



**Public Submission**

**By BHP Billiton**

**In Response to the Draft Decision on DBP's  
Proposed Revisions to the Dampier to Bunbury  
Natural Gas Pipeline Access Arrangement**

**20 May 2011**

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# PART A - INTRODUCTION

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## 1 Background

On 1 April 2010, DBNGP (WA) Transmission Pty Limited (**DBP**) submitted proposed revisions to the access arrangement (**Proposed Access Arrangement**) for the Dampier to Bunbury Natural Gas Pipeline (**DBNGP**) to the Economic Regulation Authority (**Regulator**) for approval under the *National Gas Access (Western Australia) Act 2009* which amends and implements the *National Gas Law (NGL)* and *National Gas Rules (NGR)* in Western Australia. DBP also provided supporting information to the Proposed Access Arrangement.

On 15 April 2010, the Regulator invited submissions from interested parties on the Proposed Access Arrangement, to be submitted by 11 June 2010.<sup>1</sup> On 3 June 2010, the Regulator extended the period for submissions to 9 July 2010.<sup>2</sup>

On 9 July 2010 BHP Billiton (**BHPB**) lodged a submission in response to the Proposed Access Arrangement (**BHPB's First Submission**).

On 14 March 2011 the Regulator issued a redacted draft decision not to approve the Proposed Access Arrangement (**Draft Decision**), and invited DBP to submit additions or other amendments to the Proposed Access Arrangement to address matters raised in the Draft Decision by 18 April 2011. The Regulator also invited other interested parties to make submissions on the Draft Decision by 20 May 2011.

On 18 April 2011, DBP lodged amendments to the Proposed Access Arrangement (**Amended Proposed Access Arrangement**), in response to the Regulator's Draft Decision and related required amendments. DBP also provided supporting information to the Amended Proposed Access Arrangement. Based on the table set out in DBP's supporting submission 47 (**DBP's Submission 47**), it appears that DBP have accepted 29 of the Regulator's 109 required amendments.<sup>3</sup> DBP purports to have addressed the remaining 80 required amendments in the Amended Proposed Access Arrangement, however, BHPB can see few instances where DBP has proposed amendments which address the Regulator's required amendments.

In addition to the Amended Proposed Access Arrangement, DBP indicated that a number of further supporting submissions which explain and substantiate the amendments and additions to the Amended Proposed Access Arrangement (**Supporting Submissions**) would be filed as soon as possible and in any event no later than 20 May 2011.<sup>4</sup>

Given BHPB has not has the opportunity to consider DBP's Supporting Submissions, BHPB reserves its right to consider and analyse the DBP's Supporting Submissions (and any other subsequent submissions) and to make submissions to the Regulator in response to DBP's Supporting Submissions.

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<sup>1</sup> ERA, April 2010, "Notice - Invitation for Public Submissions - Proposed Revised Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline".

<sup>2</sup> ERA, June 2010, "Notice - Proposed Revised Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline - Extension of Time to Make Submissions".

<sup>3</sup> DBP, 18 April 2011, "Submission 47: Revised Access Arrangement Proposal" page 3-13.

<sup>4</sup> DBP, 18 April 2011, "Submission 47: Revised Access Arrangement Proposal" paragraph 1.9(b) - (j), page 2.

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## 2 Introduction

This submission is made by BHPB in relation to the Draft Decision, the Amended Proposed Access Arrangement and the following supporting information which was lodged by DBP with the Amended Proposes Access Arrangement:

- (a) the amended proposed access arrangement information (**Amended Proposed Access Arrangement Information**);
- (b) Appendix 1 - Access Contract Terms and Conditions to the Amended Proposed Access Arrangement (**Terms and Conditions**); and
- (c) DBP's Submission 47.

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## 3 Structure

This submission is structured to focus on the following areas:

- (a) Part A - Introduction
- (b) Part B - Inadequate Supporting Information
- (c) Part C - Rate of Return
- (d) Part D - Reference Service
- (e) Part E - Terms and Conditions
- (f) Part F - Other Issues

Unless otherwise defined, words and expressions used in this submission have the meaning given in the NGL, NGR, and the Amended Proposed Access Arrangement (as applicable).

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## 4 Executive Summary

### 4.1 Inadequate Supporting Information

BHPB submits that DBP has provided insufficient supporting material to enable BHPB (and other interested parties) to adequately respond to DBP's Amended Proposed Access Arrangement. BHPB notes DBP's intention to provide Supporting Submissions and reserves its rights to consider and analyse DBP's Supporting Submissions and to make submissions to the Regulator in response to DBP's Supporting Submissions.

### 4.2 Rate of Return

BHPB submits that the Regulator was clearly correct to dismiss DBP's proposed Rate of Return and the parameter values used for the determination of the Rate of Return.

BHPB broadly agrees with the Regulator's approach to determining the Rate of Return and the parameter values.

#### **4.3 Reference Service**

BHPB supports the Regulator's decision to remove DBP's proposed "R1 Service" and reinstate the full haul T1 Service (**T1 Service**), part-haul T1 Service (**P1 Service**) and back haul T1 Service (**B1 Service**). However, BHPB maintains the position set out in BHPB's First Submission in respect of including spot capacity and inlet sales services as Reference Services.

#### **4.4 Terms and Conditions**

BHPB makes the following submissions in respect of the Terms and Conditions:

- (a) DBP provides no justification for the removal of the option to renew clause, which is inconsistent with required amendments set out in the Draft Decision (discussed in paragraph 14.1).
- (b) BHPB maintains the position set out in BHPB's First Submission that shippers should be entitled to supply their own system use gas (discussed in paragraph 14.2).
- (c) BHPB maintains the position set out in BHPB's First Submission that the Operator should only be able to retain an amount of revenue from the Other Charges equal to the costs the Operator incurs as a result of the conduct entitling such charge to be levied (discussed in paragraph 14.3).
- (d) The Regulator needs to consider whether additional ring fencing requirements are required to be specified under the NGL to prohibit the Operator from disclosing Confidential Information to a third party shipper who is also an owner (discussed in paragraph 14.4).
- (e) The Terms and Conditions should contain an incentive mechanism which seeks to ensure that the DBNGP is operated as efficiently as possible (discussed in paragraph 15).

#### **4.5 Other issues**

DBP has revised the capital and operating expenditure figures in the Amended Proposed Access Arrangement, however the Regulator's required amendments set out in the Draft Decision are not reflected in these amended figures.

BHPB maintains the position set out in BHPB's First Submission that the Regulator should examine DBP's capital and operating expenditure figures closely to ensure that they comply with NGR requirements.

## PART B - INADEQUATE SUPPORTING INFORMATION

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### 5 Inadequate information in support of changes

#### 5.1 Issue

DBP has provided insufficient supporting material to enable BHPB (and other interested parties) to adequately respond to the Amended Proposed Access Arrangement as contemplated by the staged submission process in Division 8, Part 8 of the NGR. Namely, rule 59(5)(c)(iii) invites submissions to be made at least 20 business days after the end of the period the service provider has to submit additions or other amendments to the Proposed Access Arrangement. BHPB submits that without adequate supporting material from DBP, BHPB and other interested parties are not in a position to fully and properly respond to the Amended Proposed Access Arrangement.

BHPB also submits that DBP's Amended Proposed Access Arrangement Information contains insufficient information to justify the derivation of all amendments to the current access arrangement.<sup>5</sup>

#### 5.2 DBP's Supporting Submissions

While DBP has indicated that it proposes to lodge Supporting Submissions, if these have been lodged these submissions have not yet been made publicly available.<sup>6</sup>

As set out in Part A, there are few instances that BHPB can identify where DBP has proposed amendments to address or attempt to address the Regulator's required amendments. In these circumstances it is difficult for BHPB to adequately respond to the Amended Proposed Access Arrangement without further information from DBP which BHPB assumes will be contained in the Supporting Submissions.

Subsequent to the provision of the Supporting Submissions, BHPB submits that there should be a period of consultation allowed for interested parties to comment on the Supporting Submissions. BHPB reserves its right to consider and analyse the Supporting Submissions (and any other subsequent submissions made by DBP) and to make submissions to the Regulator in response to the Supporting Submissions (and any subsequent submissions made by DBP).

#### 5.3 Compliance with NGL and NGR

BHPB maintains its position set out in BHPB's First Submission that the NGR requires DBP to provide sufficient supporting information to enable BHPB (and other users) to understand the derivation of all amendments to the current access arrangement and to form an opinion as to the compliance of the Amended Proposed Access Arrangement with the provisions of the NGL and NGR.<sup>7</sup>

On this basis, any changes to the current access arrangement made by DBP should be supported by explanatory information that sufficiently sets out the reasons for the amendments in a manner that enables all users and prospective users to form an opinion as to the compliance of the Amended Proposed Access Arrangement with the provisions of the NGL and NGR. It follows that any proposed amendments not supported by such information should be rejected.

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<sup>5</sup> BHPB's First Submission, pages 36-67.

<sup>6</sup> At the date of this submission the Supporting Submissions have not been made publicly available, despite DBP indicating in DBP's Submission 47 that the Supporting Submissions would be lodged as soon as possible,

<sup>7</sup> BHPB's First Submission, pages 36-67; rule 42 of the NGR.

# PART C - Rate of Return

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## 6 Introduction

### 6.1 Issue

In its Draft Decision, the Regulator rejected DBP's proposed rate of return of 10.76%, instead setting a rate of 7.16% (real pre-tax).<sup>8</sup>

In the Amended Proposed Access Arrangement, DBP failed to adopt the Regulator's required 7.16% rate of return, instead proposing a rate of 10.03%, which is approximately **40% above** the rate determined by the Regulator in its Draft Decision.<sup>9</sup>

### 6.2 Summary - BHPB position

BHPB submits that:

- (a) the Regulator was clearly correct to dismiss a rate of return of 10.76%;
- (b) the rate of return of 7.16% proposed by the Regulator in the Draft Decision is supported by the selection of parameters as discussed in this Part C; and
- (c) the rate of return proposed by DBP in the Amended Proposed Access Arrangement should be rejected.

### 6.3 BHPB's First Submission

In BHPB's First Submission, BHPB submitted that the 13.55% (nominal pre-tax) rate of return proposed by DBP in the Proposed Access Arrangement was not reasonable on the following basis:

- (a) DBP overstated the current risks facing the DBNGP and its owners.
- (b) DBP's proposed cost of equity was inflated and unjustifiable:
  - (i) under the NGR, DBP is required to use a financial model to estimate the cost of equity. It is not open to DBP to disregard financial models and instead use estimated forecasts of dividend yields;
  - (ii) in addition, the use of estimated forecasts of dividend yields to determine the cost of equity is unreliable and inappropriate;
  - (iii) the appropriate financial model to use under the NGR is the well accepted Capital Asset Pricing Model (**CAPM**) and the results from the alternative financial models should be disregarded; and
  - (iv) the MRP proposed by DBP in its CAPM was overstated and should be 5-6%.
- (c) DBP's proposed cost of debt was unreasonable:
  - (i) DBP should have determined the cost of debt using the well accepted basis of the nominal risk free rate plus a cost of debt margin instead of using an alternative approach; and

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<sup>8</sup> Draft Decision, para. 759 and required amendment 8.

<sup>9</sup> Amended Proposed Access Arrangement Information, page 22.



- (ii) DBP's proposed cost of debt of 9.73% was too high in comparison to recent regulatory decisions and should be no greater than 8.75%.
- (d) DBP should not have assigned a nil value to gamma:
  - (i) regulatory decisions have not accepted 0 as an appropriate gamma;
  - (ii) a value of 0 is not appropriate given the existence of Australian shareholding in the DBNGP; and
  - (iii) an appropriate value for gamma is 50-65%.

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## 7 Cost of equity

### 7.1 Issue

In the Draft Decision, the Regulator adopted the CAPM (Sharp-Lintner) model to determine a cost of equity of 10.26% (nominal post-tax).<sup>10</sup>

In response to the Draft Decision, DBP has failed to incorporate the Regulator's required cost of equity value in the Amended Proposed Access Arrangement, instead proposing a revised cost of equity of 12.5%, **22% higher than** the cost of equity value required by the Regulator under the Draft Decision.<sup>11</sup>

### 7.2 Summary - BHPB position

BHPB supports the Regulator's use of the CAPM (Sharp-Lintner) model for the purposes of calculating the cost of equity in the Draft Decision.

BHPB also supports the Regulator's determination that other versions of CAPM sought to be adopted by DBP in determining the cost of equity, namely the Black CAPM, the Fama-French CAPM, and the zero-beta Fama French CAPM, as well as the use of dividend yields, are not appropriate for determining the cost of equity under the NGR.<sup>12</sup>

Consistent with BHPB's First Submission, BHPB supports the Regulator's rejection of DBP's proposed cost of equity of 13.5% in the Draft Decision, and further submits that the Regulator should similarly reject a cost of equity of 12.5% proposed by DBP in the Amended Proposed Access Arrangement.

BHPB supports the cost of equity value of 10.26% proposed by the Regulator in the Draft Decision.

### 7.3 Background information

#### (a) DBP's Proposed Access Arrangement

In the Proposed Access Arrangement, DBP proposed a cost of equity of 13.5%. In doing so, DBP effectively ignored the results of the Sharp-Lintner CAPM and other financial models, preferring instead to adopt an approach based on analysing dividend yield forecasts.

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<sup>10</sup> Draft Decision, para. 756, table 45 and required amendment 7.

<sup>11</sup> Amended Proposed Access Arrangement Information, page 24.

<sup>12</sup> Draft Decision, para. 480.

**(b) BHPB's First Submission**

In BHPB's First Submission, BHPB submitted that the cost of equity of 13.5% proposed by DBP was inflated and unjustifiable.

BHPB's key submissions in respect of the method adopted by DBP to calculate the cost of equity were as follows:

- (i) under the NGR, DBP is required to use a financial model to estimate the cost of equity. It is not open to DBP to disregard financial models and instead use estimated forecasts of dividend yields;
- (ii) in addition, the use of estimated forecasts of dividend yields to determine the cost of equity is unreliable and inappropriate; and
- (iii) the appropriate financial model to use under the NGR is the well accepted CAPM and the results from the alternative financial models should be disregarded.<sup>13</sup>

**(c) Regulator's Draft Decision**

In response to DBP's proposal in relation to the determination of the cost of equity, the Regulator in its Draft Decision:

- (i) determined that the Sharp-Lintner CAPM is the most widely used CAPM model to estimate the cost of equity. The Regulator was not aware of any regulators in Australia who use different versions of the CAPM to estimate the cost of equity for their decisions;<sup>14</sup>
- (ii) **did not** accept DBP's submission that other versions of CAPM, namely the Black CAPM, the Fama-French CAPM, and the zero-beta Fama French CAPM, are well accepted models;<sup>15</sup> and
- (iii) **did not** approve DBP's approach of using dividend forecast reports to estimate the cost of equity.<sup>16</sup>

In order to determine the cost of equity, consistent with BHPB's First Submission, the Regulator applied the Sharp-Lintner CAPM model to calculate a value of 10.26%.<sup>17</sup>

## **7.4 Amended Proposed Access Arrangement**

**(a) Approach adopted to calculate the cost of equity**

In the Amended Proposed Access Arrangement, contrary to the determination of the Regulator in the Draft Decision, DBP appears to have adopted a random approach to calculate the cost of equity based on continuing to use the estimated forecast of dividend yields plus a premium and multiple financial models.<sup>18</sup>

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<sup>13</sup> BHPB's First Submission, page 15.

<sup>14</sup> Draft Decision, para. 468.

<sup>15</sup> Draft Decision, para 480.

<sup>16</sup> Draft Decision, para. 481.

<sup>17</sup> Draft Decision, para. 756 and table 45.

<sup>18</sup> Amended Proposed Access Arrangement Information, page 23.

DBP continues to refer to the Sharp-Lintner CAPM, Black CAPM, the Fama-French CAPM, and the zero-beta Fama French CAPM financial models in the Amended Proposed Access Arrangement Information.

While DBP appears to set out the Sharp-Lintner CAPM calculation in its Amended Proposed Access Arrangement Information, it seems that DBP has ignored the cost of equity value determined from the Sharp-Lintner CAPM. DBP has simply asserted (without any supporting material) that a cost of equity should not be as low as the cost of equity estimated by DBP using the Sharp-Lintner CAPM.<sup>19</sup>

**(b) Cost of equity value**

In the Amended Proposed Access Arrangement DBP has proposed a revised cost of equity of 12.5%, which is **22% higher** than the cost of equity required to be adopted by the Regulation in the Draft Decision.<sup>20</sup>

**7.5 The use of estimated forecasts of dividend yields is unreliable and inappropriate**

As noted in paragraph 7.4(a) above, DBP appears to have used the estimated forecast of dividend yields plus a premium to determine a range for the cost of equity value, and then selected a point within that range to determine a cost of equity value of 12.5% (with no reasoning as to the basis for reaching this point).<sup>21</sup>

The Regulator expressly provided in the Draft Decision that, “*the Authority **does not approve the approach of using dividend forecast reports to estimate the cost of equity.***”<sup>22</sup> BHPB supports the Regulator’s position in this regard. As set out in section 8.4 of BHPB’s First Submission, BHPB maintains that, aside from the fact that using forecast dividend yields to estimate the cost of equity fails to satisfy the legislative requirements to use a financial model, it also should be disregarded for the following reasons:

- (a) the estimate is overly simplistic and the use of such estimated forecasts has been demonstrated to provide unreliable results;
- (b) a reliance on analysts’ estimated forecasts has been shown to likely result in an upwardly biased estimate; and
- (c) contrary to rule 42 of the NGR, DBP has provided insufficient evidence to support the input assumptions on which its estimate is based.

On this basis, the calculation of the cost of equity in the Amended Proposed Access Arrangement should be rejected by the Regulator.

**7.6 The use of Sharp-Lintner CAPM**

In the Amended Proposed Access Arrangement Information, DBP continues to refer to the Black CAPM, Fama-French CAPM and zero-beta Fama French CAPM financial models.<sup>23</sup>

In the Draft Decision the Regulator considered the use of these alternative financial models in significant detail and concluded that such models are not “well accepted financial models” for the

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<sup>19</sup> Amended Proposed Access Arrangement Information, page 23. BHPB notes that in any event, it opposes the results of DBP’s Sharp-Lintner CAPM as the inputs used by DBP are inflated.

<sup>20</sup> Amended Proposed Access Arrangement Information, page 23.

<sup>21</sup> Amended Proposed Access Arrangement Information, pages 23 to 24.

<sup>22</sup> Draft Decision, para. 481.

<sup>23</sup> Amended Proposed Access Arrangement Information, page 23.

purposes of rule 87 of the NGR.<sup>24</sup> BHPB supports this position, and restates its submissions in this regard as set out in section 8 of BHPB's First Submission.

Table 1 below ("Summary of Cost of Equity Models Adopted by Australian Regulators"), set out in BHPB's First Submission reveals that the CAPM is the principal model used by Australian regulators in determining the appropriate cost of equity. This table has been updated to show that all regulatory decisions made since BHPB's First Submission have continued to adopt a CAPM cost of equity model.

**Table 1: Summary of Cost of Equity Models Adopted by Australian Regulators**

Year	Decision	Cost of equity model
2011	ERA - WA Gas Networks Mid-West and South-West Gas Distribution System (Final Decision)	CAPM
2011	AER - APT Allgas Queensland Gas Network (Draft Decision)	CAPM
2011	AER - Envestra Limited Queensland Gas Network (Draft Decision)	CAPM
2011	AER - Envestra Limited South Australia Gas Network (Draft Decision)	CAPM
2010	ERA - Goldfields Gas Pipeline (Final Decision)	CAPM
2010	AER - NSW Gas Networks (Final Decision)	CAPM
2010	AER - Wagga Wagga Natural Gas Distribution Network (Final Decision)	CAPM
2010	AER - ACT, Queanbeyan and Palerang Gas Distribution Network (Final Decision)	CAPM
2008	ACCC - Principal Transmission System (GasNet System) (Final Approval)	CAPM
2008	ESC - Gas Access Arrangements (Envestra (Victoria), Multinet, SP AustNet, Envestra (Albury)) (Further Final Decision and Approval)	CAPM
2007	ACCC - Dawson Valley Pipeline (Final Decision)	CAPM
2006	ACCC - Roma to Brisbane Pipeline (Final Decision)	CAPM
2006	QCA - Allgas Energy System (Final Decision)	CAPM
2006	QCA - Envestra Limited Gas Distribution Pipeline (Final Decision)	CAPM
2006	ESC - South Australian Gas Distribution System (Final Decision)	CAPM
2005	ERA - Dampier to Bunbury Natural Gas Pipeline (Draft Decision approved in Final Decision)	CAPM
2005	ERA - Goldfields Gas Pipeline (Final Decision)	CAPM
2005	IPART - AGL Gas Networks (Final Decision)	CAPM
2005	IPART - Country Energy Gas Network (Final Decision)	CAPM

<sup>24</sup> Draft Decision, para. 480.

Year	Decision	Cost of equity model
2005	ERA - Alinta Gas Distribution Systems (Mid West and South West Gas Distribution Systems) (Final Decision)	CAPM
2004	ICRC - ActewAGL Natural Gas System (Final Decision)	CAPM
2003	ACCC - Moomba to Sydney Pipeline (Final Approval)	CAPM
2003	Australian Competition Tribunal - GasNet System (Tribunal Decision)	CAPM
2002	ACCC - Amadeus Basin to Darwin Pipeline (Final Decision)	CAPM
2001	ACCC - Moomba to Adelaide Pipeline System (Final Decision)	CAPM
2001	QCA - Envestra Limited Gas Distribution (Final Decision Errata)	CAPM
2001	QCA - Allgas Energy System (Final Decision Errata)	CAPM
2000	ACCC - Central West Pipeline (Final Decision)	CAPM
2000	ICRC - ActewAGL Natural Gas System (Final Decision)	CAPM
2000	Offgar - Alinta Gas Distribution Systems (Mid West and South West Gas Distribution Systems) (Final Decision)	CAPM

The Australian Energy Regulator (**AER**) has also expressly considered and critically analysed the use of models other than the Sharp-Lintner CAPM to calculate cost of equity and, consistent with the Regulator in the Draft Decision, the AER has not accepted the use of multiple models as an approach to determining the cost of equity. Earlier this year the AER stated that:

*“the overarching approach used by Envestra - using multiple models/methods - is not a ‘well accepted financial model’ as required by r.87 of the NGR.”<sup>25</sup> (emphasis added).*

The AER also engaged an independent expert, Professor Kevin Davis of University of Melbourne, to provide expert advice on the use of the Sharp-Lintner CAPM relative to alternative models.<sup>26</sup> Importantly, in the Expert Report, Professor Davis found that:

- (a) the Sharp-Lintner CAPM is the most appropriate model to use in determining the cost of equity; and
- (b) the Black CAPM, the Fama-French CAPM and the dividend growth model rely on parameter inputs that cannot be estimated with any confidence.<sup>27</sup>

On the basis of the Regulator’s findings in respect of the use of the Black CAPM, Fama-French CAPM and zero-beta Fama French CAPM financial models and BHPB’s submissions in this section 7, the calculation of the cost of equity in the Amended Proposed Access Arrangement relies on these models should be rejected by the Regulator.

<sup>25</sup> AER, February 2011, “Draft decision - Access arrangement proposal for the SA gas network”, page 65.

<sup>26</sup> Ken Davis, Cost of Equity Issues: A report for the AER, 17 January 2011 referred to in AER, February 2011, “Draft decision - Access arrangement proposal for the SA gas network” (**Expert Report**), page 66-67.

<sup>27</sup> Ken Davis, Cost of Equity Issues: A report for the AER, 17 January 2011, pp. 10-15.

## **7.7 Cost of equity value proposed by the Regulator**

Consistent with BHPB's First Submission, BHPB supports the Regulator's rejection of a cost of equity of 13.5%, and further submits that the Regulator should similarly reject a cost of equity of 12.5% proposed by DBP in the Amended Proposed Access Arrangement.

BHPB supports the cost of equity of 10.26% proposed by the Regulator in the Draft Decision.

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## **8 Market Risk Premium**

### **8.1 Issue**

In the Draft Decision, the Regulator determined that an MRP of 6.0% be applied in determining the cost of equity.<sup>28</sup> In the Amended Proposed Access Arrangement DBP has failed to amend the MRP, maintaining an MRP of 6.5% as set out in the Amended Proposed Access Arrangement.<sup>29</sup>

### **8.2 Summary - BHPB position**

BHPB supports the Regulator's position in the Draft Decision to reject DBP's proposed MRP value of 6.5%. DBP's proposed MRP of 6.5% in the Amended Proposed Access Arrangement should likewise be rejected.

BHPB submits that an appropriate value for MRP is a point within the range of 5-6% and any MRP greater than 6% should be rejected.

### **8.3 BHPB's First Submission**

As set out in BHPB's First Submission, BHPB maintains its position that MRP 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.<sup>30</sup>

Based on historical data, future expectations and previously adopted values of 5%-6% by Australian regulators, BHPB supported an MRP of 5%-6%.<sup>31</sup>

### **8.4 Regulator's Draft Decision**

In its Draft Decision, the Regulator determined that a reasonable point estimate for the MRP was 6%.<sup>32</sup> The Regulator based this decision on the approach taken by other Australian regulators along with adopting the AER's view that an MRP of 6% is the best estimate of a forward-looking long-term MRP.<sup>33</sup>

### **8.5 DBP's Amended Proposed Access Arrangement**

Despite Required Amendment 7 in the Draft Decision, which required DBP to amend the MRP to 6.0%, DBP has not amended its proposed MRP of 6.5%.

### **8.6 BHPB's response**

BHPB notes that the value provided by the Regulator in the Draft Decision is consistent with the regulatory decisions which have been handed down since BHPB's First Submission, as set out in Table 2 below ("Summary of MRP Values Adopted by Australian Regulators").

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<sup>28</sup> Draft Decision, para. 756, table 45 and required amendment 7.

<sup>29</sup> Amended Proposed Access Arrangement Information, page 23.

<sup>30</sup> ERA, June 2009, "Final Determination on the 2009 Weighted Average Cost of Capital for TPI's Railway Network", page 20.

<sup>31</sup> First Submission, page 24-26.

<sup>32</sup> Draft Decision, para. 755.

<sup>33</sup> Draft Decision, para. 754.

**Table 2: Summary of MRP Values Adopted by Australian Regulators**

Year	Decision	MRP (%)
2011	ERA - WA Gas Networks Mid-West and South-West Gas Distribution System (Final Decision)	6.0
2011	AER - APT Allgas Queensland Gas Network (Draft Decision)	6.0
2011	AER - Envestra Queensland Gas Network (Draft Decision)	6.0
2011	AER - Envestra South Australia Gas Network (Draft Decision)	6.0
2010	ERA - Goldfields Gas Pipeline (Final Decision)	5.0-7.0
2010	AER - NSW Gas Networks (Final Decision)	6.5
2010	AER - Wagga Wagga Natural Gas Distribution Network (Final Decision)	6.5
2010	AER - ACT, Queanbeyan and Palerang Gas Distribution Network (Final Decision)	6.5
2008	ACCC - Principal Transmission System (GasNet System) (Final Approval)	6.0
2008	ESC - Gas Access Arrangements (Envestra (Victoria), Multinet, SP AustNet, Envestra (Albury)) (Further Final Decision and Approval)	6.0
2007	ACCC - Dawson Valley Pipeline (Final Decision)	6.0
2006	ACCC - Roma to Brisbane Pipeline (Final Decision)	6.0
2006	QCA - Allgas Energy System (Final Decision)	6.0
2006	QCA - Envestra Limited Gas Distribution Pipeline (Final Decision)	6.0
2006	ESC - South Australian Gas Distribution System (Final Decision)	6.0
2005	ERA - Dampier to Bunbury Natural Gas Pipeline (Draft Decision approved in Final Decision)	5.0-6.0
2005	ERA - Goldfields Gas Pipeline (Final Decision)	5.0-6.0
2005	IPART - AGL Gas Networks (Final Decision)	5.5-6.5
2005	IPART - Country Energy Gas Network (Final Decision)	6.0
2005	ERA - Alinta Gas Distribution Systems (Mid West and South West Gas Distribution Systems) (Final Decision)	5.0-6.0
2004	ICRC - ActewAGL Natural Gas System (Final Decision)	6.0



Year	Decision	MRP (%)
2003	ACCC - Moomba to Sydney Pipeline (Final Approval)	6.0
2003	Australian Competition Tribunal - GasNet System (Tribunal Decision)	6.0
2002	ACCC - Amadeus Basin to Darwin Pipeline (Final Decision)	6.0
2001	ACCC - Moomba to Adelaide Pipeline System (Final Decision)	6.0
2001	QCA - Envestra Limited Gas Distribution (Final Decision Errata)	6.0
2001	QCA - Allgas Energy System (Final Decision Errata)	6.0
2000	ACCC - Central West Pipeline (Final Decision)	6.0
2000	ICRC - ActewAGL Natural Gas System (Final Decision)	5.0-6.0
2000	Offgar - Alinta Gas Distribution Systems (Mid West and South West Gas Distribution Systems) (Final Decision)	6.0

In the Draft Decision, the Regulator indicates that it has adopted the same approach as certain of its previous decisions,<sup>34</sup> noting that in those decisions the Regulator adopted a range of 5% - 7%, with a final point estimate of 6%.<sup>35</sup>

To the extent the Draft Decision supports a final point estimate of MRP greater than 6%, BHPB opposes this. BHPB submits that, given the stabilisation of the market, there are currently no financial market conditions that warrant any adjustment to the historical average range value for the MRP of greater than 6%. Any range that extends to a value higher than 6% is unreasonable. Regulatory decisions handed down since BHPB's First Submission have all adopted a MRP of 6% (see Table 2).

On this basis, there is no reason for the Regulator to depart from its determination of a market risk premium of 6%, and should therefore reject DBP's proposed market risk premium of 6.5%.

<sup>34</sup> Final Decisions on the Proposed Revisions to the Access Arrangements for the South West interconnected Network in 2009 and on Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline in May 2010, para. 752 of the Draft Decision.

<sup>35</sup> Draft Decision, para 752.

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## **9 Cost of debt**

### **9.1 Issue**

In its Draft Decision, the Regulator did not approve DBP's proposal to include a cost of debt of 9.73%. In the decision, the Regulator has:

- (a) adopted a risk free rate plus a cost of debt margin approach in calculating the cost of debt;
- (b) assigned a rating of BBB+ as the appropriate credit rating to determine the debt risk premium; and
- (c) determined a cost of debt of 8.71%.<sup>36</sup>

In the Amended Proposed Access Arrangement, DBP has proposed a cost of debt of 9.50%, failing to incorporate the amendments in relation to the cost of debt required under the Draft Decision.<sup>37</sup>

### **9.2 Summary - BHPB position**

In response to the Draft Decision, BHPB:

- (a) supports the Regulator's use of a nominal risk free rate plus a cost of debt margin approach;
- (b) supports the Regulator's adoption of a BBB+ rating as the appropriate credit rating to determine the debt risk premium; and
- (c) notes the close proximity of BHPB's cost of debt submission in BHPB's First Submission and the Regulator's determination in the Draft Decision of a cost of debt value of 8.71%.

### **9.3 Background Information**

#### **(a) Regulator's Draft Decision**

The Regulator determined that the cost of debt is to be calculated based on the sum of:

- (i) a nominal risk free rate, based on the Commonwealth government securities;
- (ii) a debt risk premium based on Bloomberg data for a sample of BBB+ Australian corporate bonds; and
- (iii) an allowance for debt raising costs.

In doing so, the Regulator determined that:

- (i) there is no evidence supporting DBP's use of the Bank Bill Swap Rate (**BBSW**) for the purposes of calculating the nominal risk free rate; and
- (ii) the debt risk premium should be estimated by reference to debt costs for businesses with a credit risk profile consistent with a BBB+ credit rating, at the end of October 2010, with relevant sources of market evidence including CBASpectrum and Bloomberg.<sup>38</sup>

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<sup>36</sup> Draft Decision, para. 618, table 45 and required amendment 7.

<sup>37</sup> Amended Proposed Access Arrangement Information, page 26.

<sup>38</sup> Draft Decision, para 513.

**(b) DBP's Amended Proposed Access Arrangement**

In calculating the cost of debt DBP has, contrary to the Draft Decision, failed to:

- (i) use an approach which calculates the cost of debt based on a nominal risk free rate plus a cost of debt margin;
- (ii) apply a BBB+ rating for the purposes of calculating the debt risk premium; and
- (iii) determine a cost of debt value of 8.71%.

**9.4 BHPB's Further Submission**

In this section, BHPB makes submissions on the three key areas noted in section 9.3(b) of this submission where DBP has departed from the Draft Decision, namely:

- (a) the approach DBP adopts to calculate the cost of debt;
- (b) the use of a credit rating of less than BBB to determine the debt risk premium; and
- (c) the failure to adopt a cost of debt value of 8.71%.

**(a) Cost of debt - the approach**

BHPB supports the Regulator's adoption of a risk free rate plus a cost of debt margin approach in the Draft Decision to calculate the cost of debt. This is consistent with the approach adopted by almost all regulators in Australia in recent regulatory decisions (see Table 3 below: "Summary of Cost of Debt Models Adopted by Australian Regulators").

**Table 3: Summary of Cost of Debt Models Adopted by Australian Regulators**

Year	Decision	Cost of debt model
2011	ERA - WA Gas Networks Mid-West and South-West Gas Distribution System (Final Decision)	Rf + cost of debt margin
2011	AER - APT Allgas Queensland Gas Network (Draft Decision)	Rf + cost of debt margin
2011	AER - Envestra Limited Queensland Gas Network (Draft Decision)	Rf + cost of debt margin
2011	AER - Envestra Limited South Australia Gas Network (Draft Decision)	Rf + cost of debt margin
2010	ERA - Goldfields Gas Pipeline (Final Decision)	Rf + cost of debt margin
2010	AER - NSW Gas Networks (Final Decision)	Rf + cost of debt margin
2010	AER - Wagga Wagga Natural Gas Distribution Network (Final Decision)	Rf + cost of debt margin
2010	AER - ACT, Queanbeyan and Palerang Gas Distribution Network (Final Decision)	Rf + cost of debt margin

Year	Decision	Cost of debt model
2008	ACCC - Principal Transmission System (GasNet System) (Final Approval)	Rf + cost of debt margin
2008	ESC - Gas Access Arrangements (Envestra (Victoria), Multinet, SP AustNet, Envestra (Albury)) (Further Final Decision and Approval)	Rf + cost of debt margin
2007	ACCC - Dawson Valley Pipeline (Final Decision)	Rf + cost of debt margin
2006	ACCC - Roma to Brisbane Pipeline (Final Decision)	Rf + cost of debt margin
2006	QCA - Allgas Energy System (Final Decision)	Rf + cost of debt margin
2006	QCA - Envestra Limited Gas Distribution Pipeline (Final Decision)	Rf + cost of debt margin
2006	ESC - South Australian Gas Distribution System (Final Decision)	Rf + cost of debt margin
2005	ERA - Dampier to Bunbury Natural Gas Pipeline (Draft Decision approved in Final Decision)	Rf + cost of debt margin
2005	ERA - Goldfields Gas Pipeline (Final Decision)	Rf + cost of debt margin
2005	IPART - AGL Gas Networks (Final Decision)	Rf + cost of debt margin
2005	IPART - Country Energy Gas Network (Final Decision)	Rf + cost of debt margin
2005	ERA - Alinta Gas Distribution Systems (Mid West and South West Gas Distribution Systems) (Final Decision)	Rf + cost of debt margin
2004	ICRC - ActewAGL Natural Gas System (Final Decision)	Rf + cost of debt margin
2003	ACCC - Moomba to Sydney Pipeline (Final Approval)	Rf + cost of debt margin
2003	Australian Competition Tribunal - GasNet System (Tribunal Decision)	Rf + cost of debt margin
2002	ACCC - Amadeus Basin to Darwin Pipeline (Final Decision)	Rf + cost of debt margin
2001	ACCC - Moomba to Adelaide Pipeline System (Final Decision)	Rf + cost of debt margin
2001	QCA - Envestra Limited Gas Distribution (Final Decision Errata)	Rf + cost of debt margin
2001	QCA - Allgas Energy System (Final Decision Errata)	Rf + cost of debt margin

Year	Decision	Cost of debt model
2000	ACCC - Central West Pipeline (Final Decision)	Rf + cost of debt margin
2000	ICRC - ActewAGL Natural Gas System (Final Decision)	Rf + cost of debt margin
2000	Offgar - Alinta Gas Distribution Systems (Mid West and South West Gas Distribution Systems) (Final Decision)	CAPM (using debt beta)

In the Amended Proposed Access Arrangement Information, DBP has failed to adopt a nominal risk free rate plus a cost of debt margin approach in calculating the cost of debt as determined by the Draft Decision.

Based on BHPB's review of the Amended Proposed Access Arrangement Information, it appears that DBP has continued to adopt an approach to calculate the cost of debt using BBSW as the reference rate, with costs of debt then being expressed as a total cost above BBSW. DBP has maintained that the total cost comprises a number of cost components, including lender's margin and costs specific to particular markets. BHPB notes that this approach was rejected by the Regulator in the Draft Decision, which BHPB supports.

Given that DBP has adopted an approach to calculate the cost of debt that has been expressly rejected by the Regulator in the Draft Decision, and has further failed to adopt the approach required by the Regulator, DBP's cost of debt value derived from this approach should be rejected.

**(b) Credit rating used to determine the debt risk premium**

In its Draft Decision, the Regulator determined that the credit rating for the purposes of calculating the debt risk premium is BBB+. <sup>39</sup> BHPB supports the Regulator's determination of a BBB+ rating.

Despite the determination made by the Regulator in the Draft Decision DBP does not appear to propose a credit rating but instead states that its proposed cost of debt was determined from the cost of a benchmark service provider with a credit rating "in the BBB ranges". <sup>40</sup>

In support of its submission, BHPB notes the following from the Draft Decision:

- (i) The credit rating of BBB+ has been consistently adopted in all decisions by the AER for gas distribution over eastern Australia.
- (ii) The AER has also conducted analysis to conclude that the credit rating of BBB+ is appropriate, using the median credit ratings and the "best comparators" approaches for the sample of companies including electricity and gas transmission and distribution businesses. <sup>41</sup>

<sup>39</sup> Draft Decision, para. 498.

<sup>40</sup> Amended Proposed Access Arrangement Information, page 25.

<sup>41</sup> Draft Decision, paras. 495 - 496,.

BHPB submits that there is no basis for DBP to propose a credit rating of less than BBB+ for the purposes of determining the debt risk premium for the purposes of the cost of debt, and any such credit rating should be rejected by the Regulator.

**(c) Cost of debt value**

In the Draft Decision, the Regulator rejected DBP's proposed cost of debt of 9.73%, and determined a cost of debt of 8.71%. In the Amended Proposed Access Arrangement Information, inconsistent with the required amendments in the Draft Decision, DBP has proposed a cost of debt of 9.52%.

BHPB maintains its submission that, based on readily available Australian regulatory decisions, an appropriate value for cost of debt is not more than 8.75% and the cost of debt proposed by DBP in the Amended Proposed Access Arrangement should be rejected.

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## 10 Gamma

### 10.1 Issue

In its Draft Decision, the Regulator did not approve DBP's proposal to adopt a value for the utilisation of imputation credits (commonly referred to as 'gamma' or  $\gamma$ ) of zero, instead deciding that a value of .53 (or 53%) is appropriate. In the Amended Proposed Access Arrangement, DBP has maintained a gamma of zero, failing to adopt the required amendment set out in the Draft Decision.

### 10.2 Summary - BHPB position

BHPB submits that DBP's proposed gamma of zero should be rejected, and supports the rejection of a gamma value of zero in the Draft Decision. BHPB maintains that an appropriate value for gamma is a point between .50-.65 (or 50-65%).

### 10.3 BHPB's First Submission

BHPB previously noted that rule 87(2) of the NGR provides that in determining a rate of return on capital, it will be assumed that the service provider uses a "*financing structure that meets benchmark standards as to .. financial parameters for a going concern and reflects in other respects best practice.*"<sup>42</sup>

BHPB also maintains the following as set out in BHPB's First Submission:

- (a) A nil value for gamma is not consistent with benchmark standards. This is demonstrated by readily available Australian regulatory decisions on the appropriate gamma, which have not accepted a gamma of zero.
- (b) The AER electricity WACC review which decided on a gamma of 0.65 should be noted.<sup>43</sup>
- (c) It is not appropriate to make no allowance for the value of imputation credits given the existence of Australian shareholding in the owners of the DBNGP. The presence of Australian investors in the DBNGP means a gamma of zero is clearly inappropriate. This was effectively acknowledged by DBP itself in initially proposing a value for gamma of 0.20.<sup>44</sup>

### 10.4 Regulator's Draft Decision

The Regulator considered advice previously provided to the AER and noted that imputation credits are not assumed to have zero value but rather they are simply not explicitly taken into account in either the cash flows or in the discount rate.<sup>45</sup>

On the basis of such considerations, together with the fact that imputation credits are not assumed to have a zero value to investors, the Regulator provided that setting the value of gamma to zero is not appropriate.<sup>46</sup>

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<sup>42</sup> BHPB's First Submission, page 30.

<sup>43</sup> AER, May 2009, "Final Decision - Electricity transmission and distribution network service providers - Review of weighted average cost of capital (WACC) parameters", page v.

<sup>44</sup> DBP, April 2010, "Submission 8: Rate of Return Public Version", page 25

<sup>45</sup> Handley, Report prepared for the Australian Energy Regulator on the estimation of gamma, 19 March 2010, pp. 3-4 referred to in the Draft Decision, para. 638.

<sup>46</sup> Draft Decision, para. 639.

The Regulator rejected DBP's proposal of zero in relation to gamma. The Regulator considered that a reasonable point estimate for gamma is 0.53 (or 53%).<sup>47</sup>

#### **10.5 DBP's Amended Proposed Access Arrangement**

Contrary to the Draft Decision, DBP's Amended Proposed Access Arrangement makes no amendment to gamma, retaining a value of zero.<sup>48</sup> The Amended Proposed Access Arrangement does not contain any information supporting this position.

#### **10.6 BHPB's further submission**

BHPB supports the Regulator's Draft Decision to reject DBP's proposed value for gamma of zero and submits that given the reasons provided in the Regulator's Draft Decision, there is no basis for DBP to maintain a value for gamma of zero.

In response to DBP's proposed gamma of zero in its Amended Proposed Access Arrangement, BHPB restates its submissions set out in its First Submission in respect of the benchmark standards as to the appropriate gamma, which are demonstrated by readily available Australian regulatory decisions which have not accepted a gamma of zero.<sup>49</sup>

BHPB maintains that an appropriate value for gamma is a point between 0.50-0.65 (or 50-65%).

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<sup>47</sup> Draft Decision, para. 682, table 45 and required amendment 7.

<sup>48</sup> Amended Proposed Access Arrangement Information, page 27.

<sup>49</sup> BHPB's First Submission, page 30-32.



## PART D - REFERENCE SERVICE

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### 11 Introduction

#### 11.1 Issue

In the Draft Decision, the Regulator has not approved DBP's proposal to offer only one reference service, namely the "R1 Service", and determined that the T1 Service, P1 Service and B1 Service be reinstated. The Regulator did not include inlet services or spot services as reference services.

In the Amended Proposed Access Arrangement, DBP has retained the proposed R1 Service and has not reinstated the T1, P1 and B1 Services.

#### 11.2 BHPB's First Submission

BHPB provided the following objections to the proposed R1 Service:

- (a) the "R1 Service" is less reliable than the current "T1 Service" and for that reason is unlikely to be sought or utilised by a significant part of the market;
- (b) part haul and back haul services have not been included as reference services, and these are likely to be sought by a significant part of the market; and
- (c) spot capacity and inlet sales services have not been included as reference services, and these are likely to be sought by a significant part of the market.<sup>50</sup>

On this basis, BHPB submitted that the Proposed Access Arrangement should contain:

- (a) a "T1 Service", not an "R1 Service";
- (b) P1 and B1 Services; and
- (c) spot capacity and inlet sales services.<sup>51</sup>

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### 12 "R1, T1, P1 and B1 Services"

#### 12.1 Issue

In the Draft Decision, the Regulator did not approve DBP's proposal to offer only one reference service, namely the "R1 Service", and determined that the T1, P1 and B1 Services be reinstated.<sup>52</sup>

#### 12.2 Summary - BHPB Position

BHPB supports the Regulator's position in respect of removing the proposed R1 Service as a reference service and reinstating the T1, P1 and B1 Services.

#### 12.3 Regulator's Draft Decision

In the Draft Decision, the Regulator determined that:

- (a) a service in the nature of the proposed R1 Service is unlikely to be sought by a significant part of the market and that the proposed R1 Service does not meet the requirements for a

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<sup>50</sup> BHPB's First Submission, page 33.

<sup>51</sup> BHPB's First Submission, page 33.

<sup>52</sup> Draft Decision, required amendments 2 and 3.

reference service under rule 101 of the NGR and should be removed as a reference service;<sup>53</sup> and

- (b) services in the nature of the T1, P1 and B1 Services are likely to be sought by a significant part of the market during the 2011 to 2015 access arrangement period and should be reinstated as reference services.<sup>54</sup>

#### **12.4 DBP's Amended Proposed Access Arrangement**

Contrary to the Draft Decision, DBP has failed to remove the proposed R1 Service and has also failed to reinstate the T1, P1 and B1 Services in the Amended Proposed Access Arrangement.

#### **12.5 BHPB's further submission**

BHPB maintains its position set out in BHPB's First Submission. Importantly, BHPB maintains, along with other existing shippers, that the proposed R1 Service is unlikely to be sought by a significant part of the market. Therefore, in light of rule 101(2) of the NGR, such service which is not demanded by users and prospective users should not be a reference service.

BHPB concurs with the Regulator's Draft Decision that T1, P1 and B1 Services are all pipeline services that will be sought by a significant part of the market during the period covered by the access arrangement. Consequently, BHPB agrees that these services should be specified as reference services in the DBNGP Access Arrangement.

Based on the above, and the submissions made in BHPB's First Submission, BHPB submits that DBP's proposal in the Amended Proposed Access Arrangement to retain the R1 Service and not include the T1, P1 and B1 Services as reference services be rejected.

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### **13 Spot Capacity and Inlet Sales Services**

#### **13.1 Issue**

In the Draft Decision, the Regulator determined that Spot Capacity and Inlet Sales Services provided by the means of the DBNGP should not be included in the access arrangement as reference services.

#### **13.2 Regulator's Draft Decision**

The Regulator determined in the Draft Decision that Spot Capacity and Inlet Sales Services should not be included as Reference Services on the basis that the volumes of these services sought during the current access arrangement period, and likely to be sought during the next access arrangement period do not constitute a significant part of the market.<sup>55</sup>

#### **13.3 BHPB position**

Consistent with its First Submission, BHPB maintains its position that Spot Capacity and Inlet Sales Services should be reference services as they are likely to be sought by a significant part of the market and there is no real incremental cost to DBP of providing these services.

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<sup>53</sup> Draft Decision para. 64.

<sup>54</sup> Draft Decision para. 70.

<sup>55</sup> Draft Decision, para. 86.

## PART E - Terms and Conditions

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### 14 Amendments to the Terms and Conditions

#### 14.1 Option to renew contract (clause 4.5)

**(a) Issue**

In the Draft Decision, the Regulator required DBP to amend clause 4.5 of the Terms and Conditions so that shippers must give written notice to the Operator 12 months in advance of exercising an Option (as opposed to the proposed 30 month period).<sup>56</sup>

In the Amended Proposed Access Arrangement, DBP has failed to make this amendment, instead deleting in full the option mechanism under the Terms and Conditions (clauses 4.3 - 4.7).

**(b) BHPB position**

BHPB supports the Regulator's position in the Draft Decision and submits that, consistent with the Draft Decision, DBP's proposed deletion of clauses 4.3 - 4.7 in the Terms and Conditions of the Amended Proposed Access Arrangement should be rejected, and the notice period in clause 4.5 should be amended to 12 months.

#### 14.2 System Use Gas (clause 5.10)

**(a) Issue**

In BHPB's First Submission, BHPB submitted that the Terms and Conditions should be amended to entitle, but not oblige, shippers to supply their own System Use Gas.<sup>57</sup>

In the Draft Decision, the Regulator determined that only the Operator is to be responsible for supplying System Use Gas.<sup>58</sup>

**(b) BHPB position**

BHPB submits, consistent with BHPB's First Submission, that allowing shippers to supply their own System Use Gas is the most efficient option, as the party who is in the best position to supply the System Use Gas at the lowest cost will ultimately end up doing so.

BHPB also notes with interest that, in its Technical Assessment of the DBNGP Access Arrangement, Halcrow Pacific states that DBP has agreed with a current shipper on the DBNGP to allow that shipper to supply its own fuel gas for the amount that relates to the transportation of its contracted capacity.<sup>59</sup> This indicates that there is indeed demand from shippers to supply System Use Gas.

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<sup>56</sup> Draft Decision, required amendment 32.

<sup>57</sup> clause 5.10 of the Terms and Conditions; see section 18.6 of BHPB's First Submission.

<sup>58</sup> Draft Decision, required amendment 39.

<sup>59</sup> Page 238, Economic Regulation Authority of Western Australia Dampier to Bunbury Natural Gas Pipeline Access Arrangement Review- Technical Assessment Draft Review Report by Halcrow Pacific.

### 14.3 Other Charges (clause 20)

#### (a) Issue

In the Draft Decision, the Regulator determined that clause 20.4 of the Terms and Conditions be amended so that charges levied in excess of the relevant cost to the Operator be rebatable to shippers.<sup>60</sup>

In the Amended Proposed Access Arrangement, DBP has failed to make this amendment.

#### (b) BHPB position

BHPB supports the position of the Regulator in the Draft Decision in relation to rebatable charges, and submits that DBP be required to amend the Terms and Conditions consistent with this required amendment.

BHPB notes that the reference to “*clause 17.10 of the existing terms and conditions*” in required amendment 76 of the Draft Decision appears to be an error.

### 14.4 Permitted disclosures (clause 28.3)

#### (a) Issue

In the Draft Decision, the Regulator has approved clause 28.3(a)(i), which has the effect of permitting the Operator to disclose Confidential Information to Alcoa of Australia Limited (**Alcoa**), who is currently a shipper on the DBNGP. The Regulator has approved this provision subject to clause 28.3 being amended to expressly incorporate the Operator’s obligations to comply with ring fencing provisions under the NGL and NGR.<sup>61</sup>

#### (b) BHPB position

BHPB submits that the Regulator should ensure that incorporation of the ring fencing obligations into the Access Arrangement prohibit the Operator from disclosing Confidential Information to a third party shipper who is also an owner. In particular, BHPB submits that the Regulator consider whether additional ring fencing requirements are required to be specified under the NGL to achieve this.

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## 15 Efficiency-incentive mechanism

### 15.1 Issue

The Proposed Access Arrangement does not contain an efficiency-incentive mechanism. In the Draft Decision the Regulator considered whether to incorporate an incentive mechanism, however ultimately opposed such inclusion.

### 15.2 BHPB Submission - Summary

BHPB maintains its position set out in its First Submission that the Access Arrangement should contain an incentive mechanism which seeks to ensure that the DBNGP is run as efficiently as possible.<sup>62</sup>

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<sup>60</sup> Draft Decision, required amendment 76.

<sup>61</sup> Draft Decision, required amendment 92.

<sup>62</sup> BHPB’s First Submission, page 43.

### 15.3 Draft Decision

In the Draft Decision, the Regulator's consideration of the inclusion of an incentive mechanism was limited to considering the merits of including an incentive mechanism similar to the one contained in the current DBNGP Access Arrangement (**Old Incentive Mechanism**).

The Old Incentive Mechanism provides for an amount to be added to total revenue in each of the years of the next access arrangement period where DBP outperforms forecasts of operating expenditure in years of the current access arrangement period.

The Regulator was of the view that an incentive mechanism like the Old Incentive Mechanism may create undesirable incentives for DBP, such as:

- (a) incentives to shift costs to create a benefit for the service provider under the incentive mechanism without benefiting users; and
- (b) where an incentive mechanism is applied only to operating expenditure, incentives to inefficiently substitute capital expenditure for operating expenditure.<sup>63</sup>

Based on these potential undesirable incentives, the Regulator decided not to impose an incentive mechanism in the DBNGP Access Arrangement.

### 15.4 Proposed incentive mechanism

In BHPB's First Submission, it submitted that an incentive mechanism for System Use Gas based on the following be incorporated into the Access Arrangement:

- (a) an independent specialist consultant be engaged to establish the efficient level of System Use Gas for the DBNGP. This may include a narrow range of acceptable operation; and
- (b) System Use Gas limits are then set through the Access Arrangement; and
- (c) where DBP operates the DBNGP more efficiently than the set guidelines, it is entitled to retain the revenue derived from the gas saving (or incremental System Use Gas provided by shippers); and
- (d) where DBP operates the DBNGP less efficiently than the set guidelines, it is required to provide the incremental System Use Gas above the set limits without an entitlement to pass this cost to shippers.<sup>64</sup>

The Regulator does not appear to have considered BHPB's proposed incentive mechanism in the Draft Decision.

BHPB submits that the adoption of an incentive mechanism of the kind proposed by BHPB would:

- (a) not be susceptible to the same potential undesirable incentive risks for the service provider that was of concern to the Regulator in relation to the Old Incentive Mechanism; and
- (b) be consistent with the NGL, ensure that the DBNGP is run as efficiently as possible; and
- (c) minimise gas consumption and losses and therefore associated emissions.

Based on the above, BHPB submits that an incentive mechanism of the kind proposed by BHPB should be incorporated into the Access Arrangement.

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<sup>63</sup> Draft Decision, para. 783.

<sup>64</sup> BHPB's First Submission page 44.

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## **16 Regulator's Required Amendments to the Access Arrangement supported by BHPB**

In addition to various amendments in the Draft Decision which BHPB has noted its support of elsewhere in this Submission, BHPB also supports the following decisions (and related required amendments) of the Regulator:

- (a) the Regulator's decision not to approve DBP's proposal to include a new cost pass through variation (para. 974);
- (b) the Regulator's rejection of DBP's proposed removal of clause 8.18 of the Terms and Conditions in the current Access Arrangement (para. 1248);
- (c) the Regulator's rejection of DBP's proposed removal of clause 9.5 and 9.6 of the Terms and Conditions in the current Access Arrangement (para. 1262, 1267 and 1275);
- (d) the Regulator's rejection of DBP's amendment to clauses 10.3, 10.4 and 10.7 of the Terms and Conditions in the current Access Arrangement (para. 1287, 1291 and 1295).
- (e) the Regulator's decision not to approve DBP's proposal to amend the Overrun Rate in clause 11.1 of the current Access Arrangement Terms and Conditions (para. 1303);
- (f) the Regulator's decision not to approve DBP's proposal to change the criteria in respect assignment of capacity in clause 25.3 of the current Access Arrangement Terms and Conditions ( para. 1480);
- (g) the Regulator's decision not to approve DBP's proposal to impose a new requirement on shippers wishing to utilise other shippers' daily nominations (para. 1495);
- (h) the Regulator's rejection of DBP's proposed removal of clause 26 of the current Access Arrangement Terms and Conditions which provides for a shippers' general right of relinquishment (para 1499);
- (i) the Regulator's rejection of DBP's proposed removal of the environmental warranty provided by the operator in clause 30.1 of the current Access Arrangement Terms and Conditions (para. 1536);
- (j) the Regulator's rejection of DBP's proposed removal of the provision for shippers to require the operator to provide information on planned expansions in capacity of the DBNGP for the following 5 years, as provided for in clause 31 of the current Access Arrangement Terms and Conditions (para. 1548); and
- (k) the Regulator's rejection of DBP's proposed removal of a non-discrimination provision relating to the provision of information by the operator to shippers and the treatment of all shippers on an arms' length basis, as provided for in clause 45 of the current Access Arrangement Terms and Conditions (para. 1561).

DBP has failed to incorporate all of the Regulator's Required Amendments listed above in the Amended Proposed Access Arrangement.

BHPB notes and restates its reasons contain in BHPB's First Submission which explain BHPB's support for the above decisions of the Regulator.

## PART F - OTHER ISSUES

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### 17 Capital expenditure and operating expenditure

#### 17.1 Issue

The Draft Decision requires DBP to make amendments to:

- (a) the value of its conforming capital expenditure for the 2005 to 2010 access arrangement period;<sup>65</sup>
- (b) the value of its forecast conforming capital expenditure for the 2011 to 2015 access arrangement period;<sup>66</sup> and
- (c) the value of its forecast operating expenditure for the 2011 to 2015 access arrangement period;<sup>67</sup> and

Based on BHPB's review of the Amended Proposed Access Arrangement Information, it appears that DBP has failed to make these amendments.

#### 17.2 BHPB response

BHPB submits that:

- (a) the Regulator should examine DBP's forecast operating expenditure and capital expenditure figures contained in the Amended Proposed Access Arrangement Information closely to ensure that they comply with the NGR Requirements;
- (b) to the extent that DBP's forecast operating expenditure and capital expenditure figures contained in the Amended Proposed Access Arrangement Information are greater than the figures required by the Draft Decision, these should be rejected by the Regulator; and
- (c) the Regulator should ensure that DBP provides sufficient information in support of the forecast operating expenditure and forecast capital expenditure figures proposed in the Amended Proposed Access Arrangement Information and ensure that stakeholders have had an opportunity to consider this information and make submissions to the Regulator thereon.

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<sup>65</sup> Required Amendment 5, Draft Decision.

<sup>66</sup> Required Amendment 6, Draft Decision.

<sup>67</sup> Required Amendment 10, Draft Decision.