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29 January 2010

Mr Lyndon Rowe
Chairman
Economic Regulation Authority
Level 6, Governor Stirling Tower
197 St Georges Terrace
Perth WA 6000

Dear Mr Rowe

Goldfields Gas Pipeline - Public Submission in Response to BHP Billiton's Submission on Draft Decision

Please find attached the Goldfields Gas Transmission Pty Ltd (GGT) Public Submission (Submission) in response to the BHP Billiton Submission on the Authority's Draft Decision dated 9 October 2009.

In this Public Submission, GGT has deleted some of the information that was contained in the Confidential Submission dated 22 January 2010 that is considered to be confidential and has identified such deletions by the insertion of the words: "[Information Confidential]".

The Public Submission will also be separately provided electronically on CDRom.

Yours faithfully

Barrie Sturgeon
Acting General Manager

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GOLDFIELDS GAS PIPELINE

Response to BHP Billiton Public Submission on Draft Decision to Proposed Revisions to Access Arrangement

Public Version

Submitted to Economic Regulation Authority

29 January 2010

Goldfields Gas Transmission Pty Ltd
ACN 004 273 241

GGT Public Response to BHP Billiton Submission on
Draft Decision to Proposed Revisions to Access Arrangement

Contents

1 Introduction

1. This Submission is lodged by Goldfields Gas Transmission Pty Ltd ("GGT") in support of the proposed revisions to the Access Arrangement ("Revised Access Arrangement") and Access Arrangement Information ("AAI") for the Goldfields Gas Pipeline ("GGP") lodged on 23 March 2009. The Revised Access Arrangement and AAI were prepared and lodged pursuant to Section 2 of the National Third Party Access Code for Natural Gas Pipeline Systems ("Code").

2. On 9 October 2009, the Economic Regulation Authority ("the Authority") issued its Draft Decision on the proposed revisions. The Authority proposed not to approve GGT's Proposed Revisions on the basis that it believes the Revised Access Arrangement did not satisfy the requirements in sections the Code.

3. GGT filed a submission in response to the Draft Decision on 11 December 2009 ("Response").

4. On 11 December 2009, BHP Billiton ("BHP Billiton") also filed a submission in response to the Draft Decision.[1]

5. This submission addresses those comments or positions put forward by BHP Billiton:
   - which are erroneous in fact; and/or
   - which are based on flawed understanding of the Code.

6. In general, BHP Billiton's submission demonstrates a lack of understanding of the coverage framework in the Code. This lack of understanding has undermined much of BHP Billiton's submission, including its submissions on the treatment of uncovered expansions of capacity, new facilities investment, the extensions/expansions policy, and load forecasting.

7. This submission does not generally address matters in BHP Billiton's December submission which are addressed in GGT's Response.

[1] Public Submission By BHP Billiton In Response to the Draft Decision on GGT's Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline dated 9 October 2009 - 11 December 2009

2 Coverage related matters

2.1 BHP Billiton response to Draft Decision – December 2009

8. In its December 2009 submission, BHP Billiton states[2] that the Draft Decision *is consistent with the submissions made by BHP Billiton in its First Submission [dated 30 June 2009]:*

   a) the ERA has distinguished between a future extension to the GGP and a future expansion of Capacity of the GGP;

   b) the ERA has decided that a capital asset constructed to expand capacity and enable the Service Provider to provide Services in the nature of haulage services is a New Facility (ie infrastructure) for the purposes of the Code that forms part of the Covered Pipeline;

   c) the ERA has decided that the Services for the purposes of the Code include the haulage services for additional capacity provided by means of the GGP as a Covered Pipeline (including the New Facilities infrastructure that forms part of the GGP); and

   d) the ERA has decided that such capital assets are used to provide Services and are to be treated as part of the Capital Base.

9. In this submission, BHP Billiton's submission dated 30 June 2009 is referred to as the "June submission".

2.2 BHP Billiton Submission June 2009

10. The December submission[3] refers to the following claims made in the June submission:

> *"..all Capacity that is, or becomes, available on the GGP which is provided by means of the infrastructure comprising the Covered Pipeline should be dealt with under the Access Arrangement as part of the Covered Pipeline."*
>
> *"Infrastructure (such as compressors) which expands Capacity on the GGP is part of the GGP. That additional Capacity represents a haulage Service provided by means of the GGP (as a Covered Pipeline) and that Service falls within the Code."*
>
> *"An extension to the GGP (considered separately from an expansion of Capacity of the GGP) is capable of being uncovered and providing a relevant Service in its own right (being from one point to another point serviced by that extension)."*
>
> *"Costs in relation to the Covered Pipeline as a whole (including infrastructure expanding Capacity) should be applied in a fair and reasonable manner across all Services provided by means of the Covered Pipeline."*

[2] Ref. section 5.5

[3] Ref. section 5.3

2.3 GGT response

2.3.1 General

11. GGT did not respond in detail to the June submission as it considered that, on the whole, it was apparent on the face of it that the June submission was incorrect. In light of BHP Billiton's restatement of the position set out in the June submission,[4] GGT wishes to address several matters in the June submission.

12. To the extent that the June submission relies on the same reasoning as the Draft Decision, the June submission is incorrect for the reasons set out in GGT's Response. In summary:

    a. While additional infrastructure (such as the compressors developed by GGT) may physically be attached to the 'GGP', such assets do not form part of the Covered Pipeline unless incorporated as such under the relevant Extensions/Expansions Policy. Accordingly, any haulage service provided by means of the relevant expansion cannot be a 'Service' under the Code.[5] In this regard, BHP Billiton's submission attempts to blur the distinction between the 'GGP' on the one hand and the Covered Pipeline on the other. GGT contends that the critical issue is what constitutes the Covered Pipeline for the purposes of the Code.

    b. BHP Billiton asserts that costs in relation to the Covered Pipeline as a whole should be applied in a fair and reasonable manner across all Services provided by means of the Covered Pipeline. However, there is no reasonable argument that the costs associated with expanded capacity which does not form part of the Covered Pipeline constitute 'costs in relation to the Covered Pipeline'. An asset developed for the purpose of expanding capacity cannot fall within the definition of 'New Facility' in circumstances where the service provider has elected not to treat the expanded capacity as part of the Covered Pipeline.[6]

    c. BHP Billiton is incorrect in its conclusion that Services under the Code include haulage services which are capable of being provided by means of expanded capacity which the service provider has elected is not to be treated as part of the Covered Pipeline.[7]

    d. For the same reasons, it cannot reasonably be concluded that such assets (not being New Facilities) should be treated as part of the Capital Base or otherwise taken into account in setting Total Revenue.

13. In addition, the June submission and consequently the December submission are flawed for the reasons below.

[4] Ref. December submission, paragraph 4.1

[5] Ref. GGT's Response, paragraphs 67 to 98.

[6] Ref. GGT's Response paragraphs 86 to 96

[7] Ref. GGT's Response paragraphs 67 to 83.

2.3.2 Expansions of Capacity are not part of Covered Pipeline

14. As the Draft Decision concluded, the Expansions of Capacity are not part of the Covered Pipeline.[8]

15. In its December submission, BHP Billion stated that it *"broadly supports the position reached by the Regulator in the Draft Decision"*[9] and there is no discussion of any disagreement with the conclusion that the Expansions of Capacity are not part of the Covered Pipeline. It therefore seems that BHP Billiton recognises that the conclusion in the Draft Decision is correct and GGT will accordingly not address in detail the arguments in the June submission on this issue.

16. To the extent that the June or December submissions rely on the incorrect view that the Expansions of Capacity were to be treated as part of the Covered Pipeline, they are flawed.

2.3.3 Failure to recognise Code regime for coverage

17. A significant part of the June submission relies on the view that the Code does not provide for uncovered capacity:[10]

> *"the Code does not contemplate the concept of 'uncovered capacity' of the nature proposed to be created by GGT";*
>
> *"The concept of 'Coverage' has no application to Capacity";*
>
> *" 'Capacity' is not capable of being 'treated as part of the Covered Pipeline' ".*

This is incorrect as it fails to recognise the clear language and intent of the Code, which explicitly recognises that expansions of capacity can be uncovered – and will be uncovered unless covered as a result of specific processes.[11] To the extent that the June or December submissions rely on these incorrect views, the submissions are flawed.

18. In the same way, the submission fails to recognise that the Code provides an exclusive regime for addressing whether expansions become Covered[12] and that the Code clearly provides for a service provider, under an approved Extensions/Expansions Policy, to be able to elect that capacity is not to be part of the Covered Pipeline and thus outside the Access Arrangement.[13] This failure to recognise the clear regime in the Code in relation to the Coverage of expanded capacity and the terms of an Extensions/Expansions Policy means that the submission is unreliable.

[8] Ref. Draft Decision paragraph 174, 188.

[9] Ref. December submission, section 5.2

[10] Ref. June submission, paragraph 5.2 page 9, 5.5(c) page 12 and 5.6 page 13; and similar statements in paragraphs 4.1, 5.5(a) page 11, 5.7 page 14 and 5.8 page 16.

[11] see GGT's Response paragraphs 56 to 63, 69 to 70

[12] Ref GGT's Response paragraphs 69, 70

[13] See, for example, June submission, section 5.8, page 16

19. Further, the submission proceeds as if the question before the Authority is to be answered by an assessment of the coverage criteria, and contains lengthy discussion on the test for coverage under section 1 of the Code and the circumstances in which part of a pipeline could become uncovered:[14]

> *"however the question of whether such an extension to, or expansion of, a Covered Pipeline is to form part of that Covered Pipeline must be determined by reference to the criteria in clause 1.9 of the Code".*
>
> *"If part of a Pipeline is to be 'uncovered', such a result can apply only if one or more of the criteria set out in clause 1.9 of the Code is not satisfied in respect of a Service to be provided by means of that part of the Pipeline".*

20. While such discussions may be relevant to the National Competition Council ("NCC") and the Minister's consideration of an application for coverage of the Expansions of Capacity, or for revocation of coverage of some part of the Covered Pipeline, it is not relevant to the Authority's consideration of the proposed revisions to the Access Arrangement.

21. Similarly, the June submission fails to fully portray the NCC's position on the matter of Capacity. The submission states that there have been no submissions to the NCC *"discussing the concept of 'covered' or 'uncovered' Capacity let alone endors(ing) such a distinction."*[15] In support of this, the submission refers[16] to paragraph 3.9 of the NCC's Final Recommendation in relation to revocation of coverage of the Moomba Adelaide Pipeline System ("MAPS"):[17]

> *"in which 'uncovered' sections of that Pipeline (prior to revocation) arising from new facilities developed under the Extensions/Expansions Policy were identified principally as a series of laterals (paragraph 3.9)"*

22. However, the submission fails to refer to:

    (a) the introductory sentence to the same paragraph 3.9, where the NCC stated that *"Under the Gas Code, extensions to, or expansions in the capacity of, a pipeline form part of the covered pipeline only if provided for in the extensions/expansions policy under an access arrangement"*; and

    (b) the fact that the Final Recommendation expressly recognised the existence on the MAPS of uncovered Capacity (paragraph 3.10).

23. In light of the above, GGT submits that the proper conclusion is that the NCC does recognise and "endorse" the distinction between "covered" and "uncovered" capacity. To the extent the BHP Billiton submissions suggest otherwise, they are inaccurate or misleading.

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[14] Ref. June submission section 5.7 pages 14 and 15

[15] Ref. June submission section 5.6

[16] Ref. June submission section 5.7, footnote 5 page 14.

[17] The Minister accepted the NCC's Recommendation and revocation was declared in due course.

2.4 Conclusion

24. For the reasons set out in sections 2.1 to 2.3 above, BHP Billiton is wrong in its submission to support the Authority's decision:

    (a) to include the cost of the assets used to provide the Expansions of Capacity during the current Access Arrangement Period in the Capital Base of the GGP for the purpose of determining the Reference Tariff; and

    (b) to include all actual and forecast costs, revenues and volumes relating to the Expansions of Capacity in the upcoming Access Arrangement Period in determining the Reference Tariff.

3 Volume forecasts

25. In section 6, BHP Billiton discussed GGT's Revised Access Arrangement forecasts and submitted that the Authority should utilise the volume forecasts prepared by BHP Billiton.

3.1 BHP Billiton Submission

26. In paragraph 1 of section 6.2 of its submission, BHP Billiton states:

> *BHP Billiton submits that the volume forecasts used in the Draft Decision to determine the Reference Tariff are crucial and must "represent best estimates arrived at on a reasonable basis", as required under the Code. On this basis, BHP Billiton submits that the Regulator should:*
>
> *i) reject GGT's forecasts as clearly contrary to the requirements of the Code;*
>
> *ii) utilise the volume forecasts prepared by BHP Billiton set out in section 6.8; and*
>
> *iii) request information from GGT regarding any expressions of interest it has received from, or negotiations it has had with, prospective Users to assist in determining the appropriate forecasts.*

27. GGT considers that the proposal outlined by BHP Billiton is incorrect and/or unreasonable, as discussed in sections 3.2 to 3.8 below.

3.2 Code Requirements

28. In paragraph 4 of section 6.3 of its submission, BHP Billiton stated that:

> *However, BHP Billiton submits that, in the absence of proper forecasts provided by the Service Provider (as is the case with the Proposed Access Arrangement), the Regulator is not in a position to simply utilise these forecasts in determining the Reference Tariff as, by the Regulator's own admission, these do not "represent best estimates arrived at on a reasonable basis" (s. 8.2(e) of the Code). BHP Billiton submits that, in order for the Regulator to ensure that the Reference Tariff meets this requirement, it has the discretion under the Code to formulate its own "best estimates" of forecast volumes, taking into account all available information.*

29. GGT considers the BHP Billiton submission to be erroneous and based on its failure to recognise that the load attributable to the uncovered capacity is not part of the Covered Pipeline and is therefore not relevant to the derivation of reference tariffs. Further, GGT has developed forecasts on the basis that utilisation of the Covered Pipeline will remain at historical high levels.

30. Such a forecast is predicated on the associated assumptions that demand for commodities produced by end users of gas transported by the GGP will remain strong.[18] This assumption may prove to be optimistic. GGT notes that recent reports in the press predict that BHP Billiton is preparing to sell its Western Australian nickel mining and processing assets. An article in *The West Australian* of 22 December 2009 suggests that such sale is motivated by BHP Billiton's own gloomy forecast of future nickel price movements.

31. Furthermore, BHP Billiton's statement that:

> *... by the Regulator's own admission, these do not "represent best estimates arrived at on a reasonable basis ...*

32. is erroneous, as evidenced by the following statement in the Draft Decision:

> *The Authority has no information either by way of submission from any party, or based on its current knowledge, to suggest that GGT's forecasts on this occasion, do not represent a "best estimate arrived at on a reasonable basis" as required by section 8.2(e) of the Code.*[19]

3.3 GGT's Historical Volume Forecasts

33. In section 6.4 of its submission, BHP Billiton questions the accuracy of GGT's historical forecast volumes by referencing the Authority's Draft Decision.

34. As addressed in GGT's Response:

> *On 24 November 2009, the Authority requested an explanation from GGT of how the volume information submitted on 7 July 2005 was different to the volume information that GGT had supplied on 5 June 2005 in response to a notice under Section 41, of Schedule 1 of the Gas Pipelines Access (Western Australia) Act 1998 (Section 41 Notice).*[20]

[18] GGT's Reference Tariff calculation is predicated on availability of GGP capacity made available by the non-renewal of previous Gas Transportation Agreements.

[19] Economic Regulation Authority (2009), Draft Decision on GGT's Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline Submitted by Goldfields Gas Transmission Pty Ltd, 9 October 2009, para. 693, page 118

[20] GGT Response to Draft Decision to Proposed Revisions to GGP Access Arrangement, 11 December 2009, para. 329, page 58

> *In reviewing the information supplied in July 2005 and in June 2009, GGT has uncovered two errors in the MDQ information that it supplied to the Authority under a Section 41 Notice, as a result of uncovering historical correspondence that was not available at the time of this submission plus a spreadsheet error. GGT will be providing in separate correspondence explanatory details of these errors to the Authority and with an accompanying amended response to the Section 41 Notice.*[21]

35. Incorporating these required amendments into GGT's historical forecasts for the Covered Pipeline results in actuals (both MDQ and throughput) on average being lower than 2005 Access Arrangement Forecast Volumes. With the benefit of hindsight, it is apparent that GGT's 2005 forecast was optimistic in the latter years of the period 2005-09 and indicates that GGT overestimated (then) future load growth.

36. The 2005 Access Arrangement Forecast Volumes was the best forecast based on information available at the time, and was accepted by the Authority, as the best estimate arrived at on a reasonable basis per s. 8.2(e) of the Code. The Code does not give the Authority scope to revisit the previous load forecast and make retrospective adjustments for forecasting inaccuracy.

37. GGT submits that the BHP Billiton comparison of forecasted and actual contracted capacity, in paragraph 4 of section 6.4 of its submission, is erroneous as a result of BHP Billiton's mistaken belief that the load attributable to the uncovered capacity is part of the Covered Pipeline. BHP Billiton's failure to recognise the difference between Covered Pipeline load and load accommodated by the Expansion of Capacity permeates its entire submission and must be recognised when considering the submission.

3.4 Projected Growth

38. In paragraph 1 of section 6.5 of its submission, BHP Billiton states:

> *As noted above, the volume forecasts in the Draft Decision predict no increase in the average daily and total throughputs on the GGP during the upcoming Access Arrangement Period. BHP Billiton submits that there is no basis on which such figures could be deemed to be "best estimates arrived at on a reasonable basis".*

39. In Table 5-2 of GGT's Response, GGT indicated that the Capacity of the Covered Pipeline was 109 TJ/day throughout the term of the Access Arrangement. This indicates that GGT was not going to expand the Covered Pipeline during this period and therefore there could be no increase in the average daily and total throughputs on the Covered Pipeline other than minor variations with existing contracted parties. Therefore, GGT considers that BHP Billiton's statement:

[21] Op. cit., para. 330, page 58

BHP Billiton submits that there is no basis on which such figures could be deemed to be "best estimates arrived at on a reasonable basis".

40. is inaccurate based on its mistaken belief that the load attributable to the uncovered capacity is part of the Covered Pipeline, as more fully discussed by GGT in section 2 of this Response.

41. In paragraph 2 of section 6.5 of the its submission, BHP Billiton provided a brief list of potential projects within the vicinity of the GGP, which it appears that BHP Billiton, considers being potential future customers of the GGP:

A number of expansion projects have been publicly announced by companies operating in the region serviced by the GGP. For example:

- *in respect of BHP Billiton's Iron Ore Operations in the region (Media Release dated 4 February 2008, available at: http://www.bhpbilliton.com/bb/investorsMedia/news/2008/bhpBillitonApprovesFundingForAcceleratedGrowthAt WesternAustraliaIronOre.jsp):*
  - *Rapid Growth Project 4 was approved in March 2007 and will increase capacity by 26Mtpa to 155Mtpa, with construction expected to be completed in 2010;*
  - *Rapid Growth Project 5 is expected to increase capacity to more than 200 million tonnes per annum (Mtpa) during calendar year 2011;*

- *Jabiru Metals Limited announced in August 2009 a significant increase in its mineral resources and ore reserves in respect of its Jaguar Operations (ASX Announcement dated 25 August 2009, available at: http://www.asx.com.au/asxpdf/20090825/pdf/31k8x53cwnzyt6.pdf);*

- *Apex Minerals NL announced in October 2009 its intention to "to undertake substantial mine development" at its Wiluna gold project (ASX Announcement dated 8 October 2009., available at: http://www.asx.com.au/asxpdf/20091008/pdf/31l6nlp1lzhdpn.pdf);*

- *St Barbara Limited announced in November 2009 the potential for a new underground gold operation at its Leonora Operations in the later part of 2010 (ASX Announcement dated 9 November 2009, available at: http://www.stbarbara.com.au/uploads/tx_rlsortthis/091109_ASX_Tarmoola_Final.pdf); and*

- *Reed Resources Ltd announced in November 2009 that production for the Mount Marion Lithium Project in is anticipated to commence in 2010 (ASC Announcement dated 19 November 2009, available at: http://www.asx.com.au/asxpdf/20091119/pdf/31m4xl0xxtr0zg.pdf)*

42. GGT's response to each of these points is set out below.

BHP Billiton Iron Ore Operations

43. GGT understands that the Newman Power Station has a capacity of 184 MW[22] comprising:

- 3 x Frame 6 GE 42MW OCGT; and
- 1 x Rolls Royce Trent 60 Wet Low Emissions machine with dual-fuel capability.[23]

44. The plant currently provides 100% of the power requirement of the isolated grid which supplies electricity to the Mt Newman Joint Venture. The Mt Newman Joint Venture is the sole customer of the power station under power purchase agreements that run until 2014.[24]

45. The latter machine was installed, as part of the $90 million[25] Newman Expansion Project. The Newman Expansion Project began in June 2008 and was completed in the second half of FY09.[26] GGT assumes that Alinta Energy Limited ("Alinta") proceeded with the Newman Expansion Project, as a result of Alinta negotiating a revised power purchase agreement with the Mt Newman Joint Venture (i.e., Alinta would have proceeded with the project, as the cashflows generated by the additional power provided to the Mt Newman Joint Venture at the agreed power price less the development cost would have been sufficiently positive when discounted at the relevant hurdle rate). The Mt Newman Joint Venture is comprised of BHP Billiton (85%) and Itochu Minerals & Energy of Australia Pty Ltd, Mitsui–Itochu Iron Pty Ltd and Mitsui Iron Ore Corporation Pty Ltd[27].

46. [Information Confidential].

47. Therefore, GGT assumes that the expansions of BHP Billiton Iron Ore Operations, as mentioned above will be met by the existing capacity of the Newman Power Station, which

[22] Babcock Brown Power, Annual Report 2009, page 7

[23] Op. cit., page 9

[24] http://www.alintaenergy.com/assets/generation---operating/newman-.aspx

[25] Babcock Brown Power Presentation, ASX Release, Update on BBP Total Capital Commitments and Structure, 23 May 2008

[26] Babcock Brown Power, Annual Report 2009, page 9

[27] http://www.bhpbilliton.com/bb/investorsMedia/news/2008/bhpBillitonApprovesFundingForAcceleratedGrowthAtWesternAustraliaIronOre.jsp

includes the additional machine installed as part of the Newman Expansion Project, [Information Confidential].

48. [Information Confidential].

Jabiru Metals Limited

49. GGT notes that the Jabiru Metals Limited ("Jabiru") ASX announcement on 25 August 2009 was released circa five months after GGT submitted its Revised Access Arrangement. GGT understands that Jabiru has been able to identify additional ore reserves to replace nearly all ore treated in 2008/09[28]. GGT can find no information in this release that supports Jabiru expanding its existing facilities, i.e., requiring additional gas-fired power generation.

50. In fact, Jabiru made the statement:

> *The Company's long term objective at Jaguar is for the exploration efforts to define a resource available to the Jaguar concentrator which will support a mine life of 8 or more years. With the upgrade of both the Teutonic Bore and Jaguar mine mineral resources and the replacement of nearly 100% of the past years production in reserves, a positive first step towards this goal has been achieved.*[29]

51. At the date of this response, GGT has had no discussions with Jabiru in regard to gas transportation of additional gas on the GGP.

Apex Minerals NL

52. GGT notes that the Apex Minerals NL ("Apex") ASX announcement on 8 October 2009 was released over six months after GGT submitted its Revised Access Arrangement. A further ASX release dated 22 December 2009 indicated that Apex exploration program was based on developing "more ore sources to set up the future of the mine" rather than expanding its existing facilities, and therefore no additional gas capacity is required.

53. At the date of this response, GGT has had no discussions with Apex in regard to gas transportation of additional gas on the GGP.

[28] http://www.asx.com.au/asxpdf/20090825/pdf/31k8x53cwnzyt6.pdf), page 2

[29] Op. cit., page 4

St Barbara Limited

54. GGT notes that the St Barbara Limited ("St Barbara") ASX announcement on 9 November 2009 was released over seven months after GGT submitted its Revised Access Arrangement. GGT understands that St Barbara needs to complete a detailed feasibility study prior to making a decision whether to proceed with this new underground gold development, as indicated in this ASX announcement as follows:

> *The Company is now in the strong position of being able to consider the Tarmoola development opportunity along with the Tower Hill development opportunity, to decide which project would represent the best economic value to bring into production and utilise the available mill capacity at Gwalia for five years or more*[30].
>
> *In view of Tarmoola's potential development status alongside Tower Hill as an alternative source of feed to fully utilise the Gwalia mill capacity, the current Tarmoola sale process is being re-evaluated in the context of available funding options and pending completion of further evaluation work during the March 2010 quarter.*[31]

55. At the date of this response, GGT has had no discussions with St Barbara in regard to gas transportation of additional gas on the GGP.

Reed Resources Limited

56. GGT notes that the Reed Resources Limited ("Reed Resources") ASX announcement on 19 November 2009 was released over seven months after GGT submitted its Revised Access Arrangement. In this release, Reed Resources indicated that:

> *The Company has commenced Phase 1 of its Resource Definition drill program (Figure 2), targeting a Mineral Resource of 7-8 Mt of spodumene pegmatite at a grade of 1.3-2.0% Li_2O. The drilling is expected to be complete by the end of November. The potential quantity and grade of the exploration target is conceptual in nature and there has been insufficient exploration to define it as a mineral resource and that it is uncertain if further exploration will result in the determination of a mineral resource.*[32]

[30] http://www.stbarbara.com.au/uploads/tx_rlsortthis/091109_ASX_Tarmoola_Final.pdf, page 1

[31] Ibid.,

[32] http://www.asx.com.au/asxpdf/20091119/pdf/31m4xl0xxtr0zg.pdf), page 2

57. Furthermore, Reed Resources indicated that:

> *A mineral resource estimate is planned to be completed by the end of Q1 2010. The Joint Venturers expect to mobilise a processing plant and related equipment in Q2 2010. First shipments of product, at a production rate of 17,000 tonnes per month of +6.5% Li2O concentrate is expected to commence from Q3 2010, subject to a decision to mine and obtaining all necessary approvals.*[33]

58. At the date of this response, Reed Resources is not a User on the GGP and that GGT has had no discussions with Reed Resources in regard to gas transportation of Gas on the GGP.

59. Therefore, in summary, as at the date of this submission not one of the projects BHP Billiton has identified as a potential customer of the GGP has approached GGT about additional gas transportation services on the GGP. This inaction (or inaction as the case may be) is reflective of the inherent uncertainty facing mining operations (and hence pipeline load forecasting) in the regions served by the GGP.

60. Furthermore, GGT understands that the expansions at BHP Billiton's Iron Ore Operations have already been taken into account by [Information Confidential].

3.5 New Facilities

61. In its submission,[34] BHP Billiton argues that GGT's volumes forecast should be rejected. because GGT must anticipate increased volumes because it has invested in capital to serve them:

> *BHP Billiton submits that GGT itself clearly anticipates an increase to the average daily and total throughputs on the GGP based on data in the Tariff Model in the Draft Decision (as provided by GGT). For example the Tariff Model includes the following amounts for "New Facilities Investments":*
>
> *(a) $15.3M for Compressor Stations Upgrade in 2010 (for forecast New Facilities Investment); (para 315 of DD) and*
>
> *(b) $25.2M in 2008 and $52.2M in 2009 for "Uncovered" Compressor Stations Capex (for New Facilities Investment already carried out). (para 695 of DD)*

62. GGT reiterates the point made in the supporting submission to the Access Arrangement Revisions[35] that the New Facilities Investment related to compressor stations relates to

[33] Op. cit., page 3

[34] BHP Billiton submission s6.6.

[35] GGT Supporting Submission to Proposed Revisions to Access Arrangement, 21 April 2009, Appendix A3.

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improving the efficiency and reliability of the compressor stations which are part of the Covered Pipeline. This investment "is necessary to maintain the safety, integrity or Contracted Capacity of Services" as per Code section 8.16(a)(ii)(C); there are no additional volumes of gas to be transported by this investment.

63. However, as discussed more fully in GGT's Response and in section 2 above, the investment in compressor stations upgrades (2010) and uncovered capacity (2008 and 2009) is not New Facilities Investment and the services provided by that capacity are not Services under the Code.

64. The assessment of the reasonableness of the forecast volumes must be conducted in light of the Capacity of the Covered Pipeline. The inlet capacity of the Covered Pipeline is approximately 109 TJ/day. [36] As indicated in the proposed revised Access Arrangement Information, there is no forecast New Facilities Investment to expand the capacity of the Covered Pipeline. It is necessary to forecast, then, that the Capacity of the Covered Pipeline will remain at 109 TJ/day for the duration of the Access Arrangement Period.

65. The BHP Billiton submission is flawed on this issue due to the errors discussed in section 2 above.

3.6 Authority to Obtain Information from GGT on Forecast Volumes

66. In paragraph 1 of section 6.7 of its submission, BHP Billiton states:

> *BHP Billiton submits that the issues raised in sections 6.5 and 6.6 above are sufficient to give the Regulator reason to believe that GGT has information that may assist the Regulator in the performance of its obligations under the Code. (In particular, information which will assist the Regulator to ensure that forecasts required in setting the Reference Tariff represent best estimates arrived at on a reasonable basis (section 8.2 of the Code) and the general principles in section 8.1 of the Code.) On this basis, BHP Billiton submits that the Regulator should utilise its powers under section 41 of the Gas Pipelines Access (Western Australia) Act 1998 (WA) to require GGT to provide the Regulator with any information that relates to the potential growth of throughput on the GGP during the upcoming Access Arrangement Period, including:*
>
> *a) any expressions of interest received by GGT from Prospective Users of the GGP;*
>
> *b) information in relation to negotiations or discussions GGT has had with prospective users of the GGP for the upcoming Access Arrangement Period; and*
>
> *c) any of GGT's internal forecast modelling information it has prepared for its own purposes.*

[36] GGT Response to Draft Decision to Proposed Revisions to GGP Access Arrangement, 11 December 2009, para. 331, page 59

67. GGT submits that, as detailed in above the issues raised by BHP Billiton are not supportable, as they are full of inaccuracies, misrepresentation and unsupported assertions. Little or no weight should therefore be given to BHP Billiton's proposal.

3.7 BHP Billiton's Volumes Forecasts

68. In section 6.8 of the its Response, BHP Billiton put forward volume forecasts for the GGP for the Access Arrangement Period ("BHP Billiton's GGP Volume Forecast"). BHP Billiton's GGP Volume Forecast is arrived at through the following discussion:

> *BHP Billiton submits that the use of extrapolation of historical figures contained in the Draft Decision is a reasonable and appropriate basis for setting Reference Tariffs, with those estimates being:*
>
> *a) Historical Extrapolation of 5 year data; and*
>
> *b) Historical Extrapolation of 9 yr data.*
>
> ***Historical extrapolation of 5 year data** from the current Access Arrangement provides a good indication of likely future utilisation. The current Access Arrangement Period includes both 'boom' and 'bust' economic conditions with expansions, closures and new ventures. There appears to be no abatement of project expansions and potential new projects on the GGP.*
>
> ***Historical extrapolation of 9 year data** from the current Access Arrangement Period and from the period prior to this provides a more conservative estimate of likely contracted Capacity. This includes the slow growth period of 2000 to 2004, and could be considered as a very conservative long term average growth of business in the Goldfields.*
>
> *It should be noted that BHP Billiton's proposal (being the average of the two extrapolations) represents a very modest 7.4% annual growth of contracted Capacity.*
>
> *Table 2 below sets out BHP Billiton's volume forecast amounts, and Figure 1 sets out BHP Billiton's volume forecasts in graph form.*
>
> *The Regulator's Tariff Model has been included in the table for comparison purposes only. BHP Billiton considers it unreasonable to use the Regulator's Tariff Model as a basis for establishing a 5 year forecast. Further, this is inconsistent with the GGT's plans for immediate continuation of capital expenditure to expand the Capacity of the GGP.*

Table 2: BHP Billiton's volume forecast amounts for GGP

2010-2014 Access Arrangement - Proposed Contracted Capacity					
	2010	2011	2012	2013	2014
Regulator's Tariff Model (TJ/day)	156.8	157.0	156.9	157.2	157.2
Historical Extrapolation 5 yr (TJ/D)	162.6	177.2	193.2	210.6	229.5
Historical Extrapolation 9 yr (TJ/D)	157.7	166.7	176.3	186.3	197.0
BHP Billiton's Proposal (TJ/D)	160.2	172.0	184.7	198.4	213.2

69. GGT makes the following observations on BHP Billiton's GGP Volume Forecast:

(i) The BHP Billiton forecast is fundamentally flawed due to the error made by BHP Billiton in relation to the treatment of the uncovered capacity of the GGP;

(ii) it does not take into account that the nominal fully expanded capacity of the GGP is 167 TJ/day[37] and additional capacity over and above this value would be provided by looping, which GGT estimates would take circa 2 years of planning and construction for each stage of expansion based on DBNGP experience. Furthermore, such expansions would require substantial capital expenditure, which is not discussed in BHP Billiton's GGP Volume Forecast;

(iii) it is not supported or substantiated by detail on where the additional growth will come from, i.e. BHP Billiton does not provide a detailed list of potential projects, which are likely to proceed and which will require new gas supplies. At most, BHP Billiton has provided a list of qualified or conditional announcements by one or more companies which are at best speculative prospects;

(iv) the average 7.4% annual growth equates to an average annual increase of 12.8 TJ/day over the period 2010 - 2014. This equates to a substantial customer being signed each year of this period or one or more customers carrying out substantial expansions each year;

(v) for comparison purposes, there is a significant difference between the BHP Billiton's GGP Volume Forecast and the Regulator's Tariff Model Forecast equating to a geometric average of 20.1 TJ/day; and

(vi) it is based on simple extrapolation of historical loads. However, this fails to recognise that for many years, regulators have recognised that different load forecasting methodologies are appropriate in different circumstances:

2.1 An appropriate methodology

ACIL would suggest there are two general approaches to forecasting relevant to the particular circumstances faced by AGLGN:

[37] http://www.ggt.com.au/html/02doi2.htm

- *micro-analysis informed by survey of customers, market analysis (including major changes such as contestability in the retail market) and plans to extend the network; and*
- *macro-analysis driven by historical trends and relationships between drivers of gas demand, including State Final Demand (SFD), population growth, relative energy prices, technology and weather.*

In any forecast of NSW and ACT gas demand over a five year period, it might reasonably be expected that both methodologies would be employed. In particular, the micro-analysis is most accurate where there are identified customers and there is good knowledge about their demand over the forecast period. The macro-analysis is important both for forecasting demand from groups of homogeneous customers for which it is not practical to survey and for making judgments about the accuracy of the micro-analysis toward the end of the forecast period when survey results might be expected to be less reliable.[38]

As the GGP does not serve a large population of homogeneous customers, it is not appropriate to base the load forecast on a macro analysis. This is what BHP Billiton has proposed by calculating an extrapolation of historical load growth. BHP Billiton has made no attempt to reconcile this extrapolation to any causal factors such as state GDP or any other economic indicators.

In contrast, GGT has based its load and demand forecast on a micro analysis of all contracts for capacity, which addresses 100% of the load forecast.

GGT submits that BHP Billiton's GGP Volume Forecast arbitrarily uses an extrapolation of historical load could not be considered a reasonable basis on which to develop a load forecast for a pipeline of this nature. Therefore, it can not be considered to be a best estimate arrived at on a reasonable basis" as required by section 8.2(e) of the Code.

70. In summary, GGT considers that BHP Billiton's GGP Volume Forecast for the Covered Pipeline is not based on best estimates arrived at on a reasonable basis; it is inaccurate and contains misrepresentations and unsupported / unsubstantiated assertions. It is therefore not Code compliant.

[38] Review of AGLGN Gas Demand Forecasts - A Report to IPART by ACIL Consulting, July 1999, available at http://www.archive.ipart.nsw.gov.au/pdf/Gas99-7-2.pdf

3.8 BHP Billiton's Conclusion

71. In paragraph 1 of section 6.9 of its submission, BHP Billiton indicated that:

> *BHP Billiton submits that, in the absence of reasonable estimates from GGT of volume forecasts, the Regulator should use the figures set out in BHP Billiton's Proposal, which provides an average of all historical data available.*

72. In section 3.7, GGT documented that BHP Billiton's GGP Volume Forecast for the Covered Pipeline is not Code compliant, is inaccurate and contains misrepresentations and unsupported / unsubstantiated assertions. Therefore, GGT submits that BHP Billiton's Volume Forecast is not applicable to the Revised Access Arrangement.

73. In paragraph 2 of section 6.9 of its submission, BHP Billiton indicated that:

> *In addition, BHP Billiton submits that the issues raised in sections 6.5 and 6.6 above are sufficient to establish that GGT has information that may assist the Regulator in the performance of its obligations under the Code, and the Regulator should request this information from GGT.*

74. In section 3.6, GGT contends that its responses to sections 6.5 and 6.6 of the BHP Billiton Response, as detailed in the above sections 3.4 and 3.5 clearly indicate that the issues raised by BHP Billiton are not supportable, as they are full of inaccuracies, misrepresentation and unsupported assertions.

75. In paragraph 3 of section 6.9 of its submission, BHP Billiton indicated that:

> *In the event that GGT provide revised estimates, and those estimates are considered reasonable by the Regulator, then BHP Billiton would not be opposed to those estimates being included as a one-third contributor to above estimate average.*

76. GGT considers the above quoted suggestion by BHP Billiton that, if the Authority found GGT's forecast to be acceptable, then they should be "blended" one-third with BHP Billiton's arbitrary GGP Volume Forecast to be entirely unreasonable. GGT submits that, if the regulator finds GGT's forecast reasonable, then they are reasonable in their own right and it would be inappropriate to "blend" a reasonable forecast with an unreasonable forecast (that is, BHP Billiton's arbitrary extrapolation forecast) for the purposes of determining reference tariffs under the Revised Access Arrangement.

3.9 Trigger and Incentive Mechanisms

77. In its submission on the Draft Decision, GGT objected to the Authority's proposed Trigger Mechanism on the grounds that it was not required, and related to an inappropriate measure (applications for increases in the capacity allowed under the pipeline license).

78. BHP Billiton appears to concur that linking the trigger mechanism to the pipeline license is inappropriate, because it could send inappropriate signals for investment.[39] However, BHP Billiton appears to favour a trigger mechanism tied to the difference between the forecast and actual contracted capacity:[40]

> *However, in the alternative, if the Regulator rejects BHP Billiton's proposed forecast set out in section 6.8, a Trigger Event mechanism that discourages forecast underestimates is necessary. The appropriate Trigger Event should be based on variance between forecast contracted capacity and actual contracted capacity. Such a variance should not be in excess of 5% of forecast contract Capacity as:*
>
> *(a) 5% variance is material; and*
>
> *(b) any Trigger Event outside 5% Variance from forecast is likely to be a significant detrimental behaviour modifier.*

79. GGT submits that a trigger mechanism is neither required nor appropriate. Consistent with the Code's incentive mechanisms, the Service Provider is encouraged to "grow the market" for pipeline services from the Covered Pipeline. Once the Regulator has accepted a load and demand forecast, any incremental revenue arising from sale of Services above and beyond that level accrue to the benefit of the Service Provider.[41]

> *The Principles also require that, where appropriate, Reference Tariffs be designed to provide the Service Provider with the ability to earn greater profits (or less profits) than anticipated between reviews if it outperforms (or underperforms against) the benchmarks that were adopted in setting the Reference Tariffs. The intention is that, to the extent possible, Service Providers be given a market-based incentive to improve efficiency and to promote efficient growth of the gas market (an Incentive Mechanism).*

80. and

> *8.44 The Reference Tariff Policy should, wherever the Relevant Regulator considers appropriate, contain a mechanism (an Incentive Mechanism) that permits the Service Provider to retain all, or any share of, any returns to the Service Provider from the sale of the Reference Service:*

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[39] BHP Billiton Public Submission In Response to Draft Decision on Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline 11 December 2009, s. 7.4 p 15.

[40] Op cit, s. 7.5, para. 2 p 16

[41] National Gas Code, preamble to Chapter 8.

> *(a) during an Access Arrangement Period, that exceed the level of returns expected for that Access Arrangement Period; ...*
>
> *particularly where the Relevant Regulator is of the view that the additional returns are attributable (at least in part), to the efforts of the Service Provider. Such additional returns may result, amongst other things, from lower Non Capital Costs or greater sales of Services than forecast.*

81. However, even if a Trigger Mechanism were considered to be appropriate to constrain the scope of the incentive mechanism, it would be ineffective. As the Covered Pipeline has only about 4TJ/day of available capacity, there is no scope for a greater than 5% increase in contracted volumes. The proposed trigger mechanism would be ineffective. GGT submits that there is no benefit in imposing an ineffective trigger mechanism.

3.10 Comments on Reference Tariffs

82. Notwithstanding its incorrect comments on the amount of gas transported by the Covered Pipeline as discussed above, BHP Billiton makes a series of comments regarding a supposed over-recovery of revenues:[42]

> *As a result of GGT's inaccurate volume forecasts provided for the current Access Arrangement Period (see section 6.4 above), GGT's revenue during the current Access Arrangement Period was in excess of the revenue GGT was properly entitled to receive under the Code. (s. 9.1, para. 1)*
>
> *BHP Billiton submits that GGT's over-recovery of revenue during the current Access Arrangement Period should be taken into account by the Regulator when determining the Reference Tariffs to apply during the upcoming Access Arrangement Period. BHP Billiton submits that such an approach is consistent with the provisions of the Code. (s. 9.2, para. 1)*
>
> *BHP Billiton submits that GGT will have over-recovered revenue for the equivalent of 43.4 PJ by the end of the current Access Arrangement Period. Using the Regulator's estimate of $25 million as the amount over-recovered by GGT for the understatement of contracted Capacity by 12 TJ/day, (Draft Decision, para. 689) this equates to a total over-recovery of approximately $50 million in the current Access Arrangement Period. (s. 9.3, para 1)*

83. GGT submits that BHP Billiton's comments do not contribute to the regulator's assessment of the revisions to the GGT Access Arrangement; they are invalid on two critical counts:

- The Code does not contain any provision to allow the regulator to "true up" any differences between forecast and actual volumes, demand, operating or capital costs, or depreciation.[43]

[42] Op cit., sections 9.1, 9.2, 9.3

- BHP Billiton's calculated "over recovery" relates to capacity that is not part of the Covered Pipeline.

84. BHP Billiton's submission (section 9) also demonstrates a lack of understanding of the key features of the regulatory regime embodied in the Code, notably that the Code:
    - is a price cap regime rather than a revenue cap regime, and
    - includes incentive mechanisms to drive efficiencies in the cost of operating the pipeline and in developing the market for gas transportation.

85. As discussed above the Code is, in its essence, a price cap regulatory regime. This is apparent by its focus on the calculation of a Reference Tariff. This is also apparent by the lack of any provisions for an "overs and unders" account which would be expected were the Code a Revenue Cap regime.

86. GGT is concerned about the unsupported statement by BHP Billiton that any sort of retrospective adjustment "is consistent with the provisions of the Code" (BHP Billiton s9.2). GGT would challenge BHP Billiton to provide the Code references which provide for any retrospective adjustment of revenues to be included in the calculation of future Reference Tariffs.

87. BHP Billiton also comments, in section 9.4 of its submission, that:

> *BHP Billiton submits that in order to satisfy this Code objective, an ongoing assessment of the revenue should be undertaken during the life of the asset, and for any necessary corrections to the revenue stream to be made periodically.*

88. GGT notes that the Code's requirement for expiry and review of an Access Arrangement (sections 3.17, 2.28) is precisely that – a periodic review and assessment of the costs and revenues associated with the pipeline over the life of the asset. This proposal for an ongoing assessment also runs contrary to BHP Billiton's acceptance of the incentive mechanism as described in section 7.5 of its submission:

> *BHP Billiton acknowledges that, if throughput exceeds the forecasts proposed by BHP Billiton, that GGT will earn the additional income and that this operates as an incentive for expansion."*

89. In summary, both BHP Billiton's analysis of any purported over recovery, and its recommendation to consider reducing the forward-looking Reference Tariff to account for this "over recovery" are invalid and should be summarily rejected.

90. BHP Billiton's comments on the recovery of its purported over recovery are also invalid in that they relate to volumes shipped using uncovered capacity. As discussed in section 2 above, the Code is clear on the distinction between the Covered Pipeline and the scope for expansions of capacity to not be covered and to not be considered to be part of the Covered Pipeline. As the scope of the Access Arrangement is limited to the Covered Pipeline, any analysis of actual costs or revenues must also be confined to the Covered

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[43] Save for the use of actual New Facilities Investment in the capital base roll forward in Code section 8.16(a).

Pipeline. The Authority has acknowledged that the expanded capacity is not to be considered to be part of the Covered Pipeline.[44]

91. On a more general note, GGT is concerned about BHP Billiton's use of broad, unsupported statements of this sort. Aside from undermining the credibility of BHP Billiton's submission, this type of unsupported claim has scope to undermine the rigour of the regulatory regime. GGT urges the Authority to be wary of this strategy and dismiss such unsupported comments accordingly.

92. BHP Billiton's comments in section 9 of its submission, seeking to include an adjustment for differences between actual and forecast revenue, fly in the face of the fundamentals of the price cap regime.

[44] Draft Decision para 174.

4 Rate of Return

93. In sections 10, 11 and 12 BHP Billiton claims that the upper end of the Rate Return range in the Draft Decision is unreasonably high. This is based on their opinion that lower values should be used for equity beta and market risk premium.

94. The submission advances no new material information when compared to BHP Billiton's June 2009 submission. The opinion advanced by BHP Billiton is based on either error or unreasonable assumptions and therefore should be discounted by the ERA.

4.1 Equity Beta

95. BHP Billiton fails to recognise that the Australian Energy Regulator's ("AER's") WACC Report considered only the electricity distribution and transmission WACCs. The AER did not consider gas transmission WACCs or equity betas. As GGT addressed at paragraphs 447 to 450 of GGT's Response and the Synergies report at page 27 it is unreasonable to apply electricity transmission and distribution WACCs and equity betas to gas assets and in particular gas pipeline supplying a small number of mining end users. It is unreasonable because the electricity assets AER was assessing were networks supplying large population centres with diverse end users whilst the GGP serves no large population and has a narrow concentrated end user base.

96. Compared to its June submission, BHP Billiton now seek to introduce a lower range for their estimate of beta by reference to equity beta for the American company AGL Resources. The sole reference to this entity appears only in their conclusion and as such the unsubstantiated claim should rightfully be ignored.

97. The comments extracted by BHP Billiton from the APA 2009 Annual Report highlight that APA has a diversified asset base which is dominated by two assets supplying the two major eastern Australian demand centres of Victoria and NSW. The benefit of the diversified portfolio is reflected in the APA equity beta. As the Authority is assessing the equity beta of a single asset, the GGT, betas of diversified asset portfolios is not relevant. The growth in GGP's EBITDA BHP Billiton references is a result of the capital investments APA undertook in the uncovered capacity. Further EBITDA does not relate to the equity beta of the GGT.

4.2 Market Risk Premium

98. BHP Billiton has made a submission stating that the Authority's consultant's views regarding market conditions are out-of-date. BHP Billiton claim the market has returned to normal based upon the TED Spread. It is thought that the TED Spread reflects default risk to some extent and BHP Billiton has then used this as evidence of 'normal market conditions' in Australia. For the reasons below this is wrong.

99. There are a number of problems with BHP Billiton's assertions. Firstly, the TED Spread reflects a number of key economic factors where the interplay of one may swamp the effect of others. The TED Spread reflects to some extent USD currency risk, the risk of unsecured debt, US Federal Government economic policies and the cost of US Federal Government borrowings. It is not simply the difference between secured and non secured borrowing and therefore it does not reflect default risk only.

100. Additionally the TED Spread cannot be calculated in Australia as there is a far from complete series of 3-month Treasury Note yields. The Commonwealth Government on occasion issues Treasury Notes to meet short term funding deficits. As the economy experiences both deficits and surpluses, it does not have a continual need to issue 3-month Treasury Notes.

101. The TED Spread cannot be calculated in Australia and we are not of the view that it can be applied in Australia. Synergies in their December report highlighted the extremely low correlation between Australian and US long-term BBB bond yields (which also reflect default risk) following the global financial crisis. It is therefore evident that there are different drivers in each market and the use of US data to proxy conditions in Australian financial markets is unreasonable and not valid.

102. What is preferred is to observe Australian factors to estimate Australian market conditions. Consideration must be given to the current Australia evidence as suggested by the Authority's consultant:

> *There are two important indicators that required returns on equity are relatively high in the current market. Dividend yields and default spreads on corporate debt…*[45]

103. While short term interest rates are low, consideration must be given to the debt spreads in the market from which GGT raises it funds. The longer term BBB corporate debt market still experiences spreads of more than 300 basis points . This is similar to the spreads that existed both at the time of the sub prime collapse and also at the start of the global financial crisis. In 'normal' market conditions, the spreads observed on long term BBB bonds was more in the order of 125 basis points. Dividend yields are still similar to those prevailing both at the time of the sub prime collapse and the start of the global financial crisis.

104. Current market conditions continue to suggest that we are experiencing the effects of the global financial crisis. One of the key bases for the Authority's consultant's recommendation of an MRP estimate from the higher end of the range of 6 to 7% is still relevant today.

[45] Frontier Economics (2009), Review of Weighted Average Cost of Capital Estimate Proposed by Goldfields Gas Transmission, Final Draft Report Prepared for the Economic Regulation Authority, p.10

5 Other matters

105. In section 13, BHP Billiton discussed various other matters and amendments to the General Terms and Conditions.

5.1 Provision of Sufficient Information

106. In section 13.1 of its submission, BHP Billiton stated:

> *BHP Billiton maintains its position set out in BHP Billiton's First Submission*[46]*, namely that the Code requires GGT to provide sufficient supporting information to enable BHP Billiton (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 Access Arrangement with the provisions of the Code*[47]*.*[48]
>
> *On this basis, any changes to the Access Arrangement made by GGT in response to the Draft Decision 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 Access Arrangement with the provisions of the Code. It follows that any proposed amendments not accompanied by such information should not be allowed.* [49]

107. The Authority in the Draft Decision advised that a number of the proposed changes to provisions within General Terms and Conditions were considered to be reasonable, as they clarified provisions for the benefit of Users and therefore GGT considers that no further information is required to be supplied.

108. However, for non-tariff Amendment numbers 1, 2, 18 to 43 inclusive and 45 (in regard to clauses 3.1 to 3.3 of the Access Arrangement) of the Draft Decision the Authority required various amendments to GGT's proposed revisions to General Terms and Conditions.

109. In paragraph 705 of GGT's Response, GGT indicated that it had met with the Authority to discuss the abovementioned non-tariff Amendments. At this meeting, GGT advised that it had accepted a number of the Amendments (i.e., Amendments 18, 19, 23, 24, 30, 38, 39 and 43) as required in the Draft Decision for the GGT Revised Access Arrangement. With respect to the other Amendments that were discussed at the meeting, the Authority requested that GGT provide its suggested changes to the Authority's Amendments.

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[46] BHP Billiton Public Submission In Response to the Proposed Revisions to the Goldfields Gas Pipeline Access Arrangement and Access Arrangement Information 30 June 2009, page 44

[47] Section 2.6 of the Code

[48] BHP Billiton Public Submission In Response to Draft Decision on Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline 11 December 2009, page 25

[49] Ibid.,

110. GGT has provided the Authority with explanatory information for each of its suggested changes to the Authority's Amendments incorporating the reasons for these amendments.

5.2 Efficiency Incentive Mechanism

111. In sections 13.2(a) and 13.2(b) of its submission, BHP Billiton stated:

> *The Draft Decision does not contain any incentive or obligation for GGT to operate the GGP as efficiently as possible.*
>
> *BHP Billiton submits that the Access Arrangement should contain an incentive mechanism which seeks to ensure that the GGP is run as efficiently as possible.*

112. The above representations are misleading, as GGT's Revised Access Arrangement contains an incentive mechanism, as evidenced by the following statements made by the Authority who indicated that:

> *GGT proposes to adopt an Incentive Mechanism in the calculation of the Reference Tariff as follows (sub-section 5.2(d) of GGT's Proposed Revisions, page 7):*
>
> *(1) the Reference Tariff will apply during each Year of the Access Arrangement Period regardless of whether the forecasts on which the Reference Tariff was determined are realised;*
>
> *(2) the prospect of retaining improved returns for the period to 31 December 2014 provides an incentive to GGT to achieve the forecast volume of sales and to minimise the overall cost of providing Services; and*
>
> *(3) in determining Reference Tariffs after 31 December 2014, Users will benefit from the increased efficiencies achieved by GGT up to that date through the recovery through the subsequent Access Arrangement Period of non-capital costs reflecting the efficiencies gained during the Access Arrangement Period.*[50]
>
> *GGT submitted that the proposed form of Reference Tariff regulation provides GGT with an incentive to develop the market for the Reference Service as GGT will be able to retain the benefit of volumes generated in excess of those forecast. The right to retain improved returns means GGT has an incentive to minimise the costs of providing Services (section 10.4 of the Access Arrangement Information, page 14).*[51]
>
> *The Authority notes that GGT's Proposed Revisions are consistent with the current Access Arrangement. The Authority acknowledges that an efficiency carryover mechanism is*

[50] Economic Regulation Authority (2009), Draft Decision on GGT's Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline Submitted by Goldfields Gas Transmission Pty Ltd, para. 751, page 128

[51] Op. cit., para. 753, page 129

contemplated by the Code and recognises that such a mechanism has effective incentive properties. The proposed carryover period is a maximum of the length of the forthcoming Access Arrangement Period; that is, 5 years, with any benefit to Users available only after 2014.[52]

In its Final Decision in relation to the current Access Arrangement, the Authority considered the Incentive Mechanism then proposed by GGT and found that the Incentive Mechanism inherent in the Reference Tariff specification to be generally in accordance with the relevant provisions of the Code.[53]

The Authority approves GGT's proposed Incentive Mechanism.[54]

113. In section 13.2(d) of the BHP Billiton Response, BHP Billiton proposes an incentive mechanism. GGT will respond individually to each paragraph within section 13.2(d) of the BHP Billiton submission.

114. In paragraph 1 of section 13.2(d) of its submission, BHP Billiton stated:

> *BHP Billiton submits that in taking into account the economically efficient operation of the GGP the Regulator must ensure that GGT is motivated under the terms of the Access Arrangement to minimise gas consumption and losses and therefore associated emissions. This is consistent with both the Code objectives and market practice in a competitive market where there is any attempt to pass the risk of future carbon costs to consumers.*[55]

115. The discussion above identifies that GGT does indeed have an incentive to operate the GGP efficiently. Such incentive is discussed in further detail in the text which follows.

116. The issue of who carries the commercial risk deriving from taxation of carbon emissions, GGT submits, can be addressed in a meaningful manner only when the relevant legislative framework is developed.

117. In paragraph 2 of section 13.2(d) of its submission, BHP Billiton stated:

> *The current pass through of System Use Gas costs to the pipeline Users provides little incentive for GGT to operate the GGP efficiently. Under the Proposed Access Arrangement, Users are required to provide System Use Gas to meet GGT's actual requirements, with no provision for GGT to contribute in the event of inefficient operations.*

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[52] Ibid.,

[53] Ibid.,

[54] Economic Regulation Authority (2009), Draft Decision on GGT's Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline Submitted by Goldfields Gas Transmission Pty Ltd, para. 753, page 129

[55] BHP Billiton Public Submission In Response to Draft Decision on Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline 11 December 2009, page 26

118. It is relevant at this point to provide a concise overview of System Use Gas ("SUG") prior to addressing the specific points raised by BHP Billiton.

119. SUG is comprised of a number of components. These include:

- compressor fuel;
- fuel for on site electric power generation;
- gas vented during compressor unit starts and stops;
- gas vented when pipeline sections are taken out of service;
- gas used to power instrumentation; and
- measurement variance.

120. Of these components, compressor fuel (primarily) and fuel for power generation make the primary contribution to SUG.

121. Compressor fuel usage is directly related to compressor utilisation, which in turn is directly related to pipeline throughput.

122. As identified above, GGT has a direct commercial incentive to reduce its operating costs. Operating compressors efficiently[56] is one means of reducing operating costs. In turn, operating compressors efficiently has the inevitable consequential effect of minimising compressor fuel usage.

123. On site power generation is an ongoing requirement for remote compressor stations. The dominant factor influencing electrical load is ambient temperature variation, which is beyond the control of GGT. Consequently, electrical load and hence generator fuel is a factor which is difficult to optimise.

124. Gas vented during compressor starts and stops is insignificant. However, it is in GGT's commercial interest to avoid unnecessary starts and stops, as such minimisation is a contributing factor to prolonging equipment life.

125. Venting due to pipeline sections being taken out of service is an extremely rare event.

126. Gas used to power instrumentation is miniscule.

127. Measurement variance is a function of meter accuracy. The GGP's gas flow metering consistently operates within specified tolerances. Further, both the Revised Access Arrangement and the terms and conditions applying to negotiated gas transportation services provide for comprehensive Accuracy Verification Testing. Such Testing provides an ongoing and frequent opportunity for both GGT and its customers to identify and resolve metering issues.

[56] Operating the Goldfields Gas Pipeline at pressures which maximise gas flow efficiency minimises compressor utilisation which in turn minimises fuel usage and operating hours, which in turn minimises consumption of consumables and the frequency of major overhauls.

128. It is therefore apparent that BHP Billiton's concern regarding undue consumption of SUG due to inefficient operation is unfounded.

129. In paragraph 3 of section 13.2(d) of its submission, BHP Billiton stated:

> *BHP Billiton submits that the Proposed Access Arrangement should be amended to ensure that GGT is required to operate the GGP efficiently. For this reason, BHP Billiton submits that an incentive mechanism should be incorporated into the proposed Access Arrangement which encourages GGT to comply with that requirement.*

130. As indicated above the GGT Revised Access Arrangement includes an incentive mechanism ensuring that GGT is motivated to operate the GGP efficiently.

131. In paragraph 4 of section 13.2(d) of the its submission, BHP Billiton stated:

> *BHP Billiton submits that a mechanism along the following lines would provide appropriate incentive for the efficient operation of the GGP:*
>
> *(i) an independent specialist consultant be engaged to establish the efficient level of System Use Gas for the GGP. This may include a narrow range of acceptable operation; and*
>
> *(ii) System Use Gas limits are then set through the Access Arrangement; and*
>
> *(iii) where GGT operates the GGP more efficiently than the set guidelines, it is allowed to keep incremental System Use Gas provided by Shippers below the set guidelines; and*
>
> *(iv) where GGT operates the GGP less efficiently that the set guidelines, it is required to provide the incremental System Use Gas above the set limits (at its cost).*

132. Inherent in this statement is the assumption that GGT has no incentive to operate efficiently. As identified above, this assumption is incorrect. Hence, BHP Billiton's submission on this matter is groundless.

133. In paragraph 5 of section 13.2(d) of its submission, BHP Billiton stated:

> *BHP Billiton notes that the inclusion of an incentive mechanism in respect of Shipper System Use Gas would be broadly consistent with the Access Arrangement in respect of the DBNGP.*

134. The above representation is misleading. The DBNGP does have an incentive mechanism in its Access Arrangement but:

- it relates to operating costs not fuel efficiency – the drivers for achieving efficiency in opex are starkly different from the drivers for achieving efficiency in System Used Gas (as that term is defined in the DBNGP Access Arrangement); and
- even if an operating costs efficiency mechanism is considered a relevant benchmark, the mechanism in the DBNGP Access Arrangement is structured so that System Used Gas costs are excluded from the mechanism, i.e., the relevant provisions within the DBNGP Access Arrangement are as follows:

Definition:

***System Use Gas** means Gas used by Operator for the following purposes:*

(a) replacing Gas consumed in the operation of the DBNGP (including, but not limited to:

(i)compressor fuel;

(ii) gas engine alternator fuel;

(iii) heater fuel; and

(iv) increases to linepack, other than:

(A) when caused by or for the purposes of a supply of linepack gas to a third party under a balancing or back up service arrangement; or

(B) repacking the linepack of the DBNGP after an Expansion which involves looping of the pipeline); and

(b) replacing gas which leaks or otherwise escapes from the DBNGP (whether in normal operational circumstances or due to any rupture or other abnormal leakage) and Gas vented as part of the normal operation of the DBNGP.

Clauses:

(e) For the purposes of this clause 7.12, non-capital costs for any year of the period from 1 January 2005 until 31 December 2010 do not include the costs associated with:

(i)Gas used as compressor fuel during the year;

(ii) Gas used as fuel in gas engine alternators and heaters;

(iii) Gas which is vented during maintenance activities;

(iv) Gas which is lost from the DBNGP; or

(v) Charges levied on Operator pursuant to the Economic Regulation Authority (Gas Pipelines Access Funding) Regulations 2003.

System Use Gas

Operator must supply Shipper's share of System Use Gas.

135. In paragraph 6 of section 13.2(d) of its submission, BHP Billiton stated:

> *BHP Billiton also notes that a number of Users on the GGP access the GGP under agreements outside of the Access Arrangement. On this basis, BHP Billiton submits that any incentive mechanism should be separate from the Reference Tariff (i.e. the mechanism should not, for example, seek to incorporate a fixed charge for Shipper System Use Gas into the Reference Tariff) otherwise there is a risk that shippers under legacy agreements will effectively be charged twice for Shipper System Use Gas.*

136. Again, BHP Billiton's concerns are groundless. The provisions governing SUG in the Revised Access Arrangement, the current approved Access Arrangement, and the Terms and Conditions posted on GGT's Internet website are, for all practical purposes, identical. These all provide for allocation of SUG on a pro rata basis on throughput.

137. More importantly however, BHP Billiton continues with the unfounded assumption that GGT does not have an incentive to operate efficiently. As identified above, this assumption is simply incorrect.

138. In paragraph 7 of section 13.2(d) of its submission, BHP Billiton stated:

> *Further, it would be inappropriate to impose a change to the Tariff Structure that requires GGT to purchase the whole of system use gas, where long term agreements are likely to already be in place where the Shippers are responsible for supplying Shipper System Use Gas. The Regulator, in determining an appropriate incentive mechanism should seek information from GGT on these issues.*

139. GGT does not, and is prevented from, buying and selling gas other than for system use. Consequently, GGT is not in a position to assess the benefits to be derived from the economies of scale accruing to BHP Billiton and other GGP Users. However, the Authority is in a position to acquire the information required to make such an assessment. GGT is most willing to discuss this matter further with the Authority.

5.3 Tariff Escalation Mechanism

140. BHP Billiton took exception with two aspects of the Tariff Adjustment mechanism, submitting:[57]

> *BHP Billiton submits that the Regulator's Tariff Model is intended to provide Reference Tariffs which reflect an efficient Cost of Service. The inclusion of the Regulatory Costs Escalation and the Y Escalation provides for additional return to GGT above the efficient Cost of Service.*
>
> *BHP Billiton submits that there is no justification for the inclusion of escalation factors in the Reference Tariff Calculation other than CPI.*

141. GGT acknowledges that BHP Billiton's submission was prepared without the benefit of GGT's corrections to its Tariff Adjustment Mechanism, as discussed in the Draft Decision from paragraph 812. However, BHP Billiton's objections to the regulatory cost adjustment is not related to the corrections filed by GGT.

[57] BHP Billiton Public Submission In Response to Draft Decision on Proposed Revisions to the Access Arrangement for the Goldfields Gas Pipeline 11 December 2009, p27

142. In the case of regulatory costs, BHP Billiton has failed to understand two key important features of the regulatory cost component of the Tariff Adjustment Mechanism:

- the mechanism is calculated on a one year lag. The WACC adjustment is therefore to maintain the value of the costs in present value terms; and
- the mechanism is symmetrical. The Tariff Adjustment Mechanism will equally function to pass through savings in regulatory costs in present value terms.

143. In the case of the "Y" factor mechanism, GGT notes that this was incorrectly reflected in its original submission and has since been corrected (Draft Decision paragraph 813(a)). Importantly, the function of the "Y" factor mechanism is constrained by the overall Tariff Adjustment Mechanism. It is therefore not possible for GGT to adjust the weightings of tariff components to increase its returns.

144. GGT notes the Authority's acceptance of these components of the Tariff Adjustment Mechanism.

145. GGT notes that GGT's proposed Tariff Adjustment Mechanism complies with the application of the Code's Price Path approach. Under this approach, the present value of forecast revenues, discounted at the rate of return, is equivalent to that determined under the Cost of Service approach. The Tariff Adjustment Mechanism therefore does not provide for increases of costs, but for "smoothing" the price path to be equivalent to that determined under the Cost of Service approach.