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Mr Tyson Self
Assistant Director Gas Access
Economic Regulation Authority
PO Box 8469
Perth BC WA 6849

Dear Mr Self,

Response to GGT further submission

BHP Billiton (**BHPB**) welcomes the opportunity to comment on the further submission by Goldfields Gas Transmission Pty Ltd (**GGT**) published on 10 March 2016 in relation to its proposed draft access arrangement (**Further Submission**).

The Further Submission does not contain any significant new material or raise any persuasive new arguments. BHPB continues to support the approach taken by the ERA in its Draft Decision and looks forward to the new tariffs commencing on 1 July 2016.

BHPB does, however, want to take this opportunity to briefly comment on 2 issues raised in the further expert material provided with the Further Submission:

1. HoustonKemp incorrectly presents the cost allocation issue as a choice between the ERA's method and no cost allocation at all – BHPB submits that the task is not so limited, rather it is about finding the method which is consistent with the requirements of the National Gas Law; and
2. Farrier Swier's interpretation of the National Gas Objective (**NGO**), which requires only that joint cost allocation not diminish economic efficiency (rather than requiring economic efficiency to be positively advanced), actually supports the approach adopted by the ERA.

1 Cost allocation methods

GGT presents the issue as a choice between the cost allocation method proposed by the ERA and no cost allocation at all. This proposition reaches its high water mark in the HoustonKemp report, where it is asserted that the analysis of Mr Balchin (on behalf of BHPB) is based upon certain critical assumptions, most notably that the costs that would be allocated to the uncovered services under a capacity based allocation can be recovered or absorbed by GGT.

However, this framing of the economic question and the characterisation of Mr Balchin's evidence, is in error. Mr Balchin did not in fact recommend a capacity based allocation. Instead he identified this as a reasonable starting point that was to be preferred unless it was established that such an allocation would put GGT in a position where it could not recover its costs across the covered and uncovered services. A proper interpretation of Mr Balchin's evidence is that he recommended:

- adopting a usage based allocation as a starting point;
- testing whether that allocation would be consistent with GGT recovering its costs in total across covered and uncovered services, with further advice provided as to the assumptions that may be relevant to that analysis; and
- if there is a reasonable prospect that GGT will not be able to recover its costs across the covered and uncovered services in aggregate, modifying the method of cost allocation to the extent necessary to avoid this outcome.

That is, the relevant question is not a choice between the ERA's proposed cost allocation or no allocation at all, rather it is a question of finding an allocation that is consistent with the National Gas Law.

In addition, BHPB reiterates that GGT has not provided any empirical evidence that demonstrates that the ERA's proposed allocation method would result in GGT not recovering its costs in aggregate across covered and uncovered services.

2 Meaning of the NGO – Farrier Swier report

The Farrier Swier report considers the meaning of the National Gas Objective (**NGO**). It presents a view as to how the "long term interests of consumers" and "economic efficiency" components of the NGO should be read together if they are in conflict. This is provided in response to Mr Balchin's statement that:

- he understood the legal position to be that the precise interrelationship between these components of the NGO was not settled (he did not express an opinion about this); and
- this interpretation may be important as it is more likely that there would be a benefit from allocating a share of the joint costs to unregulated services under a "long term interests of consumers" criterion rather than under an "economic efficiency" criterion. That is:
    - a price reduction would almost certainly advance the long term interests of consumers provided this was consistent with GGT having a continuing incentive to invest; and
    - the efficiency criterion imposes a further hurdle, namely that the price change must also be considered to advance economic efficiency (Mr Balchin believed this to be the case).

While the reasoning and conclusions in the Farrier Swier report are not entirely clear, the paragraph that addresses most clearly the possible tension that Mr Balchin identified is paragraph 69, which states:

> *Thirdly, the NGL provides no explicit limitation on regulatory decisions that have the effect of transferring economic rent earned by a service provider from provision of unregulated services to consumers of regulated services. This means that a*

decision maker could potentially choose to make or permit pricing decisions that had the effect of making such a transfer (subject of course to this being legally permitted by the regulatory framework). However in my opinion such a decision is subject to at least to two limitations:

- *the decision cannot result in a materially less economically efficient outcome as this would be contrary to the NGO.*
- *the decision maker should be cognisant of the risk of regulatory error in making such a decision.*

What this paragraph provides is that the NGO authorises the regulator to effect a "transfer" of economic rent to the consumers of the covered services, provided that this is not injurious to economic efficiency. Under this interpretation of the NGO, there would be no need to establish that such a transfer advanced economic efficiency, only that the transfer did not diminish economic efficiency – that is, a transfer that is neutral to economic efficiency would be acceptable.

BHPB submits that under this interpretation of the NGO, it is not necessary to demonstrate that the price reduction to covered services (that results from a joint cost allocation) would advance economic efficiency. Rather, it would only be necessary to conclude that the joint cost allocation would not diminish economic efficiency, which all experts appear to agree requires GGT to have a reasonable expectation of recovering its costs in aggregate.

BHPB further submits that the Farrier Swier interpretation of the NGO is very similar to the interpretation of the NGO that Mr Balchin considered would provide a stronger case for allocating a share of joint costs to uncovered services.

Yours sincerely

[redacted]

Ian Mumford

Senior Manager Sales Operations