



Public Submission

By BHP Billiton

**In Response to DBP's Submissions in Support of
the Dampier to Bunbury Natural Gas Pipeline
Amended Proposed Access Arrangement**

20 July 2011

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PART A - INTRODUCTION

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 2010.¹ On 3 June 2010, the Regulator extended the period for submissions to 9 July 2010.²

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

On 20 May 2011 BHPB lodged a submission in response to the Draft Decision and the Amended Proposed Access Arrangement (**Second Submission**).

On 23 June 2011, the Regulator released in redacted form various supporting submissions made by DBP which purport to explain and substantiate the amendments and additions to the Amended Proposed Access Arrangement (**Supporting Submissions**). DBP had previously claimed confidentiality over the content of all of the Supporting Submissions.

2 Introduction

This submission is made by BHPB in relation to the Supporting Submissions which were lodged by DBP, namely:

- (a) Submission 48: Overarching (**Submission 48**);
- (b) Submission 49: Response to Specific Amendments;
- (c) Submission 50: Reference Service (**Submission 50**);
- (d) Submission 51: Terms & Conditions;

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

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

- (e) Submission 52: Opening Capital Base;
- (f) Submission 53: Roll Forward of the Capital Base;
- (g) Submission 54: Operating Expenditure;
- (h) Submission 55: Rate of Return (**Submission 55**);
- (i) Submission 56: Other Tariff Matters; and
- (j) Submission 57: Non tariff Matters.

3 Structure

This submission is structured to focus on the following areas:

- (a) Part A - Introduction
- (b) Part B - DBP's Overarching Submission
- (c) Part C - Rate of Return
- (d) Part D - Reference Service

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).

4 Executive Summary

4.1 DBP's Overarching Submission

BHPB submits that neither DBP's Submission 48, nor any of the other Supporting Submissions, provides any evidence to support DBP's sweeping submission that in the Draft Decision the Regulator has, in a number of instances, supposedly failed to properly exercise its discretion. On this basis, the Regulator should give no weight to Submission 48 or the proposition that the Regulator has failed to properly exercise its discretion.

4.2 Rate of Return

Consistent with BHPB's Second Submission, BHPB supports the Regulator's rejection in the Draft Decision of DBP's proposed rate of return of 10.76%, and submits that DBP's proposed rate of return of 10.03% in its Amended Proposed Access Arrangement should also be rejected.

BHPB further submits that the Regulator's approach in determining the rate of return complies with the NGL and NGR and the Regulator correctly exercised its discretion in accordance with the NGL and NGR in determining the rate of return.

4.3 Reference Services

DBP continues to propose to offer only one reference service in the Amended Proposed Access Arrangement, namely the R1 service.

BHPB submits that the Supporting Submissions provide no basis to support to the inclusion of the R1 service and the non-inclusion of the T1 P1 and B1 services as reference services. BHPB restates its position as submitted in its First Submission and Second Submission and submits that

the Regulator should maintain its position in the Draft Decision to reject DBP's proposal to offer only the R1 service as a reference service and reinstate the T1, P1 and B1 services as reference services.

PART B - DBP'S OVERARCHING SUBMISSION

5 DBP's overarching submission

5.1 Issue

In its Submission 48, DBP has made a sweeping submission that in the Draft Decision the Regulator has, in a number of instances, supposedly failed to properly exercise its discretion.

5.2 BHPB Submission

BHPB submits that neither DBP's Submission 48, nor indeed any of the Supporting Submissions, provides any evidence to support DBP's broad claim. DBP's Submission 48 does nothing more than raise an unsupported allegation in respect of the Regulator's alleged failure to properly exercise its discretion. On this basis, BHPB submits that the Regulator should give no weight to DBP's Submission 48.

BHPB submits that, in respect of the issues raised by DBP in its Supporting Submissions, the Regulator has properly exercised its discretion in accordance with the applicable requirements of the NGL and NGR.

PART C - RATE OF RETURN

6 Introduction

6.1 Issue

In the Proposed Access Arrangement, DBP proposed a rate of return of 10.76%. In the Draft Decision, the Regulator rejected this rate of return, imposing a rate of 7.16% (real pre-tax).³ In both the Amended Proposed Access Arrangement and its Supporting Submission 55, DBP has failed to adopt the 7.16% rate of return required by the Draft Decision. DBP has instead proposed a rate of 10.03%, which is approximately **40% higher** than the rate determined by the Regulator in its Draft Decision.⁴

6.2 Summary - BHPB position

Consistent with BHPB's Second Submission, BHPB supports the Regulator's rejection in the Draft Decision of a rate of return of 10.76%. BHPB further submits that:

- (a) the Regulator's determination of the rate of return complies with applicable requirements, and applicable criteria prescribed by the NGL and NGR;
- (b) the Regulator has correctly exercised its discretion in determining the rate of return in accordance with Rule 87 of the NGR; and
- (c) there is nothing in DBP's Submission 55 that supports the Regulator departing from a rate of return of 7.16%, and on this basis the Regulator should reject DBP's proposed rate of return of 10.03%.

7 DBP's Submission 55: Rate of Return

In Submission 55, DBP continues to adopt a rate of return inconsistent with, and materially higher (by 44%) than the rate of return required by the Draft Decision.

DBP broadly claims, among other things, that:

- (a) in its Draft Decision, the Regulator did not properly exercise its discretion when determining the rate of return in accordance with the requirements under the NGR and the NGL;⁵ and
- (b) when calculating the cost of equity using the Sharp-Linter CAPM model, "adjustments" need to be made to the cost of equity by reference to the calculations of other CAPM. The other CAPM used by DBP to make these adjustments are those models that were deemed by the Regulator in the Draft Decision not to be "well accepted models" for the purposes of the NGR.⁶

³ Draft Decision, para. 759 and required amendment 8.

⁴ Amended Proposed Access Arrangement Information, page 22; Submission 55, page 40.

⁵ Submission 55, page 1.

⁶ Draft Decision, para. 480.

8 BHPB submission

8.1 Regulator's determination of the rate of return

Consistent with BHPB's Second Submission, BHPB supports the Regulator's approach in determining the rate of return in the Draft Decision and submits that the Regulator has exercised its discretion in accordance with Rule 40(3) of the NGR.

As noted by DBP in its Supporting Submissions,⁷ the Regulator has full discretion in accordance with section 40(3) of the NGR when determining the rate of return applicable under an access arrangement.

When exercising its discretion in this regard, the Regulator is free to withhold its approval to the rate of return proposed by the Service Provider if, **in the Regulator's opinion**, a preferable alternative exists that:

- (a) complies with applicable requirements of the NGL and NGR; and
- (b) is consistent with applicable criteria (if any) prescribed by the NGL and NGR.⁸

In exercising its full discretion when determining the rate of return in the Draft Decision⁹ the Regulator undertook a detailed consideration of:

- (a) previous regulatory decisions;¹⁰
- (b) the application of the relevant provisions of the NGL and NGR;¹¹
- (c) numerous submissions provided by interested parties;¹² and
- (d) advice and analysis from independent experts.¹³

Based on these considerations, the Regulator was of the opinion that a preferable alternative to the rate of return proposed by DBP existed. As permitted under Rule 40(3) of the NGR, the Regulator exercised its discretion to withhold its approval to the rate of return proposed by DBP, and impose a preferable rate. This approach is consistent with, and permitted under, the NGL and the NGR.

8.2 Rate of return proposed by DBP

BHPB submits that the Regulator's estimate of a rate of return of 7.16% in the Draft Decision complies with the applicable requirements and is consistent with applicable criteria prescribed by the NGL and NGR.

BHPB notes that, in Submission 55, DBP has failed to alter the approaches it adopted in the Proposed Access Arrangement to determine the rate of return, which were rejected by the Regulator in the Draft Decision. BHPB restates its submissions in relation to DBP's calculation of the rate of return as set out in its First and Second Submissions,¹⁴ namely that the methodology used by DBP in calculating the rate of return does not comply with the NGL or the NGR.

⁷ Submission 48, paras. 2.13 - 2.16.

⁸ Rule 40(3), NGR.

⁹ Draft Decision, paras. 325 - 756.

¹⁰ Draft Decision, paras. 390, 471 - 478, 646, 745, 752.

¹¹ Draft Decision, paras 325, 378.

¹² Draft Decision, paras 245, 375 - 376, 492, 493, 727.

¹³ Draft Decision, paras. 397 - 416, 419 - 432, 438 - 449, 451 - 467, 704.

¹⁴ First Submission, Part B; Second Submission, Part C.

BHPB submits that the reasoning offered by DBP in Submission 55 for its decision not to comply with the requirements of the Draft Decision in respect of the calculation of the rate of return provides no basis for the Regulator to depart from or alter its position in the Draft Decision.

In particular, BHPB notes that in its Second Submission, BHPB submitted that in the Amended Proposed Access Arrangement DBP appeared to adopt a random approach to calculate the cost of equity based on continuing to use the estimated forecasts of dividend yields plus a premium and multiple financial models.¹⁵ In its Submission 55, DBP has confirmed that this is the approach it has adopted for the purposes of calculating the cost of equity.¹⁶

Consistent with its First Submission,¹⁷ Second Submission,¹⁸ previous regulatory decisions¹⁹ and the Regulator's determination in the Draft Decision,²⁰ BHPB submits that DBP's use of versions of the CAPM other than the Sharp-Linter CAPM to determine the cost of equity is inconsistent with the NGL. In Submission 55 DBP has, contrary to the Regulator's determination in the Draft Decision, continued to seek to use these alternative CAPM that have been deemed not to be "well accepted models" under the NGR²¹ in an effort to obtain a more favourable cost of equity to calculate the rate of return.

BHPB submits that, in addition to its previous submissions, the manner in which DBP purports to make "adjustments" to the cost of equity determined by the Sharp-Linter CAPM by reference to the cost of equity determined by the other CAPM is an arbitrary approach to the determination of the cost of equity. By adopting this approach, BHPB submits that DBP's calculation of the cost of equity fails to meet the requirements of the NGR in that it has not been made on a reasonable basis and is not the best estimate possible in the circumstances.²²

¹⁵ Second Submission, para. 7.4.

¹⁶ Submission 55, paras. 7.32 - 7.71.

¹⁷ First Submission, para. 8.5.

¹⁸ Second Submission, para. 7.6.

¹⁹ First Submission, page 19; Second Submission, Table 1: Summary of Cost of Equity Models Adopted by Australian Regulators; see Draft Decision, para 390.

²⁰ Draft Decision, para. 468.

²¹ Draft Decision, para. 480.

²² Rule 74(2), NGR.

PART D - REFERENCE SERVICES

9 Introduction

9.1 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 service be reinstated.

In the Amended Proposed Access Arrangement and the Supporting Submissions DBP has sought to retain the proposed R1 service and has not reinstated the T1, P1 and B1 services. DBP has filed Submission 50 in support of this position.

9.2 Summary - BHPB Position

DBP's Submission 50 provides no basis to support to the inclusion of the R1 service and the non-inclusion of the T1, P1 and B1 services as reference services. BHPB restates its position as submitted in its First Submission and Second Submission and submits that the Regulator should maintain its position in the Draft Decision to reject DBP's proposal to offer only the R1 service as a reference service and reinstate the T1, P1 and B1 services.

9.3 NGR requirements

Rule 101 of the NGR provides that:

- “(1) A full access arrangement must specify all reference services.*
- “(2) A reference service is a pipeline service that is likely to be sought by a significant part of the market.”*

Rule 101 of the NGR thus requires all pipeline services that are likely to be sought by a significant part of the market to be included in the relevant access arrangement as reference services.

10 Reference service

Consistent with its submissions made in BHPB's First and Second Submissions,²³ BHPB supports the Regulator's position in the Draft Decision not to approve DBP's proposal to offer only the R1 service as a reference service and to reinstate the T1, P1 and B1 services as a reference services.

BHPB's submission is broadly based on the following:

- (a) **all** interested parties that have made submissions in respect of the reference service reject DBP's proposal to offer a single R1 reference service;
- (b) **all** interested parties that have made submissions support the inclusion of one or more of the existing T1, P1 and B1 reference services;²⁴ and

²³ First Submission, pages 33 - 34; Second Submission pages 25 - 26.

²⁴ Along with BHPB, the T1, P1 and B1 reference services are supported by Alinta, Synergy and Verve Energy. BP Australia Pty Ltd and Wesfarmers Chemicals, Energy and Fertilisers support the T1 reference service and APA Group, Chevron Australia, ERM Power Pty Ltd, NewGen Power Kwinana Pty Ltd and Rio Tinto support the P1 and B1 reference services.

- (c) **no** interested party (including existing users and prospective users) has made submissions indicating that they are likely to seek the R1 service.

BHPB submits that this provides clear evidence that:

- (a) the R1 service is **not** a service that is likely to be sought by a significant (or in fact any) part of the market; and
- (b) the T1, P1 and B1 services are services that are likely to be sought by a significant part of the market.

DBP appears to be the only party who supports the inclusion of an R1 service as the sole reference service.

In addition to the above, in DBP's Submission 50 (and its previous submissions²⁵), DBP has provided no evidence that any current or potential users are seeking, or will seek, the R1 service, and the only basis on which DBP argues that the R1 service should be included as a reference service appears to be:

- (a) that it would assist DBP grow its business and assist in the efficient operation and use of natural gas service²⁶ (which assertion is unsupported and BHPB does not agree with); and
- (b) that it will encourage competition and growth of natural gas services²⁷ (which assertion is unsupported and BHPB does not agree with).

In its Submission 50, DBP continues to submit that pre-existing contracts on the DBNGP are not evidence of the relevant market for pipeline services or evidence of whether the pipeline services to be provided under pre-existing contracts are likely to be sought by a significant part of the market.²⁸ BHPB notes that DBP has also not provided any support for this proposition.

As BHPB has previously submitted,²⁹ existing contracts on the DBNGP are relevant to determine the services that are likely to be sought by a significant part of the market in that:

- (a) the desirability of a service will be determined by its relative attractiveness compared to the services available to shippers under pre-existing contracts; and
- (b) the historical willingness of users and DBP to enter into a contract for a particular service indicates that service is likely to be sought by a significant part of the market.

Consistent with its previous submissions,³⁰ the submissions of Alinta, Synergy and Verve Energy,³¹ previous decisions by the Regulator,³² and the Regulator's Draft Decision,³³ BHPB submits that pre-existing contracts are an important indicator of the relevant market for pipeline services.

²⁵ DBP, April 2010, "Submission 3: Pipeline Services Public Version", page 5.

²⁶ DBP Submission 50, pages 5 - 6.

²⁷ DBP Submission 50, pages 5 - 6.

²⁸ Submission 50, page 3.

²⁹ First Submission, page 34.

³⁰ First Submission, page 34; Second Submissions, page 26.

³¹ Synergy, July 2010, "Submission - Damper to Bunbury Natural Gas Pipeline: Proposed Revisions to the Access Arrangement", page 3; Alinta, July 2010, "Damper to Bunbury Natural Gas Pipeline: Proposed Revisions to the Access Arrangement", pages 2 - 3; Verve Energy, July 2010, 'Submissions in relation to the Revised DBNGP Access Arrangement for the period 1 January 2011 to 31 December 2015', page 5.

³² ERA, November 2005, "Final Decision on Proposed Revisions to the Access Arrangement for the Damper to Bunbury Natural Gas Pipeline", page 29.

³³ Draft Decision, para. 56 to 61.

The position under pre-existing contracts are particularly relevant for the purposes of the proposed reference service for the Amended Proposed Access Arrangement given that, as previously stated, DBP has not provided any evidence that existing *or* prospective shippers have or will seek the R1 service. On this basis, and given that no interested party, user or prospective user has made submissions indicating an intent to utilise any other service, services under existing contracts are the best indicator to determine the services likely to be sought by the market.

DBP also submits that when determining whether a service is likely to be sought or utilised by a significant part of the market only services which can be provided by the existing spare capacity on the DBNGP should be considered.³⁴ DBP has likewise provided no support for this proposition.

This submission is clearly inconsistent with previous regulatory decisions which have approved access arrangements which contain firm reference services for pipelines which have no firm capacity available at the time of approval of the access arrangement.³⁵

In addition, BHPB notes that the Amended Proposed Access Arrangement contains a mechanism by which prospective users can seek an expansion of the pipeline by funding the expansion and obtain access to a reference service to utilise the capacity created by that expansion. Limiting references services to only those services that can be provided by utilising the spare capacity of the pipeline fails to take into account this right of users and prospective users under the Amended Proposed Access Arrangement.

³⁴ Submission 50, page 4.

³⁵ See for example ACCC Final Decision, NT Gas Amadeus Basin to Darwin Pipeline Access Arrangement (December 2002) at pages 131 - 132.