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8 June 2007

Mr Michael Walsh
Director
Network Regulation North Branch
Australian Competition and Consumer Commission
GPO Box 3648
SYDNEY NSW 2001

Dear Mr Walsh

Submission in response to draft decision on the proposed Access Arrangement for the Dawson Valley Pipeline

Attached is a submission prepared on behalf of the Service Providers for the Dawson Valley Pipeline, Anglo Coal (Dawson) Limited, Mitsui Moura Investment Pty Ltd and Anglo Coal (Dawson Management) Pty Ltd.

Yours faithfully
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ANGLO COAL

Mitsui Moura

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SUBMISSION

Provided to the Australian Competition and Consumer Commission in response to the draft decision on the proposed Access Arrangement for the Dawson Valley Pipeline

ME_72332680_1 (W2003)

1. Introduction

1.1 Anglo Coal (Dawson) Limited, Mitsui Moura Investment Pty Ltd and Anglo Coal (Dawson Management) Pty Ltd are Service Providers for the Dawson Valley Pipeline (**DVP**).

1.2 On 5 February 2007, the Service Providers submitted a proposed Access Arrangement and Access Arrangement Information for the DVP to the Australian Competition and Consumer Commission (**ACCC**) pursuant to section 2.2 of the National Third Party Access Code for Natural Gas Pipeline Systems (**Code**).

1.3 On 23 May 2007, the ACCC issued a draft decision regarding the proposed Access Arrangement in which it proposed not to approve the Access Arrangement in its current form. It proposed a number of amendments which it considers necessary for the Access Arrangement to be approved.

1.4 On the same date, the ACCC invited interested parties to make submissions on the draft decision by 8 June 2007. These are the Service Providers' submissions.

1.5 The Service Providers wish to address four issues raised in the draft decision:

(a) the amount allocated in respect of direct costs;

(b) the amount allocated in respect of indirect costs;

(c) the ACCC's assertion that '[w]hen it submitted its access arrangement, Anglo Coal did not comment on the other factors in section 8.10 of the Code'; and

(d) the calculation of the risk free rate and inflation for the purposes of determining the required rate of return.

2. Direct costs

2.1 In relation to direct costs, the ACCC states that 'the direct costs identified by Anglo Coal appear to be reasonable providing they cover all the costs which would normally be considered to be direct costs for a gas transmission pipeline'.[1] The ACCC requested and was provided with a detailed breakdown of the line items which comprised the Service Providers' estimate of direct costs. It is therefore aware of the items which comprise the estimate of direct costs.

2.2 The ACCC states that 'Anglo Coal did not reveal what, if any, marketing expenses it has included in its forecast non capital costs' and that 'Anglo Coal did not identify its forecast regulatory costs'.[2] As the ACCC is aware from the confidential detailed breakdown of direct costs provided, the Service Providers did not include estimates for marketing expenses or regulatory costs in its proposed direct costs.

2.3 In respect of marketing expenses, Anglo Coal (Dawson Management) Pty Ltd intends to engage external consultants on a contractual basis to undertake its marketing functions.[3] The marketing functions will include responding to customer requests, negotiating gas transportation contracts and managing contractual arrangements with customers. The Service Providers submit that an additional amount of $25,000 should be included in the forecast non-capital costs for the year commencing 30 June 2007 to allow for the recovery of marketing expenses. This is a cost that would be incurred by a prudent Service Provider, acting efficiently, in accordance with accepted and good industry practice and as such is recoverable under section 8.37 of the Code.

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[1] Draft decision, page 53.
[2] Draft decision, page 54.
[3] See Service Providers' application for waiver of certain ring fencing obligations dated 14 November 2006 and ACCC's final decision on the application for waiver dated 14 February 2007.

2.4 Similarly, in respect of regulatory costs, the amount allocated by the ACCC for the DVP's non-capital costs does not include any estimate of these costs. Despite the ACCC's assertion that 'these matters [reference tariff resets and ring fencing compliance reports] involve comparatively little expense', regulatory costs including costs such as those incurred in establishing and maintaining separate accounts for the DVP and legal and accounting expenses incurred in respect of regulatory reporting requirements are costs which would be incurred by a prudent Service Provider, acting efficiently, in accordance with accepted and good industry practice and as such are recoverable under section 8.37 of the Code. The Service Providers submit that an additional amount of $20,000 should be included in the forecast non-capital costs for the year ending 30 June 2007 to allow for the recovery of regulatory costs.

3. Indirect costs

3.1 The Service Providers maintain the position that the indirect costs as included in the proposed Access Arrangement are reasonable by comparison with other pipelines, even acknowledging the differences in pipeline length. The majority of overheads/ indirect costs including administrative costs, statutory costs and costs of corporate governance are incurred regardless of the length (or ORC) of the relevant pipeline.

3.2 The Service Providers find it difficult to accept the application of the 'rule of thumb' in the particular circumstances of the DVP. Ross Calvert Consulting, on whose analysis the ACCC relied in this regard, accepted that in respect of the DVP, 'certain economies of scale and scope are absent due to its short length'.[4] The Service Providers submit that this is an understatement of the true position. The DVP is one of the shortest pipelines in the Queensland gas network and due to its extremely short length, there are **no** efficiencies of scale for the DVP.

3.3 The ACCC's analysis on page 52 of the draft decision accepts that the higher the ORC of a pipeline (the major determinant of which is pipeline length), the lower the non-capital costs are as a percentage of ORC. Accordingly, as the ORC for the DVP is significantly less than the 'small pipelines' of Central West, Riverland and Mildura, the non-capital costs as a percentage of ORC would be expected to be significantly higher. On this basis, the Service Providers submit that 4% would be a more appropriate 'rule of thumb' indicator. This would allow an amount of $203,760 for indirect costs (assuming the amount allocated to direct costs remains $163,000).

3.4 Finally, the Service Providers submit that, in the current environment of high employment and high wages, the allocated amount of $137,000 for indirect costs is manifestly inadequate and unsustainable.

4. Initial Capital Base

4.1 At page 20 of the draft decision, the ACCC states that '[w]hen it submitted its access arrangement, Anglo Coal did not comment on the other factors in s.8.10 of the code'.

4.2 This is incorrect. At section 3.3(c)(i) of the Confidential Supporting Information document lodged with the proposed Access Arrangement on 5 February 2007, it is stated 'Anglo Coal has considered the factors outlined in section 8.10 of the Code and it considers that there are significant limitations with the use of any approach other than DORC for establishing the ICB of the DVP'. Sections 3.3(c)(ii) and (iii) provide more detail of these limitations.

[4] Ross Calvert Consulting Report, April 2007, page 18. Quoted in the draft decision, page 52.

5. Rate of return

5.1 The Service Providers are aware that a body of thought exists that the yield on Commonwealth Government securities (including bonds) as a proxy for the risk free rate of capital is downwards biased.

5.2 The ACCC has used the Commonwealth Government bond rates to estimate the risk free rate and inflation for the purposes of the draft decision.[5] The ACCC has also indicated that it will use updated bond rate data to estimate the risk free rate and inflation for the purposes of the final decision.[6]

6. Conclusion

6.1 The Service Providers consider that the amount allocated for non-capital costs was too low and should be increased.

6.2 The Service Providers submit that, in particular, the non-capital costs should be adjusted to include:

(a) an estimate of marketing expenses and regulatory costs in the forecast direct costs; and

(b) a more reasonable amount for indirect costs given that the majority of indirect costs are incurred regardless of the length (or ORC) of the relevant pipeline.

6.3 With the exception of proposed amendment 5, the Service Providers accept the ACCC's proposed amendments as outlined in the draft decision. They will shortly provide the ACCC with a revised proposed Access Arrangement and Access Arrangement Information.

[5] Draft decision, page 46.
[6] Draft decision, page 46.