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**To:** Michael Walsh

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**From:** Alice Chong

**Date:** 21/08/2007

**Re:** arrangement

**Pages:** 6

Urgent

For Review

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Dear Sir /Madam:

Please pass this document to Michael Walsh.

Regards

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August 20<sup>th</sup>, 2007

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

Dear Mr Walsh

Re: Dawson Valley Pipeline – Proposed Access Arrangement

In view of the recently announced extension of time for approval of the proposed Access Arrangement for the Dawson Valley Pipeline, and having had time to contemplate both the Draft Decision of 27 May 2007 and responses to it, we would like to take this opportunity to highlight a number of key points that we feel should be taken into account prior to a final determination being made.

We have summarised matters in the attached Submission. In essence, there are some errors of fact and interpretation that we believe, once corrected, should have an effect on the findings in relation to Access Arrangements for the DVP.

We urge you to take account of the matters raised in the attached. The need for Regulatory processes to achieve outcomes that replicate those of a competitive market (particularly where such competitive market outcomes have previously existed and can be demonstrated) cannot be overstated.

If the matters outlined in this submission are addressed it is anticipated appropriate regulatory outcomes, consistent with the objectives of the *National Third Party Access Code for Natural Gas Pipeline Systems*, will be achieved.

Yours sincerely,

Stephen Mitchell  
Managing Director

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This submission provides an overview of mistakes and misjudgements inherent in the Draft Decision regarding the Access Arrangement for the Dawson Valley Pipeline.

***Factual errors have adversely influenced the ACCC's findings regarding pipeline optimisation***

The ACCC has mistakenly found (pages 25-26 of Draft Decision) that:

- gas industry practice has generally favoured 168.3 mm as the minimum practical diameter for a gas transmission pipeline; and
- "...the pipeline configuration used...[in estimating ORC]...should not be optimised by reducing its diameter".

We believe the statement regarding gas industry practice is incorrect. Molopo contends that gas transmission pipelines are sized to meet the market requirement without over investment in speculative or redundant capacity. The fact that gas transmission pipelines tend to be greater than 150 mm in diameter is nothing more than a reflection of the size of respective markets to be serviced and operating pressure regimes.

Examples of gas transmission pipelines of smaller diameter that have been developed to suit market requirements include:

- Western Power Corporation constructed a nominal 50 mm diameter pipeline to transport gas over 32 km to Onslow (in WA's northwest);
- Magellan Metals has recently constructed an 88.9 mm diameter pipeline to transport gas to its operation near Wiluna in WA; and
- Envestra's 148 km Mildura and 232 km Riverland gas pipelines are both nominally 100 mm in diameter.

The statement that the pipeline configuration should not be optimised is contrary to the proper application of the optimised replacement methodology.

It would be illogical to suggest that the pipeline examples set out above should have been unoptimised and therefore of larger diameter.

***The 'Optimised Replacement' configuration adopted by the ACCC is Sub-optimal***

The ACCC has recognised (page 24 of Draft Decision) that:

- the true capacity of the 150 mm nominal diameter Dawson Valley Pipeline is around 40 TJ/d; and
- the capacity as stated by Anglo Coal (namely 30 TJ/d) reflects upstream rather than pipeline conditions.

In contrast, the quantity of gas to be transported through the Dawson Valley Pipeline, as accepted for the purpose of establishing the Reference Tariff, is only 8 TJ/d.

The suggestion that a 150 mm nominal diameter pipeline (with 5 times the requisite level of capacity) is optimal is mistaken and leads to unfair conclusions.

***Material cost savings are realisable through optimisation***

A 100 mm nominal diameter pipeline would have a capacity in excess of 14 TJ/d and could therefore meet the accepted market requirement at materially lower cost than the proposed 150 mm nominal diameter 'optimal replacement' pipeline.

Examples of the cost savings achievable through proper optimisation include:

- The use of 100 mm instead of 150 mm diameter linepipe will lead to a steel tonnage reduction of at least one-third, amounting to around \$0.4m (without allowing for possible wall thickness reductions associated with use of smaller diameter pipe);
- Savings in excess of \$0.1m will be realised through a reduction in linepipe coating material requirements; and
- Construction costs (such as welding, joint coating and NDT) will be reduced by an estimated \$12/m, representing in a saving of \$0.55m. Additional savings will accrue as quicker construction progress will also lower accommodation type costs.

The potential to achieve cost reductions in excess of \$1.0m (i.e., more than 10%) is material and must be taken into account in selection of the pipeline configuration that is optimal for the market to be served.

***Alternatively (if the replacement pipeline configuration is not optimised) adjustments are required to take account of redundant or speculative capacity.***

If a 150 mm nominal diameter pipeline is retained as a reference for the purpose of establishing the Initial Capital Base then either:

- a significant portion (between 65% and 80%) of the capacity and hence the value of the existing pipeline must be recognised as representing Redundant Capital; or
- a similarly significant portion of the value of the existing pipeline must be treated as representing a Speculative Investment.

In either case, the amount in question must be excluded from the Capital Base used in establishing the Reference Tariff.

***It is inappropriate to ignore the amount paid for the DVP by Anglo Coal***

The amount paid for the DVP by Anglo Coal has been confidentially disclosed to the ACCC (see page 21 of Draft Decision). Anglo Coal's suggestion that the allocation is not an accurate representation of value is irrelevant. The valuation was agreed between two parties in the absence of duress and in a competitive sales process. It is probable that the allocation reflected the value of the DVP on the basis of anticipated gas throughputs and prevailing tariffs. Significant weighting should be given to the clearly established fact of the cost of purchase.

***Having regard for the amount paid the proper value for ICB must be (at most) DAC, not DORC.***

Consistent with ACCC observations (page 20 of Draft Decision) the ICB should not normally fall outside the range between the Depreciated Actual Cost ('DAC') and the Depreciated Optimised Replacement Cost ('DORC').

In addition to the matters (outlined above) regarding the configuration and cost of the optimised replacement pipeline, we believe the ACCC should place a much greater emphasis on real examples of fact including:

- the amount paid by Anglo for the DVP; and
- the basis upon which tariffs were set in the past (the outcome of which is demonstrable, as recognised on page 21 of the Draft Decision).

Having proper regard for these factors it must be concluded that the ICB is not more than, and is potentially less than, the DAC of \$4.31m (as referenced at page 26 of the Draft Decision).

***It would be an extremely unfair if the Regulatory process affords windfall tariff rises to a monopoly pipeline owner.***

The reason that the DVP is covered by the Code is that, in monopoly ownership (i.e., ownership by Anglo Coal, with others) the potential exists for the pricing of services to be priced up to the bypass price.

Anglo Coal's original proposed Reference Tariff of \$0.406/GJ represented an attempt to more than double tariffs from levels previously determined in a competitive market.

We believe, the Reference Tariff proposed in the Draft Decision does little to remedy matters. The Reference Tariff proposed in the Draft Decision is still around double the level of tariff that has been demonstrated to be available in a competitive market.

The previous owner of the DVP (Oil Company of Australia) charged around \$0.135/GJ for firm service in the DVP (see page 21 of Draft Decision).

Recognising that a key objective of the *National Third Party Access Code for Natural Gas Pipeline Systems* (see page 11 of Draft Decision) is "replicating the outcome of a competitive market", it would be a manifestly unfair if the application of regulatory oversight resulted in a doubling of tariffs from levels that applied in a competitive market.

The pipeline was purchased with a clear understanding of what the prevailing tariffs were at that time. Molopo believes that perhaps a 5%-10% increase to that tariff could be borne, but such a substantial increase to a monopoly holder is manifestly unfair and would have the effect of seriously jeopardising future investment in the development of the gas fields of the Dawson Valley area.

Any significant increase in the DVP tariff would have the effect of rendering invalid the economic basis on which Molopo's prior and significant expenditure on the exploration, appraisal and early development of the field has been made.