capacity of the Covered Pipeline. In consequence of this, GGT stands to achieve "super returns" from the provision to users of Services represented by the additional capacity as the tariff structure need not be reflective of the reduced capital costs, yet these services are still provided by a monopoly asset. Thus GGT double dips through its misconceived notion of "covered" and "uncovered" Capacity of the Covered Pipeline.

6.4 Rate of Return

As an alternative to the proper allocation of costs across all Services provided by means of the Covered Pipeline (as extended or expanded), the Regulator should take account of anticipated revenues and returns from those Services which GGT purports to provide outside of the Proposed Access Arrangement. If costs are not correctly allocated to these Services then it necessarily follows that they provide substantial scope to generate profit on the GGP. Given the purported lower capital base associated with any such profit, the relevant rate of return will be substantially higher if the charges are equivalent. At the least, this “super” return, should be taken into account when determining the Rate of Return for the GGP and therefore this Rate of Return should be lower so that the average rate of return of the total GGP is consistent with the required level.

PART C - REFERENCE TARIFFS

7 Introduction

7.1 Issue

In addition to the Coverage issues raised in Part B, and resulting impact on cost sharing and rates of return, BHPB is of the view that the Reference Tariff proposed by GGT in the Proposed Access Arrangement is inflated and incorrect because:

(a) certain assumptions relied on by GGT when determining the Reference Tariff are erroneous (discussed in section 8 below);

(b) the Rate of Return used by GGT when determining the Reference Tariff is inflated due to the use of the following inaccurate parameter values:

- (i) equity beta and asset beta (discussed in section 10 below);
- (ii) market risk premium (discussed in section 11 below);
- (iii) credit rating (discussed in section 12 below);
- (iv) asymmetric risk (discussed in section 13 below);
- (v) gamma (discussed in section 14.1 below); and
- (vi) cost of raising debt (discussed in section 14.2 below); and

A number of the other inputs in the Reference Tariff calculation need careful consideration (discussed in section 14 below).

7.2 Code Requirements

Sections 8.1 and 8.2 of the Code set out the Code's General Principles in respect of a Reference Tariff and Reference Tariff Policies provided for under Access Arrangements:

"*8.1 A Reference Tariff and Reference Tariff Policy should be designed with a view to achieving the following objectives:*

(a) providing the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering that Service;

(b) replicating the outcome of a competitive market;

(c) ensuring the safe and reliable operation of the Pipeline;

(d) not distorting investment decisions in Pipeline transportation systems or in upstream and downstream industries;

(e) efficiency in the level and structure of the Reference Tariff; and

(f) providing an incentive to the Service Provider to reduce costs and to develop the market for Reference and other Services.

To the extent that any of these objectives conflict in their application to a particular Reference Tariff determination, the Relevant Regulator may determine the manner in which they can best be reconciled or which of them should prevail.

8.2 The factors about which the Relevant Regulator must be satisfied in determining to approve a Reference Tariff and Reference Tariff Policy are that:

(g) *the revenue to be generated from the sales (or forecast sales) of all Services over the Access Arrangement Period (the Total Revenue) should be established consistently with the principles and according to one of the methodologies contained in this section 8;*

(h) *to the extent that the Covered Pipeline is used to provide a number of Services, that portion of Total Revenue that a Reference Tariff is designed to recover (which may be based upon forecasts) is calculated consistently with the principles contained in this section 8;*

(i) *a Reference Tariff (which may be based upon forecasts) is designed so that the portion of Total Revenue to be recovered from a Reference Service (referred to in paragraph (b)) is recovered from the Users of that Reference Service consistently with the principles contained in this section 8;*

(j) *Incentive Mechanisms are incorporated into the Reference Tariff Policy wherever the Relevant Regulator considers appropriate and such Incentive Mechanisms are consistent with the principles contained in this section 8; and*

(k) *any forecasts required in setting the Reference Tariff represent best estimates arrived at on a reasonable basis."*

8 Reference Tariff Assumptions

8.1 Issue

In proposing the Reference Tariff and Reference Tariff Policy, GGT has made a number of assumptions concerning the current risks facing the GGP and its owners. In particular, GGT focuses on:

(a) the effects of the Global Financial Crisis (**GFC**);

(b) the increased insolvency risk from smaller mining companies; and

(c) the availability of alternative fuels as competition to gas and therefore pipeline access in the regions serviced by the GGP.

These risks are used by GGT to justify the need for increased risk premiums in a number of areas and to differentiate the risk factors to be applied to the GGP (and therefore components of the Reference Tariff calculation) from other infrastructure.

8.2 Summary - BHPB's position

BHPB's position, as set out in detail below, is that:

(a) the effects of the GFC have been significantly overstated by GGT and are unsupported by current data and also by ASX announcements by related companies of GGT;

(b) the purported insolvency risk associated with customers on the GGP is purely speculative and not supported, particularly given that BHPB estimates that over 50% of the capacity of the GGP is underpinned by related companies of BHPB with substantial additional

capacity contracted to Rio Tinto, both entities clearly not within the ambit of "small mining companies"; and

(c) while a number of users of gas from the GGP are in a position to theoretically substitute diesel for gas, this is not practical or economic given the significant price differential between the use of gas and diesel fuel. To suggest that competition from diesel fuel represents a risk to the operation of the GGP is clearly incorrect.

8.3 Impact of the Global Financial Crisis - GGT's position

In the Proposed Access Arrangement and GGT's Further Supporting Information GGT discusses, at length, the risks the GGP faces as a result of the GFC. In particular, GGT submits that the GFC has resulted in reduced throughputs, lower investment and far higher risks to the pipeline. This view is used by GGT to justify a number of assumptions and inputs in the Reference Tariff calculation, including lower throughput expectations and higher risk quotients.

In particular, GGT's position is that as a result of the GFC:

(a) capital raising will be more difficult;[13] and

(b) the historical throughput is inappropriate for use looking forward.[14]

8.4 Impact of the Global Financial Crisis - Reality

GGT places a great deal of emphasis on the GFC as a basis to increase the Reference Tariff due to perceived increased risks. As this is the basis GGT used for adjustments to many of the inputs to its tariff structure, it is important to examine the real impact of the GFC on the GGP.

In mid-to-late 2008 there were three major events which have impacted the GGP which individually would each be considered uncommon and, in the case of (a) and (c) below extremely rare, and together a less than one in 50 year event:

(a) The Varanus island explosion occurred on 3 June 2008. This resulted in a complete shutdown of exports from Apache. The effects of this are still being felt while Apache work to return their production to pre-June levels.

(b) The shutdown of BHPB's Kalgoorlie Nickel Smelter for a furnace rebuild.

(c) The GFC which has resulted in a reduction in the market price for most base metals.

Despite these events, the throughputs of BHPB through the GGP returned to pre-June levels by late August when the rebuild of its Kalgoorlie Nickel Smelter had been completed. During the period of lower than normal throughputs, GGT were still able to recover in excess of 83% of its revenue via the Reservation and Toll charges payable under its regulated arrangements as well as the proceeds from business interruption insurance.

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[13] "As well as impacting on the ability of infrastructure providers to raise capital, the financial crisis is also impacting users of the GGP. In the minerals sector served by the GGP product prices (with the exception of gold) have generally halved with nickel prices reducing to circa 20% - 25% of previous highs following the financial crisis. Consequently the GGP demand outlook is uncertain. This may be further compounded by rationalisation of the industry. Thus the impact of the financial crisis in increasing the uncertainty of the demand outlook for the GGP should also be considered."

Goldfields Gas Pipeline, 21 April 2009, "Supporting Information to Proposed Revisions to Access Arrangement Submitted to Economic Regulation Authority on 23 March 2009, Public Submission", page 14.

[14] "Load factor is calculated as being throughput (TJ/day) divided by MDQ (TJ/day) and represented as a percentage. The average historical load factor of the GGP for 2000 to 2008 inclusive is 85%. GGT has assumed that because of the global financial crisis, the forecast load factor has been assumed to be 2 percentage points lower over the forecast period 2010 to 2014."

Goldfields Gas Pipeline, 21 April 2009, "Supporting Information to Proposed Revisions to Access Arrangement Submitted to Economic Regulation Authority on 23 March 2009, Public Submission", page 29.

It is also significant to note that, while the GFC has impacted commodity prices, the prices most commodities are all still at or above 2004 levels, with both iron ore and gold actually double 2004 prices. While the GFC could be seen to have a significant impact on base metal prices this is only in comparison to the significant price spikes that have occurred since the current Access Arrangement was approved and not compared to historical trends. BHPB submits that given the prices of all relevant commodities are at least at the level of the time the current Access Arrangement was approved, there is no basis for GGT's arguments of increased risk.

Therefore, the actual combined impact of the events listed in (a) to (c) on the GGP does not appear to support GGT's assumptions. The Regulator should consider the actual figures of throughput on the GGP in order to quantify the actual impact of these events both in 2008 and 2009. This would give a strong indication as to the most realistic expectations for the GGP going forward.

8.5 Impact of the Global Financial Crisis - GGT's Public View

The corporate view of APA as released to the ASX provides an excellent insight into the position of the GGP as it contains the most recent financial figures and views of the Managing Director from as recently as March this year. The GGP is by far the largest part of APA's Western Australian operation and also a significant contributor to the total APA revenue stream. The figures and comments below paint a picture of a very healthy Western Australian operation for APA and a view of continued strong growth.

In an ASX announcement in March 2009, APA paints a much brighter picture of expectations in relation to the GGP.[15] These are a series of quotes directly from the APA website which were released to the ASX in March 2009.

> *"The demand for capacity across many of our gas transmission pipelines remains, with a number of pipeline expansion projects in Queensland and Western Australia nearing completion."*[16]
>
> *"APA's Western Australian pipelines also contributed to the rise in performance despite the disruption to gas supplies resulting from the Varanus Island incident."*[17]
>
> *"Gas transmission and distribution revenue (excluding pass-through revenue) was $287.6 million, an increase of 15.3% (pcp: $249.5 million). The increase was principally due to the growth in revenue and services on the Victorian Transmission System, the Moomba-Sydney Pipeline and the Western Australian pipelines…Western Australia's gas transportation revenue increased by $3.1 million despite the gas supply impacts caused by the Varanus Island incident in June 2008."*[18]
>
> *"In June 2008 gas supplies in WA, including into the Goldfields Gas Pipeline and Telfer Gas Pipeline, were disrupted due to the explosion at Apache Energy's Varanus Island gas processing plant. The plant recommenced production at half capacity in July 2008 and close to full production by December 2008. Overall this incident has had no material financial impact on APA due to a combination of factors including the take or pay nature of APA's revenue contracts on both pipelines, the ability of shippers to source some alternate gas supplies, and the anticipated retrieval of some revenue shortfall through business interruption insurance."*[19]
>
> *"APA has a prudent treasury policy which requires conservative levels of hedging interest rate exposures to minimise the potential impacts from adverse movements in rates. All interest rates and exchange rates on project debt and US Private Placement facilities have been fixed for the life of the facilities. APA also enters into interest rate hedges which fix a proportion of the interest rate exposure on the syndicated facility. At 31 December 2008, 80% of all interest rate exposures were either hedged or fixed interest rates, for varying periods out as far as 13 years. In addition, a level*

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[15] APA Group Website, "Open Briefing®. APA Group. MD & CFO Discuss Profit & Outlook"; and ASX, Media Release, 25 February 2009, "2009 Interim Results, Results for Announcement to the Market"

[16] ASX, Media Release, 25 February 2009, "2009 Interim Results, Results for Announcement to the Market"

[17] ASX, Media Release, 25 February 2009, "2009 Interim Results, Results for Announcement to the Market"

[18] ASX, APA Group, "2009 Interim Financial Reports".

[19] ASX, APA Group, "2009 Interim Financial Reports".

of interest rate protection is provided through CPI indexing in revenue contracts and the regulatory reviews applicable to many of APA's assets."[20]

8.6 True impact of the Global Financial Crisis

BHPB submits that the available evidence does not support the general assumptions made by GGT in relation to the GFC. The purported impact on throughput and expectations for future throughput by the GFC cannot be used justify any increase in Regulated Tariffs as this is clearly incorrect, particularly when considering APA's view of the future demand for capacity on the GGP.

The Regulator would also have historical details of throughputs on the GGP and it is believed that this data would indicate that throughput has been effectively maintained despite the events of 2008. Further evidence of this stability is provided by GGT's own expectations regarding expansion. Also, it is BHPB's understanding that the 4TJ/d of spare capacity referred to in the Revised Access Arrangement has already been fully contracted.

8.7 Insolvency risk

By GGT's own admission,[21] long-term take-or-pay contracts significantly reduce a pipeline's sensitivity to demand changes (i.e. systematic risk). Given the high level of take-or-pay commitments on the GGP, there is a case to reduce the equity beta to reflect the reduction in GGT's related volume and price risks resulting from long-term take-or-pay contractual arrangements.

However, GGT asserts that the risk mitigating effect of take-or-pay commitments should be reduced given that take-or-pay obligations cannot be enforced if an entity has become insolvent. In particular, GGT appears to assert that this insolvency risk is higher in respect of the GGP than other pipelines on the basis that the GGP services smaller mining companies where the risk of insolvency is higher.[22]

BHPB disputes this assertion and suggests it is not appropriate for the Regulator to consider the effects of insolvency as there is no reasonable likelihood of the relevant event or relevant impact and so it is speculative.

In particular, BHPB notes that the largest gas consumer through the GGP is BHPB which is estimated to make up over 50% of GGT's total throughput (with other substantial customers including Rio Tinto, comprised in the balance). Due to their strong balance sheets and credit ratings, the risk of insolvency is low, as they are more likely to continue to operate during the down cycle.

In addition, BHPB notes the following factors which support its position that the insolvency risk and impact of any actual insolvency has been overstated by GGT:

(a) The GGP covers three key mining regions (Pilbara, MidWest, and Goldfields-Esperance) in Western Australia. GGT is a strategic link in the Western Australia minerals supply chain and critical to ensuring reliability and continuity of supply of nickel and iron ore to the export market.

(b) The region served by GGT has an expected reserve life exceeding 100 years and is among the lowest cost producers of high quality commodities in the world.

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20 ASX, APA Group, "2009 Interim Financial Reports".

21 Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 - Attachment 4, Equity Beta Analysis", page 22

22 Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 - Attachment 4, Equity Beta Analysis", page 22

(c) There appears to be substantial and growing demand for gas in the region given the lack of an economic substitute (discussed below in section 8.8) as evidenced by:

  (i) the rapid take-up of the spare 4TJ/d referred to in the Proposed Access Arrangement; and

  (ii) GGT's own proposed expansions of capacity in the GGP.

Given that such a high proportion of revenue is underpinned by large organisations, BHPB submits that it is open, and appropriate, for the Regulator to determine that the actual risk of insolvency is lower than other pipelines and therefore the calculation of the Reference Tariffs should fully value the benefits offered by the take-or-pay provisions.

Alternatively, if the Regulator is of the view that the risk of customer insolvency in respect of the GGP is materially different from other pipeline systems in Australia, which BHPB strongly disputes, BHPB submits that the provisions of the General Terms and Conditions of the Proposed Access Arrangement provide GGT with sufficient rights to protect itself against the potential default of its customers as a result of insolvency. Clause 9.13 of the General Terms and Conditions requires the customer ("User") to pay to GGT a bond *"for an amount reasonably determined by GGT"* having regard to (among other things):

(a) *"the financial position of the User and the User's parent company (where applicable)"*; and

(b) *"the riskiness of the User's project in regard to which the service is required"*.

In addition to this, under clause 8.3(b)(2) of the Proposed Access Arrangement GGT can require a Prospective User to provide GGT with a Surety prior to making a Service available to the Prospective User.

BHPB submits that the rights given to GGT under clause 9.13 would be how such a risk is appropriately managed in a competitive environment and is therefore more consistent with the objectives and principles underpinning the Code. In making its determination on this issue, BHPB submits that the Regulator should have regard to the current and potential security arrangements General Terms and Conditions of the Proposed Access Arrangement in respect of customers on the GGP.

8.8 Alternative fuels

GGT seek to differentiate the risk profile of the GGP from other pipelines given the availability of alternative fuels to mining customers on the GGP. The position asserted by GGT is that the availability of alternative fuel represents a risk to the continued utilisation of the GGP as it allows for ease of substitution.[23] BHPB strongly disputes this proposition.

The concept of substitutability requires close substitutes. The concept of substitution and competition involves the principles of cross elasticity of demand and cross elasticity of supply. A high cross elasticity of demand indicates closer substitutability. That is, a market is the area of close competition. The fact that, on some occasions, one product rather than another may be selected, does not establish that the two products are "substitutable" so as to be within a single market.

[23] Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 - Attachment 4, Equity Beta Analysis", page 23

In 2003/2004 the NCC concluded, and the Minister for Energy confirmed, that diesel is not a close substitute for gas in the region serviced by the GGP.[24] For the reasons set out below, BHPB supports this position, and submits that there is no basis for the Regulator to depart from this position when considering the Proposed Access Arrangement.

The region serviced by the GGP is geographically isolated. Given this isolation, there is in fact no relevantly substitutable fuel. BHPB's position is that, in order to be a viable substitute, the relevant good or service must both be capable of physical substitution but also must be a practical and viable alternative.

The majority of gas transported through the GGP is used for the self-generation of electricity rather than as "process gas". Essentially, self-generation is required due to the lack of public electricity infrastructure in the region. Given this, electricity itself should be discounted as an effective substitute. This eliminates a key substitute which is present in respect of many other pipeline systems.

GGT make the bold assertion that liquid fuels (effectively diesel) represent competition to the GGP and therefore a risk. While it is true that diesel fuel can be a physical alternative for gas in a number of dual fuel fired electricity generation units, this substitution is not viable. The price of liquids is approximately triple that of gas and the proposed emissions trading scheme add further weight to the argument for gas over liquids.

While alternative fuel supplies are maintained by some of the larger shippers at some sites, BHPB asserts that this is for the purposes of back-up protection to deal with gas unavailability and not to allow for fuel substitution where gas is available.

9 Rate of Return

9.1 Issue

In determining the Reference Tariff, GGT have proposed a Rate of Return of 13.5%. This is a 27% increase from the Rate of Return used in the current GGP Access Arrangement, being 10.6%.

9.2 Summary - BHPB Position

It is BHPB's view that the Rate of Return of 13.5% in the Proposed Access Arrangement is inflated and unjustifiable. This is because, in addition to the distorted effect the assumptions discussed in section 8 above have on the Reference Tariff, the components used by GGT in determining the rate of return are also erroneous. BHPB's objections in relation to a number of these components are discussed in sections 10 to 15 below.

By way of reference, the parameter values used by GGT to establish the 13.5% Rate of Return are:

[24] Honourable Eric Stephen Ripper MLA, Minister for Energy, 2 July 2004, "Decision on Coverage in relation to the Application to the National Competition Council requesting that coverage of the Goldfields Gas Pipeline System (PL 24) be revoked"

WACC parameters	2005 Approved	2010 Proposed
Nominal Risk Free Rate	5.45%	4.27%
Real risk free rate	2.69%	1.83%
Inflation Rate	2.69%	2.40%
Market Risk Premium	5-6%	7.00%
Equity Beta	0.8-1.33	1-1.8
Cost of debt margin	0.98-1.225%	3.60%
Cost of raising debt	0.00%	0.125%-0.3%
Corporate Tax Rate	30.7%	30%
Franking credit value (gamma)	0.3-0.6%	20%
LT Proportion of Debt Funding	60%	60%
LT Proportion of Equity Funding	40%	40%
Equity proportion	63%	63%
Debt proportion	38%	38%
WACC - Rate of Return (range)	8.2%-10.8%	10.7-13.8%
WACC Rate of Return (pre tax nominal)	10.60%	13.50%

9.3 Code requirements

Clause 8.30 and 8.31 of the Code state:

> *"8.30 The Rate of Return used in determining a Reference Tariff should provide a return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service (as reflected in the terms and conditions on which the Reference Service is offered and any other risk associated with delivering the Reference Service).*
>
> *8.31 By way of example, the Rate of Return may be set on the basis of a weighted average of the return applicable to each source of funds (equity, debt and any other relevant source of funds). Such returns may be determined on the basis of a well accepted financial model, such as the Capital Asset Pricing Model. In general, the weighted average of the return on funds should be calculated by reference to a financing structure that reflects standard industry structures for a going concern and best practice. However, other approaches may be adopted where the Relevant Regulator is satisfied that to do so would be consistent with the objectives contained in section 8.1."*

10 Equity Beta and Asset Beta

10.1 Issues

Under the Proposed Access Arrangement, GGT is contemplating an increase in the equity beta from 0.8 - 1.33 to 1.0 - 1.8.

10.2 Summary - BHPB position

BHPB submits that the equity beta should be 0.7. In particular, GGT has:

(a) inappropriately considered and applied the equity betas of mining companies;

(b) overstated the risks associated with insolvency;

(c) overstated the availability of economic substitutes for gas in the region; and

(d) overstated the volatility of consumption.

10.3 GGT process

The equity beta measures the covariance between the total shareholder returns of a company (or another security) and a market index.

GGT has used the following approach to estimate the systematic risk of equity (beta):

(a) GGT first made an assessment of what it considered to be an appropriate benchmark for an "average" gas transmission business;

(b) GGT then adjusted this "average" beta to reflect the purported unique risk profile of the GGP; and

(c) GGT then applied first principles to effectively settle on the equity beta.

10.4 Comparable companies

Comparable companies ideally should have similar operating characteristics, in terms of exposure to price and volume risk, operating leverage (ratio of costs to revenues), upstream and downstream operations etc.

On this basis, the ideal comparable companies would be other gas transmission companies dedicated to distribute gas to mining and minerals processing activities on a contractual basis.

10.5 Comparable companies - gas transmission

By its own analysis, GGT has determined an asset beta range (0.17 to 0.73) based on a selection of six comparable gas transmission companies.[25]

It is BHPB's position that it is inappropriate to include Equitable Resources as one of these companies. The asset beta of the remaining companies ranges from 0.17 to 0.31 while Equitable Resources, with an asset beta of 0.73, is clearly an outlier.[26]

Excluding the outlier, comparable gas transmission companies result in an asset beta range of 0.17 to 0.31. On this basis, and assuming 60% gearing the equity beta would be 0.4 to 0.8.

10.6 Inappropriate use of mining companies

In addition to gas transmission companies, GGT has also incorporated the equity beta of mining companies into its analysis. As a result of including these entities, the equity beta is significantly inflated.

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[25] Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 - Attachment 4, Equity Beta Analysis", page 32

[26] This is because Equitable Resources is an integrated energy company. Equitable Resources has exploration and production assets, which have higher systematic risks than transmission and distribution assets, therefore higher beta. Given the higher systematic risk exposure, the asset beta of Equitable Resources should be is excluded.

(a) Regulator's position in its previous review of the GGP Access Arrangement

BHPB agrees with the Regulator's position taken in the previous review of the GGP Access Arrangement[27] (**Amended Draft Decision**) in relation to the GGT's use of the equity beta of mining companies, namely that "*there is no justification for determining a beta value for the GGP other than on the basis of observed values from other comparable pipeline companies*."[28]

BHPB also agrees with the following statement from the Amended Draft Decision:

> "*The view that the Rate of Return estimated for the GGP should take into account the unique risk of the GGP business is contrary to the core assumptions of the CAPM model, which provides only for non-specific or non-diversifiable risk to be taken into account.*"[29]

In BHPB's view, the information provided by GGT in support of the Proposed Access Arrangement does not contain any information which would justify a shift by the Regulator from the position taken by the Regulator in the Amended Draft Decision.

(b) Additional basis for not including the equity beta of mining companies

For the following further reasons, the equity beta of mining companies is not a relevant consideration in determining the equity beta of a transmission pipeline such as the GGP:

(a) The systematic risk of a gas transmission pipeline operator does not necessarily reflect the systematic risk of its customer. This is particularly true if systematic risk is affected by a contractual arrangement (such as a take-or-pay contract) between the pipeline operator and its customers.

(b) Long-term take-or-pay contracts significantly reduce a pipeline's sensitivity to demand changes (i.e. systematic risk). There is a case to reduce the equity beta to reflect the reduction in GGP's related volume and price risks resulting from long-term take-or-pay contractual arrangements.

(c) GGT argues that take-or-pay obligations cannot be enforced if an entity has become insolvent and this risk is particularly high for smaller mining companies.[30] As discussed at section 8 above, this insolvency risk has been overstated and, given the nature of the customers on the GGP, is clearly speculative and should be given no weight.

(d) Given the contractual agreements, GGT is effectively insulated from systematic risks that affect the mining industry; therefore mining companies are not appropriate comparable companies for GGT.

(e) GGT's position is inconsistent with the following recent decisions:

  (i) The AER decision in the context of electricity transmission and distributions to use an equity beta of 0.8 (gearing of 60%).[31]

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[27] Economic Regulation Authority, 29 July 2004, "Amended Draft Decision on the Proposed Access Arrangement for the Goldfields Gas Pipeline", page 60

[28] Economic Regulation Authority, 29 July 2004, "Amended Draft Decision on the Proposed Access Arrangement for the Goldfields Gas Pipeline", page 60

[29] Economic Regulation Authority, 29 July 2004, "Amended Draft Decision on the Proposed Access Arrangement for the Goldfields Gas Pipeline", page 60

[30] Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 - Attachment 4, Equity Beta Analysis", page 22

[31] Australian Energy Regulator, May 2009, "Final Decision - Electricity transmission and distribution network service providers - Review of weighted average cost of capital (WACC) parameters", page v

(ii) The IPART's draft report and draft decision on NSW rail access undertaking (Hunter Valley Coal Network – primarily servicing the coal export industry); the Tribunal's draft decision is to use an equity beta range of 0.7 to 1.0 (with gearing of 50% to 60%).[32]

BHPB's view is that, for the reasons set out above, the equity beta of mining companies is inappropriate to incorporate into the determination of the equity beta for the GGP.

10.7 Mining companies - appropriate weighting

While BHPB submits that the use of mining company equity betas is inappropriate, if those betas are used, BHPB disputes the methodology adopted by GGT in determining a weighted equity beta. BHPB submits that the methodology appears to double count the risks associated with throughput variability.

BHPB's position is that all pipelines are subject to revenue variability dependent upon throughput variability. This would logically hold for any pipeline system that is not underpinned by 100% take-or-pay contractual commitments. By its own admission, GGT recognise the high level of take-or-pay commitments in respect of the GGP.[33] On this basis, it would be logical to consider that the equity beta of other pipelines contains appropriate provision or recognition for a degree of this variability.

However, GGT's methodology appears to apply this pipeline equity beta to effectively the fixed portion of its revenues which is clearly inconsistent.

BHPB submits that, if the Regulator accepts the concept of including the equity beta of mining companies (which BHPB considers is inappropriate), the determination of that weighted equity beta needs to be reconsidered.

10.8 First principles

On the basis of first principles, GGT argues that the systematic risks facing the GGP justify an equity beta at the higher end of equity betas for comparable companies. In particular, GGT (in BHPB's view, erroneously) states that:

> *"The first principles analysis [undertaken by GGT] concludes that GGP's systematic risk is higher than other regulated gas pipeline businesses in Australia given its exposure to mining companies and activities and while this exposure is somewhat mitigated by long-term take-or-pay contracts this protection is only as strong as the underlying financial strength of the counterparty."*[34]

However, as demonstrated in section 7.7 above, the fact that BHPB is GGP's biggest customer means that GGP is not *"exposed to a higher systematic risk than other regulated gas pipeline businesses in Australia given its exposure to mining companies"*.

GGP covers three key mining regions (Pilbara, MidWest, and Goldfields-Esperance) in Western Australia. GGP is a strategic link in the Western Australia minerals supply chain and is critical to ensuring reliability and continuity of supply of nickel and iron ore to the export market.

The region served by GGP has an expected reserve life exceeding 100 years and is among the lowest cost producers of high quality commodities in the world.

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[32] IPART, May 2009, "Rail Access — Draft Report and Draft Decision", page 12

[33] Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 - Attachment 4, Equity Beta Analysis", page 25

[34] Goldfields Gas Pipeline, 21 April 2009, "Supporting Information to Proposed Revisions to Access Arrangement Submitted to Economic Regulation Authority on 23 March 2009, Public Submission", page 22.

GGP enjoys a diversity of customers on long-term contracts while underpinned by larger, stable mining companies. Mines operated by BHPB represented an estimated 50% of GGT's throughput during the 2009 Financial Year with other significant throughput being underpinned by Rio Tinto.

GGP has long-term, take-or-pay contracts with its major customers, which insulates GGT from short-term shock in the iron ore/nickel demand/supply cycle. 83% of the total tariffs are recovered on take-or-pay basis, leaving only 17% of the pipeline's revenues exposed to very low volume risk.[35]

In addition to these factors which reduce risk, as discussed above in section 7, the GGP is significantly insulated from risk on the basis of:

(a) strong security of revenue on the basis of minimal insolvency risk represented by customers consuming the majority of the Services on the GGP;

(b) the lack of competitive substitutes to gas in the relevant region, GGP effectively services a captive market; and

(c) clear evidence of the minimal impact of the GFC and other one off events.

These factors have the effect of reducing GGT's cash flow volatility, reducing it's systematic risk, thus resulting in an equity beta which should be much lower than typical gas transmission pipelines and the mining industry.

10.9 Previous regulatory decisions

For the reasons set out above, there does not seem to be any justification for adopting an equity beta which departs from the range of relevant betas for other pipeline assets in Australia.

Relevant decisions include:

(a) The Regulator's previous decision on the range of equity beta for the GGP, being 0.8 to 1.33.[36]

(b) The ESC (Essential Services Commission) final decision in March 2009 on the equity beta for Envestra Victoria's and Envestra Albury's Access Arrangements, being 0.7.[37]

Set out below is a summary of recent decisions on equity betas for pipelines.[38]

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35 Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 - Attachment 4, Equity Beta Analysis", page 21

36 Economic Regulation Authority, May 2005, "Final decision on the proposed access arrangement for the Goldfields Gas Pipeline", page 64

37 Essential Services Commission, 25 March 2009, "Implementation of Victoria ESC Appeal Panel Decisions E1 and E2 of 2008 - Envestra", page 27

38 Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 - Attachment 4, Equity Beta Analysis", page 22

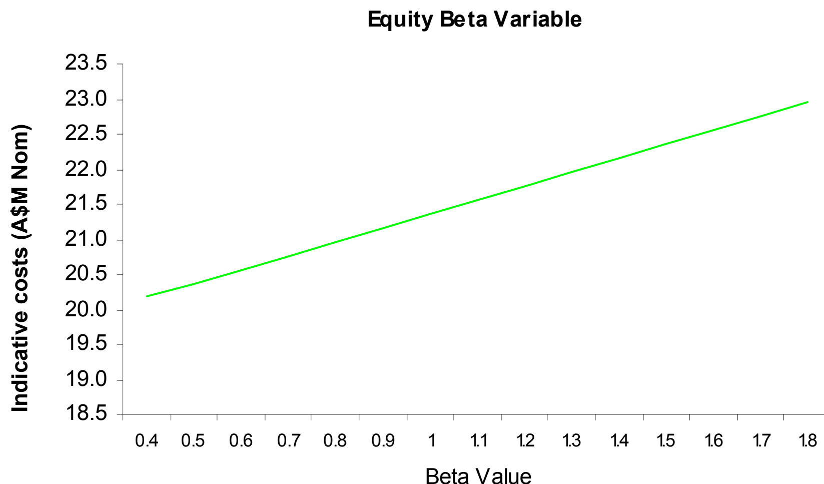
Pipeline	Year	Regulator	Equity Beta
Amadeus Basin to Darwin Pipeline	2002	ACCC	1.0
Moomba to Sydney Pipeline	2003	ACCC	1.0
Dampier to Bunbury Pipeline	2005	ERA	0.8-1.2
Goldfields Gas Pipeline	2005	ERA	0.8-1.33
Roma to Brisbane Pipeline	2006	ACCC	1.0
Dawson Valley Pipeline	2007	ACCC	1.0
Victoria Gas Transmission System	2008	ACCC	1.0
Envestra Assets	2009	ESC	0.7

10.10 Appropriate equity and asset beta

On the basis of the above analysis, a beta range of 0.7 is consistent with the current position in the market, the risk profile of the GGP and the latest relevant regulator decisions.

10.11 Sensitivity analysis

The equity beta range in the Proposed Access Arrangements is 1.0-1.8. When considering the impact of the equity beta on the cost to shippers an increase in the beta (all other WACC parameters remaining as proposed) from 0.7-1.8 results in additional costs to shippers of A$2.204M.



11 Market Risk Premium

11.1 Issue

GGT has proposed a Market Risk Premium (**MRP**) in the Proposed Access Arrangement of 7%.

11.2 Summary - BHPB Position

BHPB submits that the GGT proposed MRP of 7% is too high and inconsistent with the average MRP adopted by the market. An MRP of 5.75% would, it is submitted, be appropriate.

11.3 Principles

The MRP is the excess return that investors expect to receive over risk-free assets as compensation for the additional risk associated with equity investments. It is used to capture the "price of risk" in the Capital Asset Pricing Model (**CAPM**), and is a critical input in determining the cost of equity and weighted average cost of capital.

Approaches used to estimate the MRP can be divided into the following two distinct groups:

(a) firstly, using historical returns of equities and risk-free assets to determine an historical MRP; and

(b) secondly, using economic or financial models to determine investors' expectations for the future MRP.

The former gives reliable estimates of the MRP realised by investors in the past, but it is unclear how relevant these estimates are to the future. In contrast, forward looking models provide estimates that are more relevant to the future, but which are often variable and highly dependent on the assumptions chosen.

BHPB agrees with the Regulator that the market risk premium should be determined on the basis of both observed historical equity premia achieved in the market and a range of information sources on current and future expectations of equity premia. [39]

11.4 Historical data

Recently, the AER has noted that long term historical estimates (1883-2008, 1937-2008, and 1958-2008) produce a range of 5.7 to 6.2 percent.[40]

Historical data does not necessarily reflect future expectations. Dimson, Marsh and Staunton argued that structural changes in the economy and equity markets in the latter half of the twentieth century (which are already priced into equities) make it likely that future equity returns will be lower than those obtained historically.[41] This means that a forward looking MRP should be lower than that estimated from historical data.

This emphasises the limitations of relying on historical data alone, and the need to consider other approaches and models to estimate the MRP. The authors suggested that to estimate the forward looking MRP, past MRP needs to be adjusted downwards for unanticipated cash flow growth and unanticipated declines in business and investment risk. The authors recommended a downward adjustment of one to two percent.[42]

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[39] Economic Regulation Authority, January 2009, "Draft determination – WACC for the Pilbara Infrastructure's Railway from the Cloud Break Iron Ore Mine in the Pilbara to Port Hedland", page 12

[40] Australian Energy Regulator, May 2009, "Final Decision - Electricity transmission and distribution network service providers - Review of weighted average cost of capital (WACC) parameters", page xiv

[41] Dimson, Marsh and Staunton, "*Global evidence on the equity risk premium*", London Business School, working paper, September 2002

[42] Dimson, Marsh and Staunton, "*Global evidence on the equity risk premium*", London Business School, working paper, September 2002

11.5 Future expectations

Recent investment bank research (based upon availability of MRP information, as these assumptions are infrequently disclosed in contemporary equity research) is tabulated below:

Source	Publication / Date	Market Risk Premium
Merrill Lynch[43]	1 December 2008	5%
Macquarie Research[44]	1 April 2009	5.5%
GSJBW[45]	24 April 2009	6%
RBS[46]	21 May 2009	6%
Morgan Stanley[47]	9 June 2009	6%
Austock Securities[48]	13 March 2009	6%
Average		**5.75%**

As evidenced by this information, the average expectations of market practitioners is 5.75% and very clearly does not support a MRP of 7%.

11.6 Relevant regulatory decisions

In addition to historical data and market expectations, there is also no support for GGT's MRP position in recent regulatory decisions.

In particular, a recent decision of the Regulator in respect of Pilbara Infrastructure's rail assets in the Pilbara deemed that an MRP of 6% is appropriate.[49]

In addition, relevant decisions made by State and National regulators between 1998 and 2008 in the context of gas pipelines are set out in the table below:

[43] Merrill Lynch, broker report, 1 December 2008, 'Boral Ltd. Is this rock bottom?'

[44] Macquarie Research, broker report, 1 April 2009, 'Fortescue Metals Group FIRB ticks the box'

[45] GSJBW, results commentary, 24 April 2009, 'Fortescue Metals Group Ltd 3Q09 Production And Earnings Results'

[46] RBS, broker report, 21 May 2009, 'Fortescue Metals Group A leveraged iron ore play'

[47] Morgan Stanley, broker report, 9 June 2009, 'Telstra Corporation Circling the Wagons: Incumbent Defense',

[48] Securities, broker report, 13 March 2009, 'Sunland Group Ltd (SDG) Dirt cheap, but negative near term catalysts likely'

[49] Economic Regulation Authority, January 2009, "Draft determination – WACC for the Pilbara Infrastructure's Railway from the Cloud Break Iron Ore Mine in the Pilbara to Port Hedland", page 12

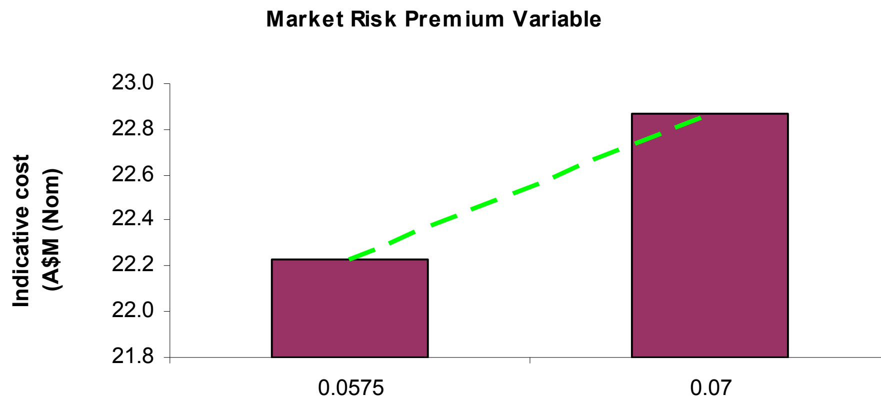
Year	Decision	Parameter value
1998	ACCC - Transmission Pipelines Australia (final decision)	6.00%
1998	ORG - Victorian Gas Distribution Networks (Mulitnet, Westar and Stratus) (final decision)	6.00%
2000	OffGAR - AlintaGas Networks (final decision)	6.00%
2000	IPART - AGL Gas Network (NSW) (final decision)	5.0-6.0%
2000	OffGAR - CMS (Parmelia Pipeline) (final decision)	6.00%
2000	ACCC - Central West Pipeline (Marsden to Dubbo) (final decision)	6.00%
2001	OffGAR - Goldfields Gas Pipeline (draft decision)	6.00%
2001	OffGAR – Tubridgie Pipeline (final decision)	6.00%
2001	QCA - Queensland Gas Distribution Networks (Allgas and Envestra) (final decision)	6.00%
2002	ACCC - Moomba to Adelaide Pipeline System (final decision)	6.00%
2002	ESC - Victorian Gas Distribution Networks (Mulitnet, Westar and Stratus) (final decision)	6.00%
2002	ACCC - Victorian Gas Transmission System (GasNet) (final decision)	6.00%
2003	ACCC - Amadeus to Darwin Pipeline (NT Gas) (final decision)	6.00%
2003	ACCC - Moomba to Sydney Pipeline (EAPL) (final decision)	6.00%
2003	OffGAR - DBNGP (final decision)	6.00%
2004	ERA - Goldfields Gas Pipeline (amended draft decision)	6.00%
2004	ICRC - ActewAGL Natural Gas System (final decision)	6.00%
2005	ERA - AlintaGas Networks (draft decision)	6.00%
2005	IPART - AGL Gas Network (NSW) (final report)	5.5-6.5%
2005	ERA - DBNGP (draft decision)	5.0-6.0%
2006	ACCC - Roma to Brisbane Pipeline	6.00%
2007	ACCC - Dawson Valley Pipeline	6.00%
2008	ACCC - Victoria Gas Transmission System	6.00%

11.7 Appropriate market risk premium

Drawing upon the various sources BHPB submits that an MRP of 5.75 is appropriate.

11.8 Sensitivity analysis

When the Market Risk Premium is adjusted to the proposed 7% from 5.75% (all other WACC parameters remaining as proposed) the cost to shippers is increased from A$22.2M to A$22.9M.



12 Credit Rating

12.1 Issue

GGT has proposed a change to the credit rating for the GGP from BBB+ to BBB-.

12.2 Summary - BHPB Position

BHPB submits that there is no basis to support a change in the credit rating applicable to the GGP.

12.3 GGT's basis

Essentially, GGT raise the following issues to support a lowering of the credit rating:

(a) the potential insolvency of small miners operates to reduce the benefit of take-or-pay protection; and

(b) the availability of substitutable fuels.

However, as set out in section 7 above, both of these issues are rebuttable on the basis of:

(a) the significant proportion of GGP capacity used to service BHPB and other large miners;

(b) the existing credit support requirements in the General Terms and Conditions and proposed Access Arrangement; and

(c) the main alternative fuel is diesel which is effectively triple the costs of gas, and therefore is not an economic alternative to the use of gas.

12.4 Relevant credit ratings

GGT refers to the following previous regulatory pipeline determinations in respect of the credit ratings applied to pipelines:[50]

Decision	National Credit Rating
ACCC - Amadeus Basin to Darwin Pipeline (2002)	BBB+
ACCC - Moomba to Sydney Pipeline (2003)	BBB+
ERA - Dampier to Bunbury Pipeline (2005)	BBB
ACCC - Roma to Brisbane Pipeline (2006)	BBB
ACCC - GasNet (2008)	BBB+

This shows that three of the five pipelines recently the subject of a regulatory determination have a rating of BBB+. The basis on which GGT distinguishes the GGP from the pipelines which have a BBB+ rating is due to GGP's "unique" risk profile as a result of its "exposure to the mining sector".[51] As set out in section 7 above, GGP's risk profile is not affected by its exposure to the mining sector.

Relevantly, BHPB notes that:

(a) the credit ratings of the largest customer on the GGP (by capacity), being BHPB, is A+;[52] and

(b) recently APT Pipelines Ltd, the financial arm of the publicly stapled trust APA Group, which owns 88% of the pipeline, has been issued a credit rating by Standard and Poor's of BBB.[53]

Based on the previous regulatory pipeline determinations as summarised by GGT,[54] the take-or-pay contractual agreements in place (including credit support requirements) and the current credit rating of GGT's most significant customer and owners there is no basis to support a change to BBB-.

12.5 BHPB position

BHPB submits that the use of the more appropriate BBB+ credit rating will result in a cost of debt margin of 3.2%.

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50 Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 – Attachment 2 Proposed Cost of Debt", page 3

51 Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 – Attachment 2 Proposed Cost of Debt", page 3

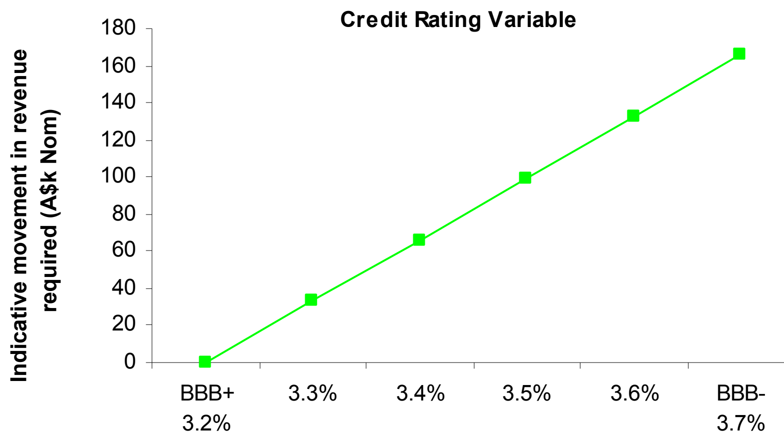
52 Reuters, June 2009, Standard and Poor's credit rating

53 Standard and Poor's, press release, June 2009, APA Groups APT Pipelines Ltd. Assigned 'BBB' rating, Stable Outlook On Strong Business Position'

54 Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 – Attachment 2 Proposed Cost of Debt", page 3

12.6 Sensitivity analysis

The adjustment of the cost of debt based on the change in credit rating from BBB+ to BBB- increases the costs by A$165k. The A$165k additional costs is directly attributed to the tariffs and therefore costs to the customers.



13 Asymmetric Risk

13.1 Issue

GGT presents the position that the GGP faces significant asymmetric risk.[55] GGT argued that the return profiles for regulated infrastructure tend to be asymmetric where regulation has a tendency to limit the potential upside gain benefits for a regulated asset, while at the same time, providing no protection from downside risk.

13.2 Summary - BHPB Position

BHPB is of the view that some of the asymmetric risks may have already been mitigated and shown to be negligible, which means that the GGT risk profile is approximately symmetric and no adjustment to the WACC is applicable.

13.3 Accuracy of GGT's Assessment of Asymmetric Risk

As discussed above in section 8, GGT make a number of assertions concerning the asymmetric risks associated with the GGP. These assertions are flawed in a number of respects.

For example, GGT has already benefited from BHPB's capital contribution in the form of the DBNGP/GGP Interconnect, which reduces GGT's downside risk by promoting diversity of supply and therefore supply security.

GGT argues that take-or-pay contracts provide no protection to the downside risk, as they are of little consequence where a customer is in liquidation.[56] GGT focuses on the effect upon revenue if a customer failed. As noted previously, GGT's largest single customer is BHPB which is estimated to account for approximately 50% of total GGP throughput. Due to its strong balance sheets and credit rating, the risk of insolvency is clearly speculative and should not be taken into account.

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[55] Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 – Attachment 5 - Asymmetric risk", page 9.

[56] Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 – Attachment 5 - Asymmetric risk", page 21

GGT, in its scenario analysis, appears to have focused on junior miners which have much higher operating leverage (thus higher risks) than their largest customers and collectively represent a much smaller portion of GGT's revenue not to mention the fact that GGT appears to ignore the benefits offered by credit support provisions of the General Terms and Conditions.

14 Other issues

14.1 Gamma

The GGT is proposing a gamma of 0.2. Recent regulatory decisions on the appropriate gamma to use include:

(a) the AER electricity WACC review decided on a gamma of 0.65[57]; and

(b) the Regulator's recent ruling a gamma of 0.5.[58]

When considering recent decisions, a gamma range of 0.5 and 0.65 would appear reasonable.

14.2 Cost of raising debt

A cost of raising debt of 0.125% - 0.3% has been included in the proposed 2010 WACC parameters. In the GGT submission the justification for the application of a cost of raising debt appears to be based on the assumption it is now 'common place' and does not provide details to support any proposed raising of debt for the GGP over the next five years. [59]

BHPB does not see justification for the application of a cost of raising debt given the Reference Service customers of the GGP are not anticipated to participate in any additional capacity expansions on the pipeline and there is no debt raising activities planned.

In fact, given that GGT does not anticipate further expansions to the pipeline to supply Reference Services, the Rate of Return should actually be reduced. BHPB submits that the cost of raising debt is inbuilt into other elements of the Rate of Return and, on the basis that there will be no debt raising, this adjustment must be removed from the Rate of Return. BHPB submits that the Regulator should make an assessment on this issue.

14.3 Historical throughput estimates

BHPB submits that the Regulator should, when considering estimates from GGT, take account of the variance between historical throughputs and the estimates used in the current GGP Access Arrangement. If the Regulator determines that there is a historical variance which has resulted in an over recovery then the Regulator should properly:

(a) determine the veracity of the estimation methodology adopted by GGT, and make necessary adjustments to the current proposed estimates; and

(b) take any historical over recovery into account to lower the Reference Tariff in the upcoming period.

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[57] Australian Energy Regulator, May 2009, "Final Decision - Electricity transmission and distribution network service providers - Review of weighted average cost of capital (WACC) parameters", page v

[58] *Hamersley Iron Pty Ltd v National Competition Council* (1999) ATPR ¶41-705; *Rail Access Corporation v New South Wales Mineral Council Ltd* (1998) ATPR ¶41-663.

[59] Synergies Economic Consulting, March 2009, "Goldfields Gas Pipeline Access Arrangement 2009 – Attachment Ongoing Debt and Equity Raising Costs ", page 1

14.4 Current over recovery

BHPB notes that the tariff path in respect of the GGP currently amounts to an over recovery of revenue compared to the cost of service. This is reflected by the Regulator on page 11 of the Issues Paper.

BHPB submits that any calculation of the Reference Tariff must be determined on the basis of the Cost of Service path and not the current revenue path.

14.5 Other inputs

BHPB notes that it is unable to assess the appropriateness of other inputs into the Reference Tariff calculation at this time. As further analysis becomes available BHPB may make supplementary submissions to the Regulator.

15 Summary position and impact

Based on the analysis provided above a range for the WACC parameters are provided below with the final range from 8.2% to 8.4%.

WACC parameters	2010 Proposed	Submission
Market Risk Premium	7.00%	5.75%
Equity Beta	1-1.8	0.7
Cost of debt margin	3.60%	3.2
Cost of raising debt	0.125%-0.3%	0%
Franking credit value (gamma)	20%	50%-65%
WACC	10.7-13.8%	8.2%-8.4%

PART D - OTHER ISSUES

16 Gas Specification (Gas Quality)

16.1 Previous submission

BHPB has already, on 29 May 2009, made a submission to the Regulator regarding its objections to the narrowing of the scope for the GGP heating value. BHPB reiterates its position that:

(a) the proposed increase in the maximum carbon dioxide from 3.6% to 4.0% should be accepted; and

(b) the proposed increase in the minimum gross heating value from 35. MJ/m^3 to 37.0 MJ/m^3 cannot be accepted.

16.2 *Gas Supply (Gas Quality Specification) Bill 2009*

BHPB notes with interest that the Government proposes to shortly release a draft of the *Gas Supply (Gas Quality Specification) Bill 2009* (WA) (**Bill**) which deals with broadening the gas specification on gas transmission pipelines in Western Australia. BHPB submits that it is inappropriate to narrow the specification of the GGP at this stage in advance of this legislation, even assuming such a course is open to the Regulator.

BHPB submits that the proposed amendment to the minimum gross heating value should be carefully considered in the context of the draft Bill. In particular, BHPB submits that GGT should not be in a position to profit from the proposed amendment to minimum gross heating value by enlivening a right to compensation or other processes under that Bill which would not otherwise exist.

Given the materiality of this issue, BHPB proposes to consider the issue once the Bill is made public. BHPB intends to make a further submission on this point in light of the Bill and submits that any subsequent submission on this issue by BHPB or any other interested party should be considered by the Regulator.

16.3 Increased capacity

Ultimately, if the Regulator accepts the proposed increase to the minimum gross heating value (and determines that the concept of Covered capacity is valid, which BHPB strong disputes), then BHPB submits that the amount of any increased capacity in the GGP as a result of that increase must properly be considered Covered Capacity. The issue with the current approach is raised above in section 6.3.

17 Amendments to the General Terms and Conditions

BHPB submits that any of the changes to the General Terms and Conditions that do not have any or any sufficient supporting information provided by GGT should be declined until such time as GGT are able to provide information in support of the relevant change. Subsequent to the provision of this information, BHPB submits that there should be a period of consultation available for shippers to comment on the changes.

Further to this, BHPB disputes the following:

(a) The 3% increase to the interest rate on late payments as being unreasonable and unjustified.

(b) The proposed removal of the obligation on GGT to return 95% of the quantity variation charges to the non offending shippers. This type of charge should not appropriately be revenue to a pipeline operator.

(c) The proposed pass through of all imposts including carbon taxes. As currently contemplated, BHPB submits that carbon tax is a tax on the asset owner, not the end user, and is aimed as a behaviour modifier for the asset owner. The simplistic pass through contemplated by GGT is inconsistent with the aim of the carbon tax. Further work is required on this concept to ensure that GGT remains responsible for the efficient operation of the GGP and motivated to minimise emissions, and does not double-dip through the operation of escalation mechanisms in the General Terms and Conditions.

(d) The amendments in clauses 6.6, 6.7 and 11.2 of the General Terms and Conditions which provide GGT with the exclusive right to provide Outlet Facilities. BHPB submits that there is no reasonable justification for GGT to extend its monopoly position.

(e) The proposed amendment in clause 9.8 of the General Terms and Conditions to limit the effect of CPI changes so that reduction is not possible. BHPB submits there can be no reasonable justification for this amendment.

(f) BHPB submits that there is no justification for the inclusion of other escalation factors in the Reference Tariff calculation other than CPI.

(g) BHPB submits that it does not have an in principle issue with moving to annual modelling. However, BHPB submits that the Regulator should consider the potential impact of this change to ensure that it does not have a negative impact on the Reference Tariff or shippers generally.