Public Submission

By BHP Billiton

In response to DBNGP (WA) Transmission Pty Ltd's proposed revisions to the

Dampier to Bunbury Natural Gas Pipeline Access Arrangement

21 May 2015

BHP Billiton Limited
Brookfield Place,
125 St Georges Terrace
Perth, WA, 6000

Tel: +61 8 6321 5196;
Fax: +61 8 6322 5196;
Web: www.bhpbilliton.com

1 Overview

DBNGP (WA) Transmission Pty Ltd (**DBP**) is the operator of the Dampier to Bunbury Natural Gas Pipeline (**DBNGP**). On 31 December 2014, DBP submitted its proposed revisions to the access arrangement for the DBNGP (**DBNGP Access Arrangement**) for the regulatory period 2016-2020 to the Economic Regulatory Authority (**Authority**).

On 20 April 2015, the Authority published an Issues Paper on the DBNGP Access Arrangement, and invited interested parties to make submissions on the DBNGP Access Arrangement by 2 June 2015.

BHP Billiton makes this submission in response to the Authority's invitation for submissions. This submission considers the following:

- **Rate of Return – cost of equity:** DBP has made a number of departures from the Rate of Return Guidelines in relation to the estimation of its cost of equity. BHP Billiton submits that there is no reason for the Authority to depart from the Rate of Return Guidelines in relation to the cost of equity, and the reference tariffs in the DBNGP proposed Access Arrangement should be set by reference to the Rate of Return Guidelines.

- **Rate of return – trailing average cost of debt:** BHP Billiton supports DBP's proposal to adopt a trailing average approach to estimate the total cost of debt. In addition, BHP Billiton submits that:

    - **Transition**: a transition should be applied to move from the calculation of the cost of debt under the current DBNGP Access Arrangement to the trailing average total cost of debt approach, and BHP Billiton supports the transition DBP has proposed.

    - **Annual updating of cost of debt**: the Authority should give further thought to how the cost of debt should be updated during the access arrangement period. Given that this updating will occur outside of a formal review process, it is imperative that the method employed be both transparent and mechanistic. The Authority's currently preferred method for deriving the debt risk premium[1] – which involves the Authority applying a number of empirical estimation processes – is not suitable for this purpose. A preferred route would be to follow the AER's approach of using the average of the RBA and Bloomberg fair value curves (extrapolated as required, also in a mechanistic manner) to derive the updated debt risk premium. In addition, the process for updating the cost of debt needs to be fully specified in the DBNGP Access Arrangement, including that the dates over which the new rates are sampled must be defined well in advance of the period in question.

    - **Weighting of trailing average**: in relation to the weighting to be applied when calculating the cost of debt, BHP Billiton has a preference for more accuracy even at the expense of complexity. However, above all this issue should not become a barrier to adopting a trailing average approach to estimating the cost of debt. Given the current and forecast under-utilisation of the DBNGP, no major capital expenditure is forecast and so this is not a material issue for the next DBNGP Access Arrangement period.

[1] ERA Draft decision on Proposed Revision to the Access Arrangement for the Mid-West and South-West Gas Distribution System dated 14 October 2014.

- **No hedging allowance** – while a second order issue, BHP Billiton notes that there is no rationale for an allowance for hedging costs under a full trailing average (as DBP proposes) because no hedging is assumed to take place.

- **Taxation:** BHP Billiton submits that the tax asset base should be based on a benchmark efficient entity operating the DBNGP business, and on this basis the tax asset base should be equal to the opening capital base as at the time the DBNGP became regulated in 2000 ($1,550 million) not its actual tax value at that time ($645 million) as proposed by DBP.

- **Revenue cap:** BHP Billiton does not support the DBP's proposal to move from a situation where the reference tariffs are subject to price cap, to a revenue cap.

- **New cost pass through:** BHP Billiton submits that the breadth of expenses potentially captured by the amendments to the New Cost Pass Through Variations is too broad. The New Cost Pass Through Variation mechanism in the current DBNGP Access Arrangement should be retained.

- **Extensions & Expansions Policy:** BHP Billiton submits that DBP's proposed changes to the Extensions & Expansions Policy should be rejected. The changes potentially enable DBP to elect whether or not an extension, enhancement, or expansion is covered after the time the relevant capacity has been fully contracted, meaning users do not get the opportunity of a clear and efficient contracting path and have no safeguard against extraction of monopoly rents. DBP also proposes that expansions are to be automatically uncovered if the Authority fails to notify DBP of coverage within 30 Business Days. This proposed time period is materially inadequate.

- **System Use Gas:** DBP's forecast operating expenditure attributable to system use gas is significantly higher than both the forecast and actual expenditure for the current DBNGP Access Arrangement. DBP's forecast system use gas expenditure was also significantly higher than the actual expenditure for the current DBNGP Access Arrangement period. BHP Billiton submits that the Authority should carefully interrogate this material increase in system use gas operating expenditure to ensure that it complies with Rule 91 of the NGR.

- **Reference Service Terms & Conditions:** DBP's proposed amendments to the terms and conditions for reference services represent a deterioration in the rights of both new and existing users compared to the current DBNGP Access Arrangement. DBP has not provided any compelling rationale for the changes to be made and absent such rationale the previous terms and conditions should remain unchanged.

Unless otherwise defined, words and expressions used in this submission have the meaning given in the *National Gas Law* (**NGL**) and *National Gas Rules* (**NGR**) as implemented in Western Australia.

2 About BHP Billiton

BHP Billiton is one of the world's largest diversified natural resources company with significant positions in major commodity businesses.

BHP Billiton (BHP Billiton Worsley Alumina Pty Ltd; BHP Billiton Nickel West Pty Ltd; BHP Billiton Petroleum (Australia) Pty Ltd; and BHP Billiton Iron Ore Pty Ltd.) is a key shipper on the DBNGP. It is a significant gas producer and major user of gas and thus has a significant interest in and demand for gas transportation in Western Australia.

3 Rate of Return – cost of equity

DBP is proposing a number of departures from the Rate of Return Guidelines for gas transmission pipelines and distribution networks (**Guidelines**) when estimating the cost of equity.

DBP is proposing its departures notwithstanding that the Guidelines were finalised little more than 1 year ago. The Guidelines were developed over the course of nearly a year of consultation and the Authority received a significant volume of material, including numerous expert reports from various parties and submissions from DBP itself. In light of that material, the Authority carefully finalised and published the Guidelines.

While BHP Billiton acknowledges that the Guidelines are not mandatory, if the Authority makes a decision in relation to the rate of return that is not in accordance with the Guidelines, the reasons for departing from the Guidelines must be compelling and clearly articulated.

The importance of following the Guidelines unless there is compelling evidence justifying a deviation was emphasised in the recent draft decision in respect of the Mid-West and South-West Gas Distribution System.[2] In that decision, the Authority generally rejected the operator's (ATCO) proposals to deviate from the Guidelines. For example, in respect of equity beta, the Authority noted that ATCO had not raised any new evidence to support its proposed deviation from the Guidelines and had only raised issues which the Authority had already considered in great detail as part of the Guidelines approval process.

BHP Billiton submits that the Authority should set the cost of equity in accordance with the Guidelines. Doing so will produce a determination which achieves the allowed rate of return objective. Considerable effort was spent on developing the Guidelines and no adequate basis has been established to justify the departures (and higher tariffs) proposed by DBP.

4 Rate of return – trailing average cost of debt

4.1 Summary of BHP Billiton submissions on cost of debt

In relation to the calculation of cost of debt under the proposed DBNGP Access Arrangement, BHP Billiton agrees with DBP's proposal that:

(a) the trailing average approach should be applied when calculating the cost of debt;

(b) the trailing average should be applied to the total cost of debt (rather than only applying a trailing average to the debt risk premium, with the spot rate applying for the base interest rate); and

(c) a transition should be applied (consistent also with the views of the Authority[3]) to move from the calculation of the cost of debt under the current DBNGP Access Arrangement to the trailing average total cost of debt approach.

In addition, BHP Billiton submits that as the application of a trailing average involves the cost of debt being updated (and reference tariffs thereby being changed) outside

---

2 ERA Draft decision on Proposed Revision to the Access Arrangement for the Mid-West and South-West Gas Distribution System dated 14 October 2014

3 ERA, Proposed Revised Access Arrangement for the Mid-West and South-West Gas Distribution Systems – Estimating the return on debt discussion paper, dated 4 March 2015.

of a formal access arrangement review process, it is imperative that the method employed to give effect to this updating be both transparent, as mechanistic as practicable and robust. To this end, BHP Billiton submits that:

(a) the Authority should give further thought to how the cost of debt should be updated during the access arrangement period. The Authority's currently preferred method for deriving the debt risk premium[4] – which involves the Authority applying a number of empirical estimation processes – is not sufficiently transparent and mechanistic for this purpose. A preferred route would be to follow the AER's approach of using the average of the RBA and Bloomberg fair value curves (extrapolated as required, also in a mechanistic manner) to derive the updated debt risk premium; and

(b) the Authority must ensure that all of the required details of the regime are set – most notably that the dates at which the new rates are to be sampled during the period are determined well in advance of the relevant dates.

BHP Billiton also submits that:

(a) in relation to the weights that are to be used, preference should be given to more accurate weights even at the expense of complexity; however, the issue should be addressed practically and not become a barrier to adopting a trailing average. Given the current and forecast under-utilisation of the DBNGP, no major capital expenditure is forecast and so this is not a material issue for the next DBNGP Access Arrangement period; and

(b) there should not be an allowance for hedging if a full trailing average is applied because no hedging is assumed to occur.

4.2 Adoption of a trailing average cost of debt to be applied to the total cost of debt

The allowance for the cost of debt should reflect debt financing costs which are commensurate with the efficient financing costs of a benchmark efficient entity.[5] Previously, all Australian regulators set the allowance for the cost of debt at the "spot rate" that was observed just prior to a new regulatory period commencing. However, this had two implications.

First, the whole of the cost of debt was set during a very short averaging period, and created the risk for regulated prices for a whole 5 year period (i.e. the access arrangement period) to be set at interest rates that were unusually high or low.

Secondly, risk was created for the regulated firms. Firms that wanted to align their debt costs with the regulatory allowances could do this to some extent by using interest rate swaps – these allowed firms to align the base interest rate they paid with the regulatory allowance – however, as firms generally stagger their debt maturities/issues (this is a requirement of rating agencies), a misalignment between a firm's own credit margin and the regulatory allowance is inevitable.

While these risks always existed, they materialised in 2009 when a series of regulatory decisions were made at a time when the cost of debt was extremely high (driven by a high debt risk premium) – decisions were made that used a debt risk premium of around 4 per cent, compared to a historical figure of 1.2 per cent.[6] The

---

4 ERA Draft decision on Proposed Revision to the Access Arrangement for the Mid-West and South-West Gas Distribution System dated 14 October 2014.

5 NGR, Rule 87; Guidelines.

6 See, for example, Jemena Gas Networks (NSW), 2010, Access Arrangement Information 1 July 2010 – 30 June 2015, as amended by order of the Australian Competition Tribunal 30 June 2011 and further amended by order of the Australian Competition Tribunal 26 September 2011, p.19, where a debt risk premium of 4.17 per cent was used.

regulated businesses were a beneficiary – their own portfolios generally contained much cheaper debt and maturities were staggered, and so little debt had to be raised at these rates.[7]

Customers responded to this with a rule change proposal,[8] proposing instead for the cost of debt to be set on the basis of a rolling portfolio – where a fixed proportion of debt is retired and raised each year – so that any repeat of 2009 (i.e., very high estimate of the prevailing cost of debt) had much less impact on prices. To their credit, regulated businesses also saw the benefits in this to them and accepted the model. The AER has expressed a preference for the trailing average cost of debt – applied to the full cost of debt – in its guidelines on the rate of return.[9]

The behaviour of the total cost of debt over time is shown in Figure 1 below.

Figure 1 – Indicative cost of debt over time (10 year term, BBB rating)

Source: RBA corporate bond series (F3 Aggregate measures of australian corporate bond spreads and yields: non-financial corporate (NFC) bonds).

The outworking of this is that there are two models that have been proposed for implementing a trailing average:

(a) "**Standard trailing average model**" – where it is assumed that regulated businesses issue a fixed proportion of their debt each year and do not undertake any further "hedging".

Under this model, the cost of debt in any year is a trailing average of the past 10 years of the total cost of debt, and a proportion of this (10 per cent under the simple model) is assumed to be refinanced each year.

(b) "**Hybrid trailing average model**" – where it is assumed that business issues a fixed proportion of their debt each year but then use interest rate swaps in order to fix the base interest rate at the spot rate at the time of a regulatory review.

7 Evidence of this is provided in Energy Users Association of Australia Rule Change Committee (2011), Proposal to change the National Electricity Rules in respect of the calculation of the Return on Debt, October.

8 Energy Users Association of Australia Rule Change Committee (2011), Proposal to change the National Electricity Rules in respect of the calculation of the Return on Debt, October.

9 AER, 2013, Rate of return guideline, December.

Under this model, the cost of debt in any year is a trailing average of the past 10 years of the debt risk premium (which is updated each year on the assumption that a fixed proportion of debt is re-issued each year) plus the spot rate for the base interest rate. In addition, an allowance is provided for the transaction costs of undertaking the hedging.

There are two important differences between the outcomes of the models.

First, the standard trailing average model should generate a more stable allowance for the cost of debt over time because all elements of the cost of debt are subject to the averaging.

Secondly, as a trade-off against this, the standard trailing average model will result in a higher cost of debt than the hybrid trailing average model, on average. This results because when interest rate swaps are used, the base interest rate is changed from a 10 year rate to a 5 year rate, albeit with some transaction costs incurred.

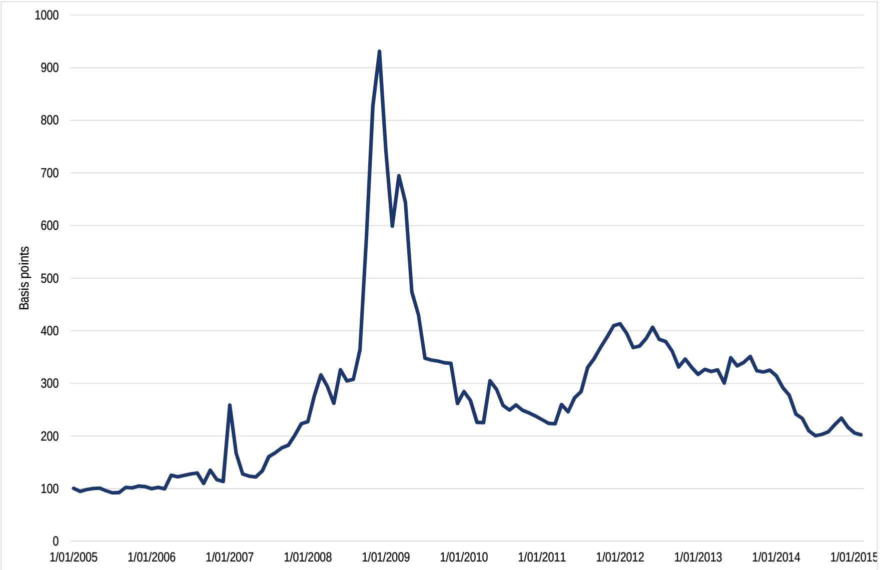
Figure 2 below highlights the first of these points, showing the variation in the 5 year "swap rate" over time (this is the base interest rate in the trailing average model). Clearly, the variation in the base interest rate is sufficiently large for its exclusion from the trailing average to leave a material risk of volatility in the cost of debt between price reviews.

Figure 2 – variation in the base interest rate (swap rate) over time (per cent)

Source: extracted from the RBA corporate bond series (F3 Aggregate measures of Australian corporate bond spreads and yields: non-financial corporate (NFC) bonds).

Figure 3 also shows the variation in the debt risk premium for completeness.

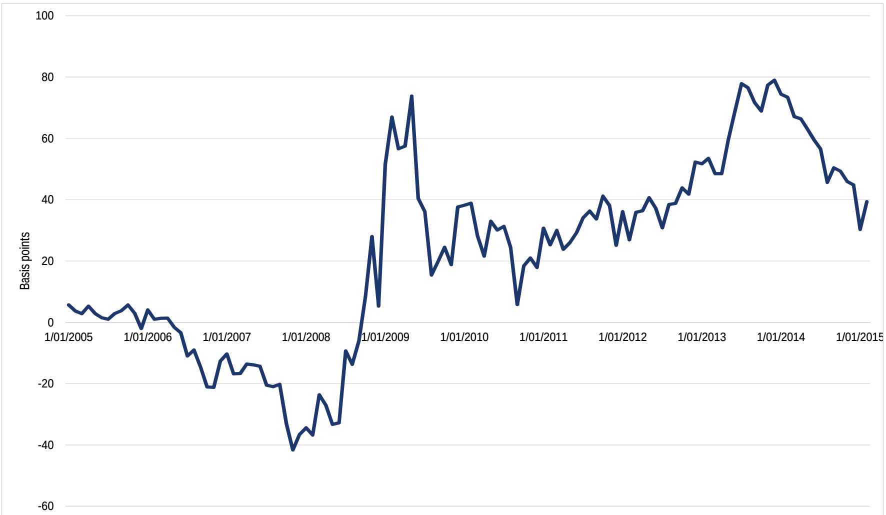
Figure 3 – variation in the debt risk premium relative to Commonwealth Government Securities over time, 10 year term BBB (in basis points = 100 x percentage points)



Source: RBA corporate bond series (F3 Aggregate measures of Australian corporate bond spreads and yields: non-financial corporate (NFC) bonds).

The difference in the cost of debt under the models varies over time, but is currently about 0.40 per cent, net of the transaction costs that are allowed for hedging. This differential over time is shown in Figure 4 below. The average addition to the cost of debt from applying the trailing average to the total cost of debt observed over this period was 22 basis points (0.022 percentage points).[10]

Figure 4 – additional cost of trailing average on the total cost of debt



In light of the above observations, BHP Billiton submits that the standard trailing average model should be adopted by the Authority when settling the cost of debt under the proposed DBNGP Access Arrangement.

---

10 This assumes the Authority's proposed hedging allowance of 2.5 basis points per annum, which is justified under a hybrid trailing average, but not under a full trailing average.

4.3 Transition to trailing average cost of debt

Applying a trailing average to estimate the cost of debt will mean that the cost of debt calculated under the proposed DBNGP Access Arrangement will incorporate historical information, even though under the previous "spot rate" regime the cost of debt would not have used that historical information, but only current rates. At the time of switching between regimes, if a transition is not applied, DBP would be better off as a result of the switch if the historical rates are higher than current rates, and worse off if historical rates are lower than current rates.

In order to manage this, DBP has proposed that it should be initially assumed that all of the historical debt in the trailing average was financed at current (spot) rates. The current rates are then replaced with new debt costs gradually over time, and the obvious windfall gain or loss from the change in method is avoided. This approach has been advocated by the AER,[11] and is supported by BHP Billiton.

4.4 Annual updating of the cost of debt

Applying a trailing average cost of debt approach requires the cost of debt to be updated over time during the access arrangement period (and for reference tariffs to be changed as a result of this).

For this to be practicable, BHP Billiton submits that there needs to be a method for deriving a debt risk premium that is easy and transparent to implement, and that will give results over time that shippers can be confident are appropriate.

BHP Billiton submits that DBP's proposal in respect of the annual updating of the cost of debt in the proposed DBNGP Access Arrangement contains insufficient detail on how it intends to update the cost of debt during the access arrangement period. The Authority should give further thought to how the cost of debt should be updated during the access arrangement period.

In this regard, BHP Billiton notes that in the Authority's most recent consideration of this issue, in the Authority's draft decision on Proposed Revision to the Access Arrangement for the Mid-West and South-West Gas Distribution System, it confirmed its intention to undertake its own analysis to determine the debt risk premium and indeed proposed to substantially increase the complexity of analysis.[12] BHP Billiton submits that this method is not suitable, as it is inappropriate for this level of analysis to be undertaken during an access arrangement period and so outside of a formal review process. This is because there is no certainty for shippers as to what the analysis will produce, and (as it is outside of a formal review) no ability to challenge or dispute the analysis.

BHP Billiton does, however, note that the AER has tried to make its method more acceptable by deciding to use the results of an independent provider of data,[13] and more recently committing to use an average of the RBA values and values produced by the Bloomberg service.[14] BHP Billiton submits that this is an approach the Authority should consider pursuing further. In this regard, given that different methods have failed to perform very well at times, it makes sense to combine different data sources and methods to derive an appropriate value. BHP Billiton supports this approach.

In addition to the method of updating the cost of debt, BHP Billiton submits that there also needs to be greater certainty as to the details of how the updating regime will apply. In particular there needs to be clarity as to the specific date during the access

[11] AER, 2013, Rate of return guideline, December, p.19.

[12] ERA, Draft decision on Proposed Revision to the Access Arrangement for the Mid-West and South-West Gas Distribution System dated 14 October 2014, para [553].

[13] AER, Rate of return guideline, December, p.21.

[14] AER, 2014, TransGrid – Draft Decision, November, Attachment 3 – Rate of Return, p.3-10.

arrangement period when the new rate will be sampled. This should be nominated by DBP upfront (even if it is kept confidential) so that DBP cannot simply choose the days when interest rates were at their highest.

4.5 Weighting to be applied when calculating cost of debt

In relation to the weights that are to be used, BHP Billiton's preference would be for weights that are more accurate, even at the expense of complexity. DBP's proposal is for a compromise that applies simple weights unless capital projects exceed a threshold, which BHP Billiton would not be averse to. However, it is important for the issue to be addressed practically and not become a barrier to adopting a trailing average. Given the current and forecast under-utilisation of the DBNGP, no major capital expenditure is forecast for the next access arrangement period, and so this is not a material issue at present in the case of the DBNGP.

5 Taxation

Following the transition from the Gas Code to the NGR, a post-tax rate of return must now be applied and the allowance for company taxation must be based upon an explicit calculation of tax (Rule 87 of the NGR). However, as part of the switch from the previous implicit allowance for taxation (through the use of a pre-tax WACC) to an explicit allowance for taxation, the Authority is required to determine an opening value for the assets for tax depreciation purposes (**Tax Asset Base**). The setting of the Tax Asset Base has similarities to the setting of the initial capital base - it requires the Authority to exercise its judgement and set an appropriate value for the tax asset base at the time of regulatory transition, in light of the requirements of the NGL and NGR.

The Authority is given some discretion in setting the Tax Asset Base because the same physical assets could have different Tax Asset Bases depending upon the history of the relevant business or businesses that owned the assets. The starting Tax Asset Base is always the cost of the assets; however, where assets are the subject of a subsequent transaction, then (depending upon the form of the transaction) the owner may be able to reset the Tax Asset Base at the acquisition price of the assets. Accordingly, in order for the Authority to determine the Tax Asset Base for a benchmark entity, it must first decide what it is reasonable to assume about the history of the relevant assets.

DBP has proposed a Tax Asset Base of $645 million, being its actual tax value as at the time the DBNGP became regulated in 2000. BHP Billiton does not support the use of this value, and instead submits that, in order to ensure consistency with the opening capital base, the most reasonable "benchmark" assumption is that the Tax Asset Base should be equal to the opening capital base as at the time the DBNGP became regulated in 2000, being $1,550 million.

6 Revenue cap

BHP Billiton does not support moving from a situation where the reference tariffs are subject to a price cap, to a revenue cap.

First, it is difficult to understand the benefits that are expected from having a revenue cap apply over the forthcoming access arrangement period. The typical rationale for a revenue cap is that it eliminates the risk to a regulated business associated with unexpected changes in demand, which is argued to be beneficial where demand is outside of the control of the regulated business and is therefore uncertain.

In the case of the DBNGP, however, the application of a revenue cap will have little impact on DBP's demand risk. DBP has 85 per cent of its current use under contracts whose prices are independent of the reference tariff and who do not have any rights to relinquish capacity until after the next access arrangement period,[15] and yet the workings of the revenue cap will assume that the prices to these customers will also vary in line with the reference tariff if demand is higher or lower than expected. Thus, only 15 per cent of the demand risk will be eliminated under a revenue cap as proposed by DBP in any event.

In addition, the DBNGP is now a mature asset, and so there is much less justification for transferring demand risk to shippers than would be the case for a new build pipeline. Similarly, to the extent that demand risk was transferred to shippers, then a good case exists for applying a lower rate of return in the calculation of reference tariffs than would apply under a price cap. It is noted that, as the Authority has applied a price cap in all gas regulatory decisions to date, this would necessitate a lower rate of return than the Authority otherwise would have determined.

More generally, it is incorrect to assume that changes in demand for the DBNGP will be outside of the control of DBP. Unlike in the case of distribution networks or electricity transmission networks, gas transmission businesses have an important role to play in facilitating the market for natural gas and use of their asset. In view of the recent drop in reservations on the DBNGP, it is important that DBP has a strong incentive in this regard, which is what having a fixed schedule of prices (with indexation) provides. It is also noted that the revenue and pricing principles highlight the need for regulated businesses to be provided with effective incentives to promote the efficient use of infrastructure, as follows:

> *"A service provider should be provided with effective incentives in order to promote economic efficiency with respect to reference services the service provider provides. The economic efficiency that should be promoted includes… the efficient use of the pipeline."*[16]

In addition, the effect of a revenue cap is to transfer the demand risk associated with the DBNGP from DBP to shippers. As well as increasing the volatility of the price for a material input, this allocation of risk will also have the effect of exposing shippers to the risk of the commercial success of competitors, which BHP Billiton does not consider appropriate (at least during an access arrangement period).

In addition, BHP Billiton sees a number of potential issues with attempting to apply a revenue cap in the context of the DBNGP.

First and foremost, it will be essential for there to be a clear line as to the services that are under the cap. DBP will have a strong incentive during the period to attempt to classify new load as being on services that are outside of the cap (so that additional revenue is retained in full by DBP), and to classify reductions in load as pertaining to services that are within the cap (so that the shortfall in revenue is made up from other customers). This clarity is something that it may be possible to achieve with clear drafting; however, the provisions proposed by DBP are both vague and ambiguous, and would need a substantial redrafting in order to protect against these risks.

Regardless of whether or not the Authority accepts DBP's proposed move to a revenue cap, it will be important for the Authority to review carefully the forecasts of demand that DBP has submitted and form its own view on the reasonableness of those forecasts. The proposed reference tariffs assume a substantial drop in capacity reservations and throughput since the last access arrangement period, and for all of that spare capacity to remain idle for the next access arrangement period (and indeed, for the extent of spare capacity to increase further). BHP Billiton submits the Authority

15 Duet Group, ASX release, 7 August 2014, 'DBP Recontracts with its Shippers'.

16 Section 24(3)(c) of the NGL.

will need to carefully test these assumptions. In addition, to the extent that this drop in utilisation is accepted, the question needs to be asked whether the substantial recent expenditure on increasing capacity was a prudent expenditure and, as a result, whether or not it should be included in the capital base.

7 New Cost pass through

Items 11.5(a)(i) and 11.5(c)(iv) of the proposed DBNGP Access Arrangement entitles DBP to pass through expenses that *"are or will be incurred as a result of circumstances beyond the control of the Operator or the [Operator's] relevant Related Body Corporate."*

BHP Billiton submits that, notwithstanding that expenses also need to meet the criteria in items 11.5(a)(ii) – (iv) in order to be passed through, the breadth of expenses potentially captured by this pass-through regime is too broad. Given how broad the scope of costs that could be captured is, the proposed cost pass through regime has the potential to de-risk the DBNGP to such an extent that it should be reflected in a lower rate of return.

While BHP Billiton acknowledges the validity of a cost pass through mechanism of the type described in item 11.5(a), BHP Billiton submits that the position under the current DBNGP Access Arrangement should be retained – the only Cost Pass Through Events that can be recovered through the operation of the clause 11.5 mechanism are limited to costs associated with a Change in Law and additional costs payable to the Land Access Minister as described in item 11.5(c)(ii) of the current DBNGP Access Arrangement.

8 Extensions and Expansions Policy

8.1 Summary of BHP Billiton submission

BHP Billiton submits that the DBP's proposed amendments to the extensions and expansions policy should be rejected by the Authority, and the current extensions and expansions policy continue to apply unamended.

The DBP's proposed amendments to the extensions and expansions policy:

- propose a procedure that is not sufficiently timely;
- improperly impose the obligation on the Authority to demonstrate to DBP why an expansion should or should not become part of the covered pipeline; and
- provide inadequate time for the Authority to consider any election by DBP for non-coverage of an expansion.

8.2 Importance of appropriate extensions and expansions policies

The policy relating to the treatment of extensions and expansions of the DBP (i.e. whether or not they are to be treated as part of the covered pipeline) is an important element of the proposed DBNGP Access Arrangement.

In Western Australia, owners of significant pipeline infrastructure, such as the DBP, enjoy a position of considerable market power. The principles of the gas access regime, especially the national gas objective (**NGO**), can be seriously undermined by an extensions and expansions policy which is not sufficiently robust and transparent.

8.3 Timing of DBP elections

Under DBP's extensions and expansions policy, DBP has the ability to elect whether or not an extension, enhancement or expansion is to become part of the Covered Pipeline. In relation to extensions and enhancements, this election must be made 'at some point in time', and in relation expansions there is no timeframe specified within which DBP must make this election (proposed DBNGP Access Arrangement clauses 7.3(a) and (b)).

This is similar to the election mechanism in the extensions and expansions policy proposed by Goldfields Gas Transmission Pty Ltd in the proposed draft access arrangement for the Goldfields Gas Pipeline. As BHP Billiton has recently submitted in relation to that extensions and expansions policy,[17] such an approach creates the risk that users are not given sufficient protection or the Authority is not able to properly consider the implications of a proposed election. In particular:

- in the case of the Goldfields Gas Pipeline, the ability for the operator to elect 'at some point in time' has resulted in the Authority's decisions on coverage being made after extension/expansion capacity has been contracted, with users not having the opportunity of a clear and efficient contracting path (a negotiated versus a regulated service) and therefore not being able to mitigate against the extraction of monopoly rents. This is inefficient and undermines the rationale for having coverage elections in the first place; and
- it does not allow the Authority sufficient time to properly consider whether a decision to consent to a proposed election contributes to the achievement of the NGO, which ultimately means the Authority's election is of limited benefit to users.

DBP's proposed amendments to the extensions and expansions policy would also create uncertainty for users when negotiating for capacity. Transportation is a key element which underpins a user's business. If users are unclear about whether the service that they are negotiating for will be regulated, it makes it more difficult to plan future investment in production.

In order to manage the above risks, BHP Billiton submits that the DBNGP Access Arrangement should provide the following:

- if DBP is to elect for an extension, enhancement or expansion not to become part of the Covered Pipeline, it must make this election prior to the extension, enhancement or expansion automatically becoming part of the Covered Pipeline as provided in clauses 7.3(a) and (b) of the proposed extensions and expansions policy (which occurs upon the consent to operate the extension, enhancement or expansion being granted under the Petroleum Pipelines Act); and
- until the Authority has made a determination in relation to any election by DBP for an extension, enhancement or expansion not to become part of the Covered Pipeline, or the extension, enhancement or expansion automatically becomes part of the Covered Pipeline by operation of the extensions and expansions policy (as discussed above), DBP should be prevented from entering into agreements with users in respect of the additional capacity.

8.4 Onus now on Authority to justify coverage

Under the current DBNGP Access Arrangement, all expansions automatically become part of the covered pipeline unless 'DBP can demonstrate to the Authority's reasonable satisfaction that the application of the access arrangement to such

[17] Public Submission by BHP Billiton in response to Goldfields Gas Transmission Pty Limited's Proposed revisions to the Goldfields Gas Pipeline Access Arrangement, 27 November 2014, section 6.2.

services is inconsistent with the National Gas Objective'.[18] BHP Billiton submits that this is an appropriate approach to the assessment of expansions, and is consistent with the National Gas Rules and the NGO.

In the proposed amendments, DBP suggests reversing the onus on who is to demonstrate whether or not an exclusion of an expansion from the Covered Pipeline is consistent with the NGO, by requiring the Authority to undertake such an assessment where DBP elects for an expansion to be uncovered.

BHP Billiton submits that putting the onus on the Authority, rather than DBP, to demonstrate why the expansion of a covered pipeline should also be covered is inconsistent with the NGO and should be rejected. This is particularly the case given that (as discussed below) if the Authority fails to make such a determination, the expansion is automatically deemed not to be covered.

8.5 Timing of decision by the Authority in relation to proposed election

In addition to putting the onus on the Authority to justify why an expansion should or should not be covered, DBP has proposed that, if the Authority determines that an expansion should become part of the Covered Pipeline, it must:

- provide 'detailed reasons for why the [Authority] is not satisfied that the application of the access arrangement to such expansion is inconsistent with the National Gas Objective and Coverage Criteria', and
- provide those reasons within 30 Business Days of receiving DBP's Non Coverage Request Notice.

If the Authority fails to comply with the above, the expansion will not form part of the Covered Pipeline.

While, as discussed above, BHP Billiton does not think that the onus should be on the Authority to justify why an expansion should be covered, a period of 30 Business Days for the Authority to consider a coverage election is materially inadequate. For example, for the last expansion election considered by the Authority (in respect of the Goldfields Gas Pipeline), there was a period of over 6 months from the time Goldfields Gas Transmission Pty Ltd made its election to the time of the Authority's final determination.

9 System Use Gas

For the current (2011 – 2015) DBNGP Access Arrangement period, DBP's approved forecast annual average operating expenditure attributable to system use gas (**SUG**) was $25.5M. Its actual annual average operating expenditure attributable to SUG for the period was $11.56M, less than half the forecast expenditure.

For the upcoming DBNGP Access Arrangement period, DBP has forecast annual average operating expenditure of $39.03M attributable to SUG. This figure is approximately 153% higher than the approved SUG forecast annual average operating expenditure for the current (2011 – 2015) DBNGP Access Arrangement period and approximately 338% higher than its actual SUG annual average operating expenditure for that period.

DBP's significant underspending on SUG compared to the approved forecast during the current DBNGP Access Arrangement period raises questions as to the accuracy of DBP's forecast SUG operating expenditure for the upcoming DBNGP Access Arrangement period.

[18] Current DBNGP AA, clause 7.3.

BHP Billiton submits that the Authority should establish why there was such a significant difference between DBP's forecast and actual SUG operating expenditure during the current DBNGP Access Arrangement period (and explain this to shippers), and ensure that the reasons for this difference will not also result in an inflated forecast amount for the upcoming Access Arrangement period.

Significant parts of DBP's supporting submissions which justify the significant increase in SUG operating expenditure for the upcoming DBNGP Access Arrangement period are redacted. BHP Billiton submits that the Authority should therefore also interrogate the basis for this increase in SUG operating expenditure to ensure that it is such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of delivering pipeline services (as required by NGR 91).

10 Reference Service Terms & Conditions

DBP has proposed a number of amendments to the terms and conditions on which it will offer reference services. BHP Billiton submits that these amendments represent a significant deterioration in the rights of users from the current DBNGP Access Arrangement. These proposed amendments will increase inefficiency, raise costs and would be contrary the achievement of the NGO – accordingly, these proposed amendments should not be approved.

In particular, the amendments set out below should not be approved.

10.1 Cashing out imbalances

BHP Billiton does not support the introduction of DBP's changes to the amounts that a Shipper or DBP must pay in the event of an Accumulated Imbalance. Accordingly, BHP Billiton submits that clause 9.9 continue to refer to "fair market value" as the amount payable by Shippers and DBP in the event of an Accumulated Imbalance.

10.2 Reinsertion of non-discrimination clauses

While information might be readily available elsewhere or ownership arrangements in relation to the DBNGP have changed since the last access arrangement, BHP Billiton submits that these provide no basis for the wholesale deletion of the protections afforded to Shippers under clause 45. Accordingly, BHP Billiton submits that clause 45 should be reinstated.

10.3 Hourly peaking limit

BHP Billiton does not support DBP's changes to clause 10.3(a), which mean that, where a Shipper exceeds the Hourly Peaking Limit, DBP can unilaterally reduce delivery of gas regardless of the operational impact of the exceedance. Accordingly, BHP Billiton submits the deletions should be reinstated.

10.4 Restriction on receipt of Overrun Gas

DBP's changes to clause 11.2(a) mean that DBP can now restrict use in the event of an overrun (irrespective of impact of the overrun on other Shippers). BHP Billiton submits that these deletions should be reinstated.

10.5 DBP's liability for Curtailment due to Planned Maintenance

BHP Billiton submits that DBP should not be immune from liability for Direct Damages caused by Curtailment due to Planned Maintenance. Accordingly, BHP Billiton submits that DBP's proposed changes to clause 17.2 and the inclusion of 'Planned Maintenance' in the definition of 'Major Works' should be reversed.