Draft Decision

Access arrangement for the Dawson Valley Pipeline

23 May 2007

File: S2007/19

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Contents

Abbreviations and glossary

AA	access arrangement
AAI	access arrangement information
ACCC	Australian Competition and Consumer Commission
ACG	Allen Consulting Group
AER	Australian Energy Regulator
AGL	AGL Sales (Queensland) Pty Limited
AMP	Anglo-Mitsui Pipeline
Anglo Coal	Anglo Coal (Dawson) Limited, Anglo Coal (Dawson Management) Pty Ltd and Mitsui Moura Investment Pty Ltd
CAPM	capital asset pricing model
CMM	coal mine methane
code	National Third Party Access Code for Natural Gas Pipeline Systems
covered pipeline	pipeline to which the provisions of the code apply
CPI	consumer price index
CSM	coal seam methane
DAC	depreciated actual cost
DJV	Dawson Joint Venture (Anglo Coal (Dawson) Limited and Mitsui Moura Investment Pty Ltd)
DORC	depreciated optimised replacement cost
DVP	Dawson Valley Pipeline
ERA	Economic Regulation Authority (Western Australia)
GHD	GHD Pty Ltd
GJ	gigajoule
ICB	initial capital base
IRR	internal rate of return
km	kilometres
KPI	key performance indicators
m	million
mm	millimetre

MAOP	maximum allowable operating pressure
MDQ	maximum daily quantity
MHQ	maximum hourly quantity
Minter Ellison	Minter Ellison Lawyers (for Anglo Coal)
Molopo	Molopo Australia Limited
MPa	megapascal
MSP	Moomba to Sydney Pipeline
NCC	National Competition Council
NPV	net present value
OCA	Oil Company of Australia (Moura) Pty Limited and Oil Company of Australia (Moura) Transmissions Pty Ltd
ODV	optimised deprival value
ORC	optimised replacement cost
PJ	petajoule (equal to 1 000 000 GJ)
QGP	Queensland Gas Pipeline (also known as the Wallumbilla to Gladstone via Rockhampton Pipeline)
RBP	Roma to Brisbane Pipeline
RCC	Ross Calvert Consulting Pty Ltd
service provider	The owner or operator of the whole, or any part, of the pipeline or proposed pipeline
SUG	system use gas
Sunshine Gas	Sunshine Gas Limited
TJ	terajoule (equal to 1 000 GJ)
Unidel	Unidel Group Pty Ltd
WACC	weighted average cost of capital
WASCA	WA Supreme Court of Appeal
WestSide	WestSide Corporation Ltd

Summary

On 5 February 2007 Anglo Coal (Dawson) Limited, Anglo Coal (Dawson Management) Pty Ltd and Mitsui Moura Investment Pty Ltd submitted a proposed access arrangement for the Dawson Valley Pipeline (DVP) to the Australian Competition and Consumer Commission (ACCC) for approval under the *National Third Party Access Code for Natural Gas Pipeline Systems* (code).

The DVP became a covered pipeline when the code came into effect in Queensland in 2000. However, no access arrangement had been approved when coverage was revoked later that year. On 10 May 2006 the Minister for Industry, Tourism and Resources determined that the DVP should again be a covered pipeline. The current approval process by the ACCC is the first assessment of an access arrangement for the DVP.

The DVP was constructed in 1996 and transports gas 47 km from coal seam methane (CSM) gas fields in the Dawson Valley in central Queensland to the Wallumbilla to Gladstone via Rockhampton Pipeline (Queensland Gas Pipeline). The pipeline is six inches in diameter and currently has a nominal maximum capacity of 30 TJ/day (approximately 11 PJ per year).

The Dawson Joint Venture owns the DVP and the associated CSM fields and is currently the only user of the pipeline. Until recently the Lowell-Helm Joint Venture, which owns the nearby Mungi gas field and the surrounding exploration permits, was also a user of the pipeline. It now sells its gas to the Dawson Joint Venture.

Draft decision

After considering Anglo Coal's proposals and submissions from interested parties, the ACCC has made a draft decision that it proposes not to approve the proposed access arrangement in its current form. This draft decision sets out the amendments (or nature of the amendments) which the ACCC considers necessary for the proposed access arrangement to be approved. A summary of the key issues is provided below. This does not constitute part of the ACCC's reasons for its draft decision. Those reasons are detailed in full in the draft decision document.

Interested parties are invited to make written submissions on this draft decision by COB Friday, 8 June 2007. After considering submissions, the ACCC will issue its final decision, which is scheduled for early August.

Key issues

Initial capital base

The initial capital base (ICB) is generally the most substantial determinant of the pipeline's tariff. The code requires the regulator to balance the interests of the pipeline owner and users when approving the ICB. This requires that consideration be given to the actual costs of developing the current pipeline and the efficient replacement costs of

the pipeline and to a number of other matters. The code requires that the ICB should not normally fall outside the range of depreciated actual cost (DAC) and depreciated optimised replacement cost (DORC).

Anglo Coal did not provide an estimate of DAC. Accordingly, the ACCC estimated a DAC from taking the actual costs in the statutory accounts of the DVP's original owner and deducting an estimate of accumulated depreciation. The ACCC has estimated DAC at $4.932m by taking the actual capital costs and depreciating them to 2000. This method follows s. 8.10(a) of the code which requires that actual capital costs be depreciated to the time that the code commenced in 2000 rather than to the date of the valuation, which is normal practice. Given the considerable length of time that has elapsed since the code commenced the ACCC has viewed this measure of DAC as overstating the written down actual cost of the pipeline. The ACCC considers that depreciating the actual costs to July 2007 is a more appropriate approach as it recognises that seven years of the DVP's service potential has been 'used up' over this time. This results in a DAC to July 2007 of $4.310m. The ACCC has some concern that an ICB based on DAC may not allow the full recovery of the actual costs of the pipeline as it cannot accurately assess the level of past returns to the pipeline.

Anglo Coal has proposed that the ICB be set equal to the value determined by the DORC methodology ($7.641m). Anglo Coal adopted the straight line approach to adjust for depreciation. The ACCC has assessed Anglo Coal's calculation of DORC and concluded that it is generally a reasonable estimate of DORC. It notes that Anglo Coal's estimate is as at July 2006. The ACCC considers that the ICB should be set as at July 2007 to more closely reflect the start of the access arrangement period and that therefore the DORC (and other methodologies) should be at this date. The ACCC had concerns about the reasonableness of estimating an ICB the pipeline using present costs after a number of years of rapid increases in pipeline construction costs. Indeed the extent of this construction cost inflation may in some instances mean that a previously viable pipeline project would not be undertaken in 2007. However, the ACCC has concluded that the recent rapid increase in construction costs is not reflected in the overall ORC proposed by Anglo Coal.

As the current owners purchased the DVP only recently (March 2006) in an arm's length transaction, the purchase price potentially provides a good indication of a market valuation. Anglo Coal has submitted that the purchase price should not be publicly disclosed. It also submitted that the purchase price is an unreliable indicator as the DVP was bought as part of a larger business which includes CSM production and exploration. The ACCC accepts that there is some uncertainty as to the methodology used for allocating a share of the combined purchase price to the DVP. However, it has no reason to consider that the allocation approach is biased.

On balance, the ACCC has concluded that the most appropriate methodology to determine the ICB in this instance is DORC. The ACCC proposes that the ICB for the DVP be set at $7.600m, which is the proposed DORC calculated at July 2007.

Non capital costs

The majority of the non capital costs proposed by Anglo Coal comprise its estimate of the share of joint costs from the combined pipeline and CSM production business that should be attributed to the DVP.

The ACCC has assessed Anglo Coal's allocation methodology and concluded that it is not consistent with the requirements of the code and unlikely to provide a reasonable estimate of the joint costs attributable to the DVP.

The ACCC has compared the proposed non capital costs with available information for other Australian pipelines and concluded that the proposed costs greatly exceed those that would be expected of an efficient pipeline operator.

The ACCC has concluded that the proposed non capital costs are not consistent with the relevant code provisions. Its draft decision is that a smaller estimate of non capital costs be used in the calculation of the reference tariff that is consistent with the costs of broadly similar Australian pipelines.

Demand

Forecast demand is an important element as it directly impacts on the level of the reference tariff. The ACCC has some concerns about the demand forecast by Anglo Coal as it assumes no growth over the proposed access arrangement period of approximately nine years at a time of growing overall demand for gas in Queensland. In addition, a number of parties submitted that they expected demand for use of the DVP would grow over the expected term of the access arrangement period.

On balance, the ACCC proposes to accept the forecasts proposed by Anglo Coal. While there is some uncertainty about the forecasts, the ACCC considers that users would be sufficiently protected against major forecasting errors through the operation of the trigger event mechanism proposed by Anglo Coal. If throughput exceeds forecast demand by more than 25 per cent Anglo Coal must submit revisions to the access arrangement to the regulator for approval.

Reference tariff level and design

Consequent to the proposed changes to the total revenue (due to amendments to the ICB and non capital costs in particular) the draft decision proposes a lower initial reference tariff level than that proposed by Anglo Coal. The ACCC agrees with Anglo Coal's proposal that the reference tariff stay at a constant real level over the access arrangement period.

In view of the scale and likely usage of the DVP over the access arrangement period, the ACCC proposes to accept the reference tariff design proposed by Anglo Coal. A single tariff zone will apply, with users charged a one part tariff based on contracted capacity.

Rate of return

The ACCC considers that Anglo Coal's approach to determining a rate of return using the Capital Asset Pricing Model (CAPM), including its selection of parameter values, is

generally consistent with the relevant code principles. The ACCC has substituted up to date market values where relevant.

Other issues

The ACCC has also proposed a number of comparatively minor amendments to be made to the access arrangement.

1. Introduction

1.1 Access arrangement

On 5 February 2007 Anglo Coal (Dawson) Limited, Anglo Coal (Dawson Management) Pty Ltd and Mitsui Moura Investment Pty Ltd submitted a proposed access arrangement for the Dawson Valley Pipeline (DVP) to the Australian Competition and Consumer Commission (ACCC) for approval under the *National Third Party Access Code for Natural Gas Pipeline Systems* (code). An access arrangement describes the terms and conditions under which a service provider will make access to the services of the pipeline available to third parties.

Chapter 2 of the code specifies that the service provider of a gas pipeline covered by the code is required to propose an access arrangement and submit it to the regulator for approval.

In assessing such a proposed access arrangement, the code specifies that the regulator must:

- inform interested parties that it has received the proposed access arrangement and the associated access arrangement information
- publish a notice in a national daily newspaper which at least:
  - describes the covered pipeline to which the access arrangement relates
  - states how copies of the documents may be obtained, and
  - requests submissions by a date specified in the notice.
- after considering submissions received, issue a draft decision that either proposes to approve the access arrangement or proposes not to approve the access arrangement and states the amendments (or nature of the amendments) that would have to be made to the access arrangement for the regulator to approve it
- after issuing the draft decision, invite further submissions
- after considering additional submissions, issue a final decision that either approves or does not approve the access arrangement (or amended access arrangement) and states the amendments (or nature of the amendments) which have to be made to the access arrangement (or amended access arrangement) in order for the regulator to approve it
- if the amendments are satisfactorily incorporated in the access arrangement, issue a further final decision (referred to as a final approval) to approve the access arrangement. If not, the regulator must draft and approve its own access arrangement addressing the specified amendments.

After granting two extensions of time for the lodgement of the access arrangement under s. 7.19 of the code, the ACCC received the proposed access arrangement and accompanying access arrangement information on 5 February 2007.[1] These documents were made public via the Australian Energy Regulator (AER) website and the public register held by the Code Registrar. Interested parties were notified that the ACCC had received the proposed access arrangement and were invited to make submissions. The ACCC published a notice in the *Australian Financial Review* and the *Courier Mail* on 16 February 2007 inviting submissions from interested parties. The submissions subsequently received are listed in Appendix B to this draft decision.

1.2 Criteria for assessment

The regulator may approve a proposed access arrangement only if it is satisfied that the access arrangement contains the elements and satisfies the principles set out in ss. 3.1 to 3.20 of the code, which are summarised below. An access arrangement cannot be opposed solely because the access arrangement as proposed does not address a matter that s. 3 of the code does not require it to address. Subject to this, the regulator has a broad discretion in accepting or not accepting an access arrangement.

An access arrangement must include a policy on the service (or services) to be offered which includes a description of the service(s) to be offered. The policy must include one or more services that are likely to be sought by a significant part of the market and any service(s), which in the regulator's opinion should be included in the policy. To the extent practicable and reasonable, users and prospective users must be able to obtain those portions of the service(s) that they require, and the policy must allow for a separate tariff for an element of a service if requested.

An access arrangement must also contain one or more reference tariffs. A reference tariff operates as a benchmark tariff for a particular service and provides users with a right of access to the specific service at the specific tariff. Tariffs must be determined according to the reference tariff principles in s. 8 of the code.

In addition to these two elements, an access arrangement must include the following:

- terms and conditions on which the service provider will supply each reference service
- a statement of whether a contract carriage or market carriage capacity management policy is applicable
- for a contract carriage pipeline, a trading policy that enables a user to trade its right to obtain a service to another person
- a queuing policy to determine users' priorities in obtaining access to spare and developable capacity on a pipeline

[1] The scheduled lodgement date was 8 August 2006, three months after coverage became effective. The first extension of the lodgement date was to 6 November 2006 and the second to 5 February 2007.

- an extensions and expansions policy to determine the treatment of an extension or expansion of a pipeline under the code
- a date by which revisions to the arrangement must be submitted, and
- a date by which the revisions are intended to commence.

In considering whether an access arrangement complies with the code, a regulator must take into account, pursuant to s. 2.24 of the code, the following factors:

- the legitimate business interests and investment of the service provider
- firm and binding contractual obligations of the service provider or other persons (or both) already using the covered pipeline
- the operational and technical requirements necessary for the safe and reliable operation of the covered pipeline
- the economically efficient operation of the covered pipeline
- the public interest, including the public interest in having competition in markets (whether or not in Australia)
- the interests of users and prospective users, and
- any other matters that the regulator considers are relevant.

Appendix A to this draft decision sets out the access arrangement information that a service provider must disclose to interested parties (Attachment A to the code).

1.3 Public consultation

Interested parties are invited to make written submissions on this draft decision by Friday, 8 June 2007. After considering submissions, the ACCC will issue its final decision, which is scheduled for early August.

All public submissions received will be placed on the AER website and the public register held by the Code Registrar. Any information considered to be confidential should be clearly marked as such and the reasons for seeking confidentiality provided. Under the terms of the code the ACCC must not disclose such information unless it is of the opinion that disclosure would not be unduly harmful to the legitimate business interests of the service provider, a user or prospective user.

Submissions should be supplied in electronic format compatible with Microsoft Word to the email address dvp2007@accc.gov.au. One original signed document should also be mailed to the postal address:

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

Copies of the proposed access arrangement and access arrangement information are available from the AER website. Copies of this draft decision may also be obtained by contacting Stacey Breen on (02) 6243 1233; fax (02) 6243 1205; or email dvp2007@accc.gov.au.

2. Background

2.1 The Dawson Valley Pipeline

The Dawson Valley Pipeline (DVP) transports gas 47 km northward from coal seam methane (CSM) gas fields in the Dawson Valley in central Queensland to the Wallumbilla to Gladstone via Rockhampton Pipeline (Queensland Gas Pipeline). The pipeline is six inches in diameter and currently has a nominal maximum capacity of 30 TJ/day (approximately 11 PJ per year).[2]

The Dawson Joint Venture is currently the only user of the pipeline. The Dawson Joint Venture comprises the owners of the pipeline (Anglo Coal (Dawson) Limited and Mitsui Moura Investment Pty Ltd (Mitsui)). Until recently the Lowell-Helm Joint Venture (comprising Lowell Petroleum NL (a subsidiary of Molopo Australia Ltd (Molopo)) and Helm Energy - Australia, LCC) was also a user of the pipeline. This joint venture has ownership of the nearby Mungi gas field and the surrounding exploration permits. It now sells its gas to the Dawson Joint Venture.[3]

A map of the DVP (identified as PPL26) and its surrounds is set out at Appendix D to this draft decision document.

The DVP was constructed in 1996 by Conoco Australia as part of its development of the Dawson Valley CSM gas fields. It was then acquired by Oil Company of Australia (Moura) Pty Limited and Oil Company of Australia (Moura) Transmissions Pty Ltd (collectively referred to as OCA) in 1998 when those companies acquired the share capital of Conoco Australia.

The current owners purchased the Moura CSM and transmission assets of OCA in March 2006. The key assets purchased were the DVP and interests in two petroleum leases (including CSM production facilities) and two authorities to prospect.[4]

The service providers of the DVP are Anglo Coal (Dawson) Limited and Mitsui as owners and Anglo Coal (Dawson Management) Pty Ltd as operator. All obligations set out in the access arrangement are imposed on the pipeline operator. For the purposes of this draft decision the service providers have generally been referred to as 'Anglo Coal'. The lawyers Minter Ellison act on behalf of the service providers in relation to the DVP access arrangement.

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2 Given the constraints of current equipment attached to the pipeline, the actual maximum flow of the DVP is 22-24 TJ/day. Anglo Coal submission (response to Molopo), 13 April 2007, p. 2.

3 Anglo Coal, *Confidential supporting information*, 5 February 2007, p. 2.

4 NCC, *Dawson Valley Pipeline: Application for coverage under the national gas code by Molopo Australia Limited: supplementary advice*, 31 October 2005, p. 3.

2.2 Coverage

The DVP initially became a covered pipeline when the code commenced operation in Queensland in May 2000 by its inclusion in schedule A to the code.

As permitted by the code, the then service provider of the DVP (OCA) applied for coverage to be revoked. After considering the application, the National Competition Council (NCC) recommended to the relevant Minister that coverage of the DVP be revoked. The reason for this recommendation was that the NCC was not satisfied that regulated access to the pipeline would promote competition in another market or that third party access would provide net public benefits.[5]

The Minister revoked coverage of the DVP, effective 8 December 2000.[6]

In March 2005 the NCC received an application for coverage of the DVP from Molopo. Molopo sought coverage to ensure that access to the pipeline is available on terms consistent with the provisions of the code so as to improve its prospects of selling its gas from the Mungi gas field to end users.[7] Molopo also considered that coverage would ensure that OCA would ring fence its gas transmission activities from other related business activities.[8]

In its final recommendation of August 2005 the NCC recommended to the relevant Minister that coverage not be granted. The NCC found that coverage would be unlikely to promote competition in the downstream market (although upstream market competition could be promoted, it was noted that the upstream market was small) and that the costs of regulation would be likely to exceed the benefits.[9]

In forming this recommendation, the NCC particularly noted that the Anglo-Mitsui Pipeline (AMP) also transported natural gas to the Wallumbilla to Gladstone Pipeline.[10] Although the pipelines run side by side for approximately 12 km, the NCC found that there were no potential users who would be able to choose between the two for gas transportation services. Nevertheless, although the NCC found that the pipelines provided different services, it concluded that the close proximity of the pipelines would be likely to impact on any market power that the owner of the DVP may have.[11]

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5 NCC, *Queensland gas pipelines: applications to revoke coverage of certain transmission pipelines under the Queensland gas access regime: recommendations*, November 2000, p. 2.

6 Nick Minchin, Minister for Industry, Science and Resources, *Decision on revocation of three Queensland gas pipelines*, 23 November 2000, p. 1.

7 NCC, *Dawson Valley Pipeline coverage application under the national gas code: final recommendation*¸ August 2005, p. 25.

8 ibid, p. 12.

9 ibid, pp. 37 & 41.

10 The AMP was previously known as the Peabody-Mitsui Pipeline. Like the DVP, coverage for this pipeline was revoked in 2000.

11 NCC, *Dawson Valley Pipeline coverage application under the national gas code: final recommendation*¸ August 2005, pp. 19-21.

Shortly after providing its recommendation to the Minister, the NCC became aware that the owner of the DVP (that is, OCA) had agreed to sell the pipeline to the owners of the AMP. That is, the two pipelines would come under common ownership.[12]

The NCC reconsidered its previous advice and concluded that the AMP would no longer provide a constraint on the pricing of services on the DVP. The new owner of the DVP (the Dawson Joint Venture) would be able to price up to the bypass price. As a result, the NCC recommended to the Minister that the DVP be covered under the code.[13]

Following this advice, the Minister decided that the DVP would be a covered pipeline, effective as from 10 May 2006.[14]

2.3 The Queensland gas market

The gas produced in Queensland is sourced both from conventional gas fields and CSM reserves.[15] The conventional gas fields are located in the Cooper–Eromanga Basin. CSM is drawn from the Bowan and Surat Basins. Queensland has over 5000 PJ of proved and probable gas reserves in total. Approximately 75 per cent of these reserves are CSM.[16]

Over the last several years the importance of CSM has grown. In 2000, CSM production was approximately 2 PJ per year which was less than five per cent of Queensland's gas needs. It has been projected that in 2007 CSM will supply approximately 98 PJ (79 per cent) of Queensland's gas demand while conventional gas supply declines.[17]

The Queensland Government's 13 per cent gas scheme requires electricity retailers to source at least 13 per cent of their electricity from gas-fired generation.[18] This is expected to continue to drive an increase in the use of CSM in electricity generation.

Queensland's gas consumption was approximately 100 PJ per year in 2004 and is expected to grow at approximately five per cent per year, which compares with the national average growth rate of 3.8 per cent. Electricity generation and mineral

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12 NCC, *Dawson Valley Pipeline application for coverage under the national gas code by Molopo Australia Limited: supplementary advice*, 31 October 2005, p. 1.

13 ibid, pp. 5-9.

14 Ian Macfarlane, Minister for Industry, Tourism and Resources, *Application for coverage of the Dawson Valley Pipeline: decision*, 26 April 2006, p. 1.

15 In addition, small quantities of CMM are produced.

16 Queensland Department of Mines and Energy, *Gas in Queensland*, 31 October 2006, viewed 1 March 2007, <http://www.energy.qld.gov.au/gas_in_queensland.cfm>

17 Stephen Wisenthal, 'Coal seam to supply 80pc of Qld's gas', *Australian Financial Review*, 5 March 2007, p. 16.

18 Queensland Department of Mines and Energy, *Gas in Queensland*, 31 October 2006, viewed 1 March 2007, <http://www.energy.qld.gov.au/gas_in_queensland.cfm>

processing accounts for over 80 per cent of total Queensland gas consumption. Most residential and small users of gas are located in Brisbane.[19]

Gas from conventional fields in the Cooper–Eromanga Basin is transported to end users via a number of transmission pipelines. The key transmission pipelines in Queensland are:

- Roma to Brisbane Pipeline
- Ballera to Wallumbilla Pipeline (South West Queensland Pipeline)
- Wallumbilla to Gladstone via Rockhampton Pipeline (Queensland Gas Pipeline), and
- Ballera to Mt Isa Pipeline (Carpentaria Gas Pipeline).

The DVP, and the neighbouring AMP, supply CSM from Dawson Valley and coal mine methane (CMM) from the Moura Mine respectively to the Alinta owned Wallumbilla to Gladstone via Rockhampton Pipeline.

2.4 Regulatory framework

2.4.1 Legislation

The main legislation and relevant documents regulating access to the Queensland gas transmission pipeline industry are:

- the code, under which transmission service providers are required to submit access arrangements and revised access arrangement to the ACCC for approval
- the Gas Pipelines Access (Queensland) Act 1998
- the Gas Pipelines Access (Queensland) Act 1998 — Derogations, and
- the Gas Pipelines Access (South Australia) Act 1997.

In accordance with the Natural Gas Pipelines Access Agreement, South Australia was the lead legislator in implementing the national gas access legislation.

Code bodies and appeals bodies for Queensland transmission pipelines are:

- the ACCC — regulator and arbitrator
- the National Competition Council (NCC) — code advisory body
- the Commonwealth Minister — coverage decision maker

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[19] Queensland Department of Mines and Energy, *Gas consumption*, 22 May 2006, viewed 1 March 2007, <http://www.energy.qld.gov.au/gas_consumption.cfm>

- the Federal Court — judicial review, and
- the Australian Competition Tribunal (the Tribunal) — administrative appeal.

2.4.2 Certification of the Queensland regime

Following advice from the NCC, the Parliamentary Secretary to the Treasurer determined on 17 July 2006 that the Queensland gas access regime is not an effective access regime under the National Access Regime (Part IIIA of the *Trade Practices Act 1974*).

As a consequence of this decision, Queensland pipelines are still subject to potential declaration under Part IIIA of the Trade Practices Act which provides for dispute resolution by the ACCC. The Commonwealth Minister's decision to not certify the Queensland gas access regime as effective does not affect the ACCC's consideration of the proposed access arrangement for the DVP.

2.4.3 Role of the AER

The ACCC has prepared this draft decision in consultation with the Australian Energy Regulator (AER). The ACCC is currently the regulator of natural gas transmission pipelines under the code (except for WA). However, relevant Australian governments have agreed that this function will be undertaken by the AER, along with regulation of natural gas distribution pipelines, in the near future.

3. Reference tariff method

3.1 Reference tariff policy

3.1.1 Code requirements

Section 3.5 of the code requires an access arrangement to include a policy describing the principles that are to be used to determine a reference tariff. This reference tariff policy must, in the regulator's opinion, comply with the reference tariff principles set out in s. 8 of the code. General reference tariff principles are set out in ss. 8.1 and 8.2 in particular.

Section 8.1 states that a reference tariff and reference tariff policy should be designed with a view to achieving a number of objectives. These are:

> (a) providing the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering that Service
>
> (b) replicating the outcome of a competitive market
>
> (c) ensuring the safe and reliable operation of the Pipeline
>
> (d) not distorting investment decisions in Pipeline transportation systems or in upstream and downstream industries
>
> (e) efficiency in the level and structure of the Reference Tariff, and
>
> (f) providing an incentive to the Service Provider to reduce costs and to develop the market for Reference and other Services.

The code acknowledges that the s. 8.1 objectives may conflict. The regulator may determine how the objectives can best be reconciled or which of them should prevail.

Section 8.2 sets out the factors about which the regulator must be satisfied in determining to approve a reference tariff and reference tariff policy. These are:

> (a) the revenue to be generated from the sales (or forecast sales) of all Services over the Access Arrangement Period (the Total Revenue) should be established consistently with the principles and according to one of the methodologies contained in this section 8
>
> (b) to the extent that the Covered Pipeline is used to provide a number of Services, that portion of Total Revenue that a Reference Tariff is designed to recover (which may be based upon forecasts) is calculated consistently with the principles contained in this section 8
>
> (c) a Reference Tariff (which may be based upon forecasts) is designed so that the portion of Total Revenue to be recovered from a Reference Service (referred to in paragraph (b)) is recovered from the Users of that Reference Service consistently with the principles contained in this section 8
>
> (d) Incentive Mechanisms are incorporated into the Reference Tariff Policy wherever the Relevant Regulator considers appropriate and such Incentive Mechanisms are consistent with the principles contained in this section 8, and

(e) any forecasts required in setting the Reference Tariff represent best estimates arrived at on a reasonable basis.

3.1.2 Proposal

Section 5 of the proposed access arrangement sets out a policy that describes the principles that are used to determine the proposed reference tariff. This reference tariff policy describes the methodology used in deriving the reference tariff and the structure of the reference tariff. It also sets out information about the treatment of new facilities investment and redundant capital and describes the proposed incentive mechanism.

3.1.3 Submissions

No submissions were received on this aspect of the proposed access arrangement.

3.1.4 Assessment

As required under s. 3.5 of the code, Anglo Coal has included a reference tariff policy in the proposed access arrangement. The ACCC's assessment of each of the elements of the reference tariff policy is provided in the relevant sections of this draft decision.

3.2 Reference tariff methodology

3.2.1 Code requirements

Section 8.3 of the code states that the manner in which a reference tariff may vary within an access arrangement period is within the discretion of the service provider. A service provider may implement:

(a) a cost of service approach[20] - where tariffs are adjusted throughout the access arrangement period to account for actual outcomes (such as sales volumes and actual costs) to ensure that the actual costs of the services are recovered

(b) a price path approach - where tariffs are determined prior to the commencement of the access arrangement period and follow a path which is not adjusted to take account of subsequent events until the start of the next access arrangement period

(c) the reference tariff control formula approach - where tariffs may vary over the access arrangement period in accordance with a specified formula or process

(d) the trigger event adjustment approach - where a reference tariff may vary within the access arrangement period following the occurrence of a specified event, or

[20] This approach is distinct from the Cost of Service approach detailed in s. 8.4 of the code, which refers to the methodology used to determine total revenue.

(e) any variation or combination of the above.

The selection of one of the above approaches is subject to s. 8.3A and that the regulator is satisfied that the approach as implemented will be consistent with s. 8.1. Section 8.3A states that a reference tariff may only vary during an access arrangement period in accordance with an approved reference tariff variation method.

Section 8.4 of the code outlines the three methodologies available to the service provider to determine total revenue. The methodologies are:

- Cost of service: where the total revenue is set to recover costs with those costs to be calculated on the basis of a return on the assets that form the covered pipeline, depreciation of the capital base and the non capital costs incurred in delivering all services

- Internal rate of return (IRR): where the total revenue is set to provide an acceptable IRR (consistent with ss. 8.30 and 8.31 of the code) for the covered pipeline on the basis of all forecast costs, and

- Net present value (NPV): where the total revenue is set to deliver a NPV for the covered pipeline (on the basis of forecast costs) equal to zero, using an acceptable discount rate (consistent with ss. 8.30 and 8.31 of the code).

Regardless of which method is adopted, the method should be utilised in accordance with generally accepted industry practice. In addition, other methodologies that can be translated into one of these forms are acceptable under s. 8.5 of the code.

Section 8.5A of the code allows the above methodologies to be applied on a nominal basis, a real basis or any other basis dealing with the effects of inflation, provided that the basis used is specified in the access arrangement and is applied consistently in determining the total revenue and the reference tariffs.

3.2.2 Proposal

Section 5 of the proposed access arrangement states that the reference tariff has been derived through a price path approach based on an application of the NPV methodology. Anglo Coal has stated that this approach is designed to permit it to recover revenue to cover the efficient costs of the DVP over the expected life of the asset. It is also designed to provide Anglo Coal with an incentive by permitting it to retain the benefit of achieving greater than forecast volumes and lower than forecast costs.

In establishing the price path for the proposed access arrangement period, Anglo Coal has proposed that the initial reference tariff be indexed in subsequent years according to the CPI-X formula specified in section 4.1 of the access arrangement. In addition to this annual adjustment, Anglo Coal has proposed that if there is a material change in new or existing taxes or duties during the access arrangement period, then this is a specified event for the purposes of s. 8.3B of the code and the reference tariff may be adjusted by

Anglo Coal to pass through such an amount to users.[21] Prior to such an adjustment, Anglo Coal would provide a written notice to the regulator specifying the changes, the proposed variation to the reference tariff and effective date for the variations.

3.2.3 Submissions

No submissions were received on this aspect of the proposed access arrangement.

3.2.4 Assessment

Anglo Coal has stated that the reference tariff is derived from an application of the NPV methodology. The ACCC has reviewed Anglo Coal's revenue model and concluded that, while it uses an NPV approach to normalise (smooth) the reference tariff path, the revenue calculation actually uses the cost of service methodology. That is, the total revenue is calculated to recover costs associated with the rate of return on assets that form the capital base, depreciation of that capital base and non capital costs incurred in delivering services. The code (s. 8.4) permits the adoption of a cost of service approach for the calculation of total revenue. The ACCC considers that this methodology has been correctly applied by Anglo Coal. Consequently, it should be accurately described in Anglo Coal's reference tariff policy.

In order to fully satisfy the requirements of s. 8.4 of the code, the ACCC considers that the access arrangement and access arrangement information should accurately describe the method used to determine total revenue used in the revenue model.[22] Therefore, the ACCC proposes the following amendment.

Proposed amendment 1

In order for the DVP access arrangement to be approved, Anglo Coal must amend the reference tariff policy to state that the total revenue is calculated according to the cost of service methodology.

The ACCC has discussed this proposed amendment with Anglo Coal. It has confirmed that it will implement this proposed amendment.[23]

Anglo Coal has stated that its proposed reference tariff has been derived through 'a Price Path approach based on an application of the NPV methodology' as permitted under s. 8.3(b) of the code.

While Anglo Coal's proposed approach in part reflects a price path approach, its adoption of a CPI-X formula is consistent with a reference tariff control formula approach (s. 8.3(c)) and its inclusion of a variation to the reference tariff if a specified event (namely, a change in certain taxes) occurs is consistent with a trigger event adjustment approach (s. 8.3(d)). The code (s. 8.3(e)) permits the adoption of a combination of the price path, reference tariff control formula and trigger event

21 Access arrangement, section 4.8, p. 9.

22 This includes reference to the residual value in section 5 of the access arrangement.

23 Minter Ellison letter to ACCC, 15 May 2007, p. 1.

adjustment approaches. As such, Anglo Coal's approach is consistent with the code. However, this methodology should be accurately described in Anglo Coal's reference tariff policy.

In order to fully satisfy the requirements of s. 8.3 of the code, the ACCC considers that the reference tariff policy should accurately reflect the reference tariff variation methodology set out in the access arrangement. Therefore, the ACCC proposes the following amendment.

Proposed amendment 2

In order for the DVP access arrangement to be approved, Anglo Coal must amend the reference tariff policy (section 5 of the access arrangement) to state that the reference tariff may be varied during an access arrangement period through the application of a combination of the price path, reference tariff control formula and trigger event adjustment approaches.

In addition, Anglo Coal must adopt the proposed amendments 9 and 10 in chapter 7 of this draft decision in order to satisfy the requirements of s. 8.3A and to fully satisfy the requirements of s. 8.3 of the code.

The above proposed amendment, as well as those located in chapter 7, has been discussed with Anglo Coal. It has confirmed that it will implement these proposed amendments.[24]

3.3 Incentives

3.3.1 Code requirements

Section 8.1(f) of the code states that a reference tariff policy should be designed with a view to providing an incentive 'to reduce costs and to develop the market for reference and other services'. Section 8.2(d) also allows an incentive mechanism to be incorporated into the reference tariff policy that the regulator is satisfied is appropriate and consistent with the objectives in s. 8 of the code. Section 8.4 allows the service provider to retain some or all of the benefits arising from efficiency gains under an incentive mechanism.

In addition to these broad statements, the code sets out some particular guidance on the use of incentive mechanisms. Section 8.44 provides that the reference tariff policy should, wherever the regulator considers it appropriate, contain an incentive mechanism that provides the service provider with an opportunity to retain a share of returns arising from the sale of the reference service. This should particularly be the case where the additional returns can be attributed, at least in part, to the actions of the service provider.

[24] ibid.

In accordance with s. 8.45 an incentive mechanism may include (but is not limited to) the following:

(a) specifying the reference tariff that will apply during each year of the access arrangement period based on forecasts of all relevant variables

(b) specifying a target for revenue from the sale of all services and that a certain proportion of any revenue received in excess of that target be retained by the service provider and that the remainder must be used to reduce the tariffs for all services or to provide a rebate to users, and

(c) a rebate mechanism for rebatable services that provides for less than a full rebate of revenues from the rebatable services to the users of the reference service.

Section 8.46 sets out the following objectives for an incentive mechanism:

(a) to provide the Service Provider with an incentive to increase the volume of sales of all Services, but to avoid providing an artificial incentive to favour the sale of one Service over another

(b) to provide the Service Provider with an incentive to minimise the overall costs attributable to providing those Services, consistent with the safe and reliable provision of such Services

(c) to provide the Service Provider with an incentive to develop new Services in response to the needs of the market for Services

(d) to provide the Service Provider with an incentive to undertake only prudent New Facilities Investment and to incur only prudent Non Capital Costs, and for this incentive to be taken into account when determining the prudence of New Facilities Investment and Non Capital Costs for the purposes of sections 8.16(a) and 8.37, and

(e) to ensure that Users and Prospective Users gain from increased efficiency, innovation and volume of sales (but not necessarily in the Access Arrangement Period during which such increased efficiency, innovation or volume of sales occur).

3.3.2 Proposal

Anglo Coal has proposed that an incentive mechanism be incorporated in its reference tariff policy. Section 5 of the access arrangement states that:

- the level of the reference tariff has been determined to enable Anglo Coal to develop the market for the reference service and other services

- the prospect of Anglo Coal retaining improved returns for the period to 30 June 2016 provides an incentive to Anglo Coal to increase the volume of sales and to minimise the overall cost of providing services (consistent with ss. 8.44 to 8.46 of the code), including non capital costs and stay in business capital, and

- in determining the reference tariff after the date of the commencement of revisions to the access arrangement, Anglo Coal will ensure that users and prospective users will benefit from increased efficiencies achieved by Anglo Coal up to that date.

3.3.3 Submissions

No submissions were received on this aspect of the proposed access arrangement.

3.3.4 Assessment

In terms of providing incentives to Anglo Coal to reduce costs and increase throughput, the proposed provisions of the access arrangement largely reflect a price path approach to varying the reference tariff during an access arrangement period. In general, a price path approach provides an incentive for the service provider to perform better than the forecast costs and demand used to initially calculate the reference tariff.

However, the inclusion of a trigger event adjustment approach mechanism (in section 4.8) and a major events trigger (in section 10.2) would be expected to reduce the incentives faced by Anglo Coal compared to the incentives under a 'pure price path' approach. In particular, Anglo Coal may only enjoy the benefits of out performance for a shorter period than the proposed access arrangement period if throughput exceeds forecasts by more than 25 per cent and an access arrangement review is triggered.

On balance, the ACCC considers that Anglo Coal's proposal to retain the additional revenue if it outperforms its forecasts for the remainder of the access arrangement period provides it with an appropriate incentive to operate efficiently and to develop the market for the services of the DVP.

Section 8.46(e) of the code states that one of the objectives of an incentive mechanism is that users or prospective users gain from increased efficiency, innovation and volume of sales (but not necessarily in the access arrangement period during which such increased efficiency, innovation or volume of sales occur). Section 5 of the access arrangement states that, when determining the reference tariff to apply at the commencement of revisions to the access arrangement, Anglo Coal will ensure that users and prospective users will benefit from increased efficiencies achieved by Anglo Coal up to that date. The regulator can take this undertaking into account when assessing Anglo Coal's proposed revisions to its access arrangement.

In conclusion, the ACCC considers that it is appropriate for Anglo Coal's proposed access arrangement to contain an incentive mechanism (s. 8.44) and that the proposed incentive mechanism is consistent with code requirements.

4. Capital base

4.1 Initial capital base

4.1.1 Code requirements

For pipelines that were in existence at the commencement of the code, ss. 8.10 and 8.11 are the relevant specific provisions of the code for establishing the initial capital base (ICB). Section 8.10 sets out a number of factors that the regulator should consider. These are:

(a) the value that would result from taking the actual capital cost of the Covered Pipeline and subtracting the accumulated depreciation for those assets charged to User (or thought to be charged to Users) prior to the commencement of the Code

(b) the value that would result from applying the "depreciated optimised replacement cost" methodology in valuing the Covered Pipeline

(c) the value that would result from applying other well recognised asset valuation methodologies in valuing the Covered Pipeline

(d) the advantages and disadvantages of each valuation methodology applied under paragraphs (a), (b) and (c)

(e) international best practice of Pipelines in comparable situations and the impact on the international competitiveness of energy consuming industries

(f) the basis on which Tariffs have been (or appear to have been) set in the past, the economic depreciation of the Covered Pipeline, and the historical returns to the Service Provider from the Covered Pipeline

(g) the reasonable expectations of persons under the regulatory regime that applied to the Pipeline before the commencement of the Code

(h) the impact on the economically efficient utilisation of gas resources

(i) the comparability with the cost structure of new Pipelines that may compete with the Pipeline in question (for example, a Pipeline that may by-pass some or all of the Pipeline in question)

(j) the price paid for any asset recently purchased by the Service Provider and the circumstances of that purchase, and

(k) any other factors the Relevant Regulator considers relevant.

Following acknowledgement of the numerous factors included in s. 8.10 of the code, the WA Supreme Court of Appeal in Re Michael noted that the task of the regulator was to 'establish' the capital base rather than set a 'value'. While, as the Court noted, ss. 8.10(a) and (b) referenced particular valuation methodologies, the inclusion of the other factors in s. 8.10 indicates that the regulator is to consider matters that would not normally be related to the value of a pipeline. That is, 'the process is more than one of mere valuation'.[25]

[25] *Re Dr Ken Michael AM; ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231, par. 74.

The code states in s. 8.11 that the ICB 'normally should not fall outside the range of values determined under paragraphs (a) and (b) of section 8.10'. The Court acknowledged the tension in the code for the regulator in considering the factors of ss.8.10 (c)-(k) and s. 8.11. It noted that the process involved one of discretion for the regulator to weigh the divergent considerations. To aid in this evaluation the Court stated that it should be the objectives of s. 8.1 of the code that guide the regulator.[26]

The objectives of s.8.1 of the code are:

(a) providing the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering that Service;

(b) replicating the outcome of a competitive market;

(c) ensuring the safe and reliable operation of the Pipeline;

(d) not distorting investment decisions in Pipeline transportation systems or in upstream and downstream industries;

(e) efficiency in the level and structure of the Reference Tariff; and

(f) providing an incentive to the Service Provider to reduce costs and to develop the market for Reference and other Services.

To the extent that any of these objectives conflict in their application to a particular Reference Tariff determination, the Relevant Regulator may determine the manner in which they can best be reconciled or which of them should prevail.

The Court also acknowledged the final statement in s. 8.1 of the code that the various objectives of s. 8.1 may conflict. It stated 'in exercising the discretions contemplated by the last paragraph of s. 8.1 the Regulator should take into account the factors in s. 2.24(a) to (g)'.[27]

4.1.2 Proposal

Anglo Coal has proposed an ICB equal to its depreciated optimised replacement cost (DORC) estimate of $7.641m (as at 1 July 2006). This figure is derived by applying straight line depreciation to its estimate of the optimised replacement cost (ORC) of $9.169m assuming an economic life of 60 years and a remaining life of 50 years.[28]

Anglo Coal considers that the existing pipeline design is optimal and that the current configuration of the DVP is the minimum design for a transmission pipeline. To derive the ORC Anglo Coal relied on a desk top update of the historical costs to reflect changes in unit rates. This exercise was undertaken by GHD Pty Ltd (GHD) on behalf of Anglo Coal.[29]

When it submitted its access arrangement Anglo Coal did not comment on the other factors in s. 8.10 of the code. Anglo Coal provided additional information at the request of the ACCC.

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[26] [2002] WASCA 231, pars. 75-76.

[27] ibid, par. 85.

[28] Access arrangement information, section 3, p. 5.

[29] AAI, section 3, p. 5.

In response to a request to provide a depreciated actual cost (DAC) valuation of the DVP, Anglo Coal advised of the current written down value of the DVP, derived from the purchase price which it considers to be confidential.[30]

On 31 March 2006 the pipeline assets and various CSM fields were sold to Anglo Coal and Mitsui for a total of $22m.[31] The allocation of the purchase price to the pipeline was provided confidentially to the ACCC.[32] Anglo Coal claims that this allocation is 'not an accurate representation of value and should be weighted accordingly.'[33] Anglo Coal has stated that the total sale price 'reflects a range of factors including what value or synergy the purchaser could bring to the transaction.'[34]

In relation to the basis on which tariffs have been set in the past, Anglo Coal advised that it has no knowledge of the basis used by previous owners to set tariffs.[35]

4.1.3 Submissions

Molopo submitted that the current configuration of the pipeline is not optimal and that a pipeline with a smaller diameter (100 mm or potentially 75 mm) could comfortably transport the 2 920 TJ/year that is Anglo Coal's projected flow. It concluded that 'to the extent that the cost of a notional replacement pipeline is used in establishing the ICB, it is essential that the configuration in question be optimal'.[36]

Molopo also submitted that the recent sale price should be disclosed and taken into account in setting the ICB.[37] Molopo undertook its own analysis and concluded that the value of the DVP was negligible. A key factor in Molopo's analysis was its estimate of the value of the Dawson Valley gas reserves.[38]

Molopo submitted that it paid approximately $0.19/GJ for a non-firm service. It further submitted that the previous owner of the DVP (OCA) had charged around $0.135/GJ for firm gas to $0.182/GJ for non-firm gas.[39] Molopo compared this with Anglo Coal's proposed reference tariff of $0.406/GJ. While Molopo did not specifically state that these prices were a relevant consideration in establishing the ICB, the code requires the

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30 Minter Ellison email to ACCC, 16 March 2007, p. 1. Anglo Coal considers this description to be commercially sensitive and will provide a public version

31 Origin Energy, *Origin sells its Moura CSG interests for $22m*, 7 September 2005, <http://www.origin.com.au/news/news_detail.php?pageid=83&newsid=588>

32 Anglo Coal, *Extract from Schedule 2: Purchase Price Allocation*, (attachment to *Confidential supporting information*), 5 February 2007; Minter Ellison letter to ACCC (confidential), 13 April 2007, letter and attachments.

33 Anglo Coal, *Confidential supporting information*, 5 February 2007, pp. 3-4.

34 Minter Ellison email to ACCC, 16 March 2007, p. 4.

35 ibid, pp. 1-2.

36 Molopo submission, 9 March 2007, p. 2.

37 ibid.

38 Molopo has requested that its analysis be considered to be confidential. Molopo submission (confidential), 27 March 2007, pp. 1-2 & attachments.

39 Molopo submission, 9 March 2007, p. 4.

regulator to take into account the basis on which tariffs were charged in the past (8.10(f)).

4.1.4 Assessment

This section provides the ACCC's assessment of Anglo Coal's proposal for the ICB. It first considers the proposed economic life of the DVP. Second, it considers the factors set out in s. 8.10 of the code as well as other relevant factors. The ACCC's conclusions on the ICB then follow.

Economic life

The expected economic life of a covered pipeline is an important consideration in the current assessment as it is relevant to the extent to which the asset has already been used and how much life is expected to remain. It can affect both the level of the ICB and the subsequent depreciation profile that is used in determining the reference tariff. For example, for an existing pipeline, a longer economic life will generally lead to a higher ICB than otherwise (as a relatively smaller amount of the asset would be considered to have already been used). Anglo Coal has proposed a 60 year economic life for the DVP with a remaining economic life (in 2006) of 50 years.

The expected economic life of a pipeline depends on its expected technical life and the level and duration of expected demand for its services. The technical life will depend on engineering considerations, such as the type of external coating and the maintenance regime (in particular, regular pigging and on-going cathodic protection). For a pipeline such as the DVP, the economic life will depend on the extent of CSM reserves in its vicinity that can be recovered cost effectively (relative to the 'net back' market price) and the rate at which the reserves are depleted.

The ACCC also notes that the DVP has sufficient capacity to accommodate a tripling of current CSM production rates. While there is very little to suggest that CSM production rates would be likely to increase to such an extent, any increases would use up reserves at a commensurate rate and shorten the economic life of the DVP (for a given quantity of reserves).

The ACCC requested advice from its technical consultant Ross Calvert Consulting Pty Ltd (RCC) on the expected life of the DVP. RCC advised that a 60 year technical life is reasonable.[40] It also advised that it is reasonable to conclude that there will be end use (that is, downstream) markets available to be served by the DVP over a 60 year life. However, RCC advised that there are a number of uncertainties about whether there are sufficient gas reserves to sustain a 60 year life for the DVP. RCC assessed available information on gas reserves in the proximity of the DVP which it found to be inconclusive.

[40] Ross Calvert Consulting, *Report on Dawson Valley Pipeline access arrangement and access arrangement information*, April 2007, p. 14.

RCC concluded:

> … CSG production may or may not continue for the next 50 years in the vicinity of the DVP and gas may or may not be carried in the DVP for the next 50 years. The author is not aware of sufficient evidence to reject an economic life of a further 50 years.[41]

The ACCC agrees with RCC that a 60 year technical life for the DVP is reasonable. There is likely to be downstream demand for its services over the next 50 years but there are uncertainties about whether there will be upstream supply of gas into the pipeline over this entire period. On balance, the ACCC agrees with RCC that there does not appear to be sufficient evidence to reject the proposed economic life.

The ACCC proposes to accept Anglo Coal's proposed 60 year life for the purpose of calculating the remaining life when determining the ICB.

Depreciated actual cost (s. 8.10(a))

Section 8.10(a) of the code requires the regulator to consider the value that would result from taking the actual capital cost of the covered pipeline and subtracting the accumulated depreciation for those assets charged to users (or thought to have been charged to users) before the commencement of the code. This value is commonly referred to as DAC.

The Western Australia Supreme Court of Appeal in Re Michael observed that in calculating the DAC the starting point is the actual capital cost which is then depreciated (usually in line with accounting standards).[42]

Section 8.10(a) provides that only depreciation to the date that the code commenced can be taken into account in this valuation approach. The code commenced operation in Queensland on 18 May 2000. The annual report of Conoco Australia (the original owner of the pipeline) indicates the actual capital cost was $5.237m.[43] Adjusting for depreciation to May 2000 produces a DAC of $4.932m.[44]

This figure would be particularly relevant in establishing the DVP's ICB if that task was undertaken in 2000 when it first became a covered pipeline. However, as coverage of the DVP was revoked soon after the code commenced, an ICB for the pipeline was not established at that time. However, it is questionable whether the calculation of $4.932m as DAC is as relevant to the current consideration of ICB.

The normal approach to DAC as a methodology is that the valuation would be calculated as at the relevant valuation date. This is particularly relevant to a pipeline, such as the DVP, for which some delay has occurred between the commencement date of the code and the establishment of the ICB. The ACCC considers that it is appropriate

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41 ibid.

42 [2002] WASCA 231, par. 163.

43 Conoco Australia Pty Ltd, *Annual Report year ended December 31 1997*, p. 16.

44 The ACCC is unaware of how depreciation was actually charged to customers prior to regulation. In line with accounting practices, the ACCC has assumed depreciation on a straight line basis over the life of the asset. The whole asset value was assumed to be depreciated over the proposed asset life of 60 years from commencement in November 1996.

to take into account the calculation of DAC as at 1 July 2007.[45] This is discussed below in reference to s. 8.10(c) of the code.

Alternatively, any depreciation not accounted for under s. 8.10(a) could be considered under s. 8.10(k) of the code.

The figure provided by Anglo Coal in response to a request for a DAC is not a DAC valuation as required by the code as it was based on the sale price as included in its accounts rather than the original cost to construct the pipeline. This value would be better described as the current written down value and is more relevant to s. 8.10(j).

Depreciated optimised replacement cost (s. 8.10(b))

Section 8.10(b) requires an assessment of the value of the pipeline from applying a DORC methodology.

As noted above, the ACCC proposes to accept Anglo Coal's proposal that the life of the DVP is 60 years. The ACCC also considers that straight line depreciation (as proposed by Anglo Coal) is appropriate to calculate DORC from ORC.

Anglo Coal states in its access arrangement information that the maximum capacity of the DVP is 30 TJ/day.[46] The ACCC notes that the previous owners of the pipeline, OCA, advised the NCC that the capacity of the DVP was 20 TJ/day. In contrast, Molopo considers the capacity to be 38 TJ/day.[47] Anglo Coal disputes Molopo's submission, stating that while the theoretical maximum capacity of the pipeline is 30 TJ/day, the actual maximum capacity using current equipment is 22-24 TJ/day.[48] It stated:

> The difference between the two figures is explained by compression, pressure vessel ratings and the after cooler pressure ratings. The existing compressors and dehydration equipment have pressure ratings slightly lower than the DVP and hence constrain the capacity of the DVP.[49]

The ACCC commissioned Unidel Group Pty Ltd (Unidel) to conduct an independent review of Anglo Coal's estimate of the ORC which was provided by GHD. Unidel estimates the capacity to be 40 TJ/day and notes that the limits stated by Anglo Coal are part of field delivery and not part of the pipeline.[50] Anglo Coal's forecast demand over the proposed access arrangement period is 8 TJ/day. Irrespective of whether the capacity of the pipeline is 22 or 30 TJ/day (or more), there will be considerable excess capacity. This raises the question of whether the pipeline is oversized and if a pipeline with a smaller diameter should be used as the basis for calculating the ORC.

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45 For the calculation of asset valuations at 1 July 2007 (rather than 1 July 2006 as proposed by Anglo Coal), see section 6.5 of this draft decision.

46 AAI, section 1, p. 3.

47 Molopo submission, 9 March 2007, p. 1.

48 Anglo Coal submission (response to Molopo), 13 April 2007, p. 2.

49 ibid.

50 Unidel Group, *Dawson Valley Pipeline access arrangement review*, 30 April 2007, pp. 12-13.

Anglo Coal submitted that any reduction in the size of the pipeline would result in a minimal reduction in cost but a significant reduction in capacity. According to Anglo Coal, a smaller pipe diameter would not cater for future market growth. Anglo Coal submitted that, if a pipeline were built with a smaller diameter, looping would be required to cater for market growth. This would be a more expensive option than initially constructing a larger pipeline.[51] The ACCC notes that Anglo Coal is not forecasting any market growth in the next 10 years.[52]

The ACCC commissioned RCC to independently review the GHD report. RCC advised:

- GHD's estimate of $9.169m for ORC for the DVP in its current configuration is reasonable
- a 168.3 mm pipeline has considerably more capacity than the next lower standard diameter (114.3 mm) but only a minimal increase in costs, and
- gas industry practice has generally favoured 168.3 mm as the minimum practical diameter for a transmission pipeline.[53]

RCC concluded that the pipeline configuration proposed by Anglo Coal for the ORC was appropriate. RCC also concluded that the existing route was appropriate for the purpose of determining an ORC.[54]

Unidel advised that GHD's general approach and methodology for estimating ORC were acceptable. It concluded that current volumes could be delivered by a pipeline with a smaller diameter, but the costs would only be reduced by less than 10 per cent. In relation to construction costs, Unidel concluded that GHD's estimates are at the lower end of pipeline costs in the current market. However, it noted that GHD's estimate of DORC fell within the accuracy level of plus or minus 25 per cent.[55] Unidel considered $11.3m would be a more appropriate ORC.[56]

As Molopo has submitted, a smaller diameter pipeline would have sufficient capacity to accommodate forecast demand. The ACCC is aware that some Australian transmission pipelines (in particular, the Mildura and Riverland pipelines) have a smaller diameter. However, as indicated by Anglo Coal, diameters less than 150 mm are not commonly used for gas transmission pipelines.[57]

In light of the advice from technical consultants as noted above, the ACCC has concluded that the estimate of $9.169m for ORC (in the third quarter 2006), and the pipeline configuration used for this, is reasonable and that the pipeline should not be

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51 Anglo Coal submission (response to Molopo), 13 April 2007, p. 3.

52 AAI, section 5, p. 8.

53 RCC report, April 2007, p. 11.

54 ibid, p. 12.

55 Unidel report, 30 April 2006, p. 9.

56 ibid, p. 4.

57 Anglo Coal submission (response to Molopo), 13 April 2007, p. 3.

optimised by reducing its diameter. Reducing the diameter of the pipe would lead to a significant reduction in capacity with comparatively little cost saving.

The ACCC also requested advice from Unidel concerning increases in pipeline construction costs that have occurred in recent years, which are discussed later in this section. The ACCC was concerned that potentially temporary cost increases might be reflected in the ORC and the DORC. The code does not permit a subsequent optimisation if the assumptions underpinning the determination of the ICB are found to no longer apply.

A DORC of $7.600m as at 1 July 2007 is derived from an ORC of $9.169m (third quarter 2006 dollars).[58] The ACCC considers that this DORC appropriately addresses s. 8.10(b) of the code.

Other well recognised asset valuation methodologies (s. 8.10(c))

Section 8.10(c) of the code requires the regulator to consider the value that would result from applying other well recognised asset valuation methodologies in determining the ICB.

Section 8.10(a) of the code describes a form of DAC that is calculated by taking into account only depreciation prior to the commencement of the code (for Queensland, this is 18 May 2000) irrespective of the date that the ICB is established. However, given the time that has elapsed since the code commenced, the ACCC considers that it is relevant to take into account depreciation from that time to the present. The well recognised method of calculating DAC is to take into account depreciation up to the date for which the valuation is done. The pipeline started transporting gas in November 1996.[59] Depreciating the actual cost based on the 60 year (economic and technical) life proposed by Anglo Coal, results in a DAC as at 1 July 2007 of $4.310m.

Molopo submitted that the purchase price of the DVP should be taken into account when establishing the ICB.[60] No other parties put forward any other recognised asset valuation methodologies.

The WA Supreme Court of Appeal in Re Michael considered Epic's argument that the purchase price was relevant under s. 8.10(c) as representing the asset's market value. To the extent that the price paid by Anglo Coal for the DVP in 2006 represented the fair market value of the assets, it also could be considered as a relevant factor under this section. However, consistent with the WA Supreme Court of Appeal, the sale price is also a relevant consideration under s. 8.10(j).[61] The ACCC's analysis of the DVP's sale price is discussed later in this chapter.

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58 Anglo Coal's estimate of ORC was calculated in the third quarter 2006 and the DORC calculated as at 1 July 2006. The ACCC has adjusted Anglo Coal's estimate to derive the DORC as at 1 July 2007 (see section 6.5 of this decision).

59 CSIRO, *CHRRUP: Who's involved – mining sector*, 28 February 2000, p. 3, viewed 1 May 2007<http://chrrupp.lp.qld.csiro.au/Who/mining.htm>

60 Molopo submission, 9 March 2007, p. 2.

61 [2002] WASCA 231, par. 171.

The Court also commented on optimised deprival value (ODV).[62] The ACCC acknowledges that this is a well understood alternative valuation approach. It has used this methodology on one occasion (for the Amadeus Basin to Darwin Pipeline (ABDP) access arrangement). In that instance the ACCC made use of the existing long term contract that utilised the vast majority of the pipeline's capacity to derive an estimate of the pipeline's value based on the revenue to be generated in the future.[63]

Such an approach is not relevant to the DVP for two reasons. No such long term contracts are in place and its transportation services are sold as part of a bundled product. Consequently, it is not possible to value its future revenues based on existing contractual arrangements. Nor is scrap value, which is likely to be close to zero, an appropriate value under an ODV approach as the NPV of the expected income would be greater than the scrap value because of the on-going demand for services.

Advantages and disadvantages of each valuation methodology (s. 8.10(d))

Section 8.10(d) of the code requires the regulator to consider the advantages and disadvantages of each valuation methodology applied under ss. 8.10(a), (b) and (c). However, s. 8.10(d) does not guide the regulator on what criteria it should use to assess the advantages and disadvantages of each valuation methodology.

Accordingly, the ACCC has had regard to the s. 8.1 objectives in its consideration of s. 8.10(d). The ACCC regards this approach as being consistent with the WA Supreme Court of Appeal.[64] Consideration of the s. 8.1 objectives for the ICB is discussed later in this decision.

International best practice and impact on international competitiveness (s. 8.10(e))

In establishing the ICB s. 8.10(e) of the code requires the regulator to consider the international best practice of pipelines in comparable situations and the impact on the international competitiveness of energy consuming industries.

Anglo Coal and other interested parties made no comment on this section.

The WA Office of Gas Access Regulation (OffGAR, now the Economic Regulation Authority (ERA)) considered the issue of international best practice in asset valuation in its draft decision on the Dampier to Bunbury Natural Gas Pipeline. It considered the practices in the UK and US, as these are the two countries with the longest history of energy regulation. OffGAR concluded that the US regulators have traditionally relied on historical cost valuations and UK regulators have relied on replacement cost methodologies such as DORC. OffGAR noted that UK regulators have in some cases adopted 'market valuation' approaches.

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62 Under the ODV approach, the value of an asset is the lesser of its DORC and the NPV of the income that can be generated from that asset.

63 ACCC, *Final Decision: Access arrangement proposed by NT Gas Pty Ltd for the Amadeus Basin to Darwin Pipeline*, 4 December 2002, pp. 36-37.

64 [2002] WASCA 231, par. 76.

Regarding the Australian regulatory experience, OffGAR stated regulators have used DORC as the starting point and in some instances discounted the DORC in accordance with some criteria balancing the interests of the service provider and users. Typically, the criterion has been that regulated tariffs should not exceed existing tariffs. OffGAR concluded that there is no established or well accepted 'international best practice'.[65]

This information suggests that both historical costs and valuations based on replacement costs should be considered in the process of establishing the ICB.

The second limb of this provision requires consideration of the international competitiveness of energy consuming industries in Australia. The ACCC considers that the international competitiveness of domestic industries is enhanced by low, but sustainable, input costs, such as for gas transportation.

Similarly, businesses that compete internationally will benefit from low, sustainable costs. In particular, an end user of the DVP is Queensland Nitrates plant at Moura, which supplies explosive grade ammonium nitrate to local coal mines. The international competitiveness of those mines is enhanced by low input costs.

As capital costs tend to form the bulk of gas transportation tariffs, it follows that the lower the ICB the lower will be tariffs to users. This consideration tends to support an asset valuation based on the lower end of the feasible range of asset valuations.

Basis for past tariffs, economic depreciation and historical returns (s. 8.10(f))

Section 8.10(f) deals with the basis on which tariffs have been (or appear to have been) set in the past, the economic depreciation of the covered pipeline and the historical returns to the service provider from the covered pipeline.

The ACCC understands that the great majority of transportation services has been sold as part of a bundled product with the supply of gas by the current and previous common owners of the pipeline and associated CSM fields and facilities. The ACCC is unaware of whether previous owners set a nominal or deemed tariff for transporting gas sold as a bundled product.

The ACCC also understands that no third party tariffs have been published for the DVP. While some third party contracts were written for transportation only (for example with Molopo, which expired in December 2006) the price was a matter for negotiation between the parties involved.

Molopo submitted that the tariffs set by OCA were substantially lower than the proposed reference tariff. Molopo also submitted that it expects that the reference tariff that will be approved by the ACCC 'will be below the level charged historically for use of the DVP'.[66] While the difference in tariff level is substantial, this is not a sufficient indicator that the proposed tariff is not appropriate. The basis for the OCA tariffs would

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65 Office of Gas Access Regulation, WA, *Draft Decision: Proposed access arrangement Dampier to Bunbury Natural Gas Pipeline*, Part B, 21 June 2001, pp. 145-147.

66 Molopo submission, 9 March 2007, p. 4.

also need to be considered. Anglo Coal has advised that it has no knowledge of the basis used by previous owners to set tariffs.

Since January 2007, in accordance with an undertaking provided in support of an application for waiver of certain ring fencing provisions, the pipeline arm of the integrated business nominally charges the CSM production arm for the transportation of its gas.[67]

Historical transportation prices provide little guidance in setting the ICB for the DVP in accordance with the code as little is understood about how these prices were determined. In addition, while limited historical accounting depreciation is known, there is insufficient information for the ACCC to gain an understanding of economic depreciation or historical returns for the DVP. Accordingly, in establishing the ICB little weight is given to past prices and by implication to the economic depreciation and historical returns derived from those prices.

Reasonable expectations under the prior regulatory regime (s. 8.10(g))

Section 8.10 (g) of the code requires the regulator to consider the reasonable expectations of persons under the regulatory regime that applied to the pipeline before the commencement of the code.

Neither Anglo Coal nor any interested party commented on this section.

The regulatory regime that applied to the DVP before the code was established under the *Petroleum Act 1923* (Qld). Under the provisions of that Act, tariffs for Queensland gas pipelines were set in accordance with access principles or by negotiation. In the case of the DVP no access principles were set and tariffs were a matter for negotiation between the parties involved.

As stated above in relation to s. 8.10(f), past prices provide little guidance in setting reference tariffs under the code. Moreover, for Anglo Coal to continue to set all tariffs on a negotiated basis without offering at least one reference service and associated reference tariff would be inconsistent with regulation under the code.

It would be reasonable to conclude that the previous regulatory regime could not have given rise to any reasonable expectations that the pipeline owner would be able to continue to negotiate tariffs in such an environment in the event of the introduction of a new regime that provided for regulated reference tariffs. Accordingly, the previous regulatory regime could not have given rise to any reasonable expectations that would bear upon establishing the ICB of the pipeline under the current regulatory regime.

The economically efficient utilisation of gas resources (s. 8.10(h))

Section 8.10(h) of the code requires the regulator to consider the effect (of the ICB) on the economically efficient use of gas resources.

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[67] ACCC, *Final Decision: Applications to waive ring fencing obligations by Anglo Coal (Dawson) Limited, Anglo Coal (Dawson Management) Pty Ltd and Mitsui Moura Investment Pty Ltd for the Dawson Valley Pipeline*, 14 February 2007, p. 8.

Neither Anglo Coal nor any interested party commented directly on this section. However, WestSide commented on the level of the tariff proposed by Anglo Coal and submitted that it would act as a significant impediment to the development and commercialisation of gas resources in the region.[68]

The economically efficient use of gas resources can best be achieved by setting a value for the ICB that is consistent with the objectives in s. 8.1 of the code. In particular, the asset value should allow the opportunity for recovery of efficient costs, replicate the outcomes of a competitive market and not distort investment decisions in gas transportation or upstream and downstream gas industries.

Comparability with the cost structure of competing pipelines (s. 8.10(i))

Section 8.10(i) of the code requires the regulator to consider the comparability with the cost structure of pipelines that may compete with the pipeline in question (for example, a pipeline that may by-pass some or the entire pipeline in question).

Anglo Coal did not comment on this section.

The AMP also provides transportation services to the Dawson Valley area. As noted in chapter 2 of this draft decision, the AMP primarily transports CMM to the Wallumbilla to Rockhampton via Gladstone Pipeline. As determined by the NCC, the DVP and AMP do not provide the same service.[69] The NCC also noted that the DVP and AMP are under common ownership.[70] For these reasons, despite the close proximity of the pipelines, the ACCC does not regard them as competing pipelines for the current assessment.

Westside submitted that Anglo Coal's proposed tariff was too high and could lead to uneconomic by-pass. As ORC reflects the most efficient route and design of a replacement (or by-pass) pipeline, an ICB and tariffs reflecting DORC or less should not lead to a result which encourages inefficient bypass.

The price paid for any asset recently bought by the service provider (s. 8.10(j))

Section 8.10(j) of the code requires the regulator to consider the price paid for any asset recently bought by the service provider and the circumstances of the purchase. The WA Supreme Court of Appeal found that this section can apply to the purchase of a whole pipeline, not merely a component of a pipeline.[71]

Anglo Coal submitted that because the DVP was sold as a package the sale price allocation 'is not equivalent to the concept of the "price paid" under section 8.10(j) of

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68 WestSide submission, 21 March, 2007, p. 2.

69 NCC, *Dawson Valley Pipeline coverage application under the national gas code: final recommendation,* August 2005, p. 21.

70 NCC, *Dawson Valley Pipeline application for coverage under the national gas code by Molopo Australia Limited: supplementary advice*, 31 October 2006, p. 6.

71 [2002] WACSA 231, par. 171.

the code'.[72] The ACCC does not agree with this interpretation. The ACCC considers that s. 8.10(j) does not preclude the consideration of an asset sold as part of a package.

Molopo expressed concern that the DVP purchase price from the March 2006 sale process had not been disclosed by Anglo Coal.[73] The price allocated to the DVP as a part of the March 2006 sale has been provided to the ACCC and has been taken into account in the ICB assessment. The ACCC has agreed to treat the price as confidential.

In arriving at its conclusion that the value of the DVP is negligible, Molopo assigned a value for all the assets other than the DVP (based partly on confidential information available to it) and subtracted the total from the sale price of $22m to arrive at an estimate of the value of the DVP. Given the information available to it, the ACCC acknowledges Molopo's method of valuing the DVP. However, it considers that the purchase price allocation for the DVP from Anglo Coal carries more weight. It also notes that asserting that the DVP is of negligible value is synonymous with asserting that the DVP is redundant. Clearly this is not the case as the pipeline is required to transport the gas from its source of supply to its markets.

Moreover, Molopo's conclusion relies heavily on the value it places on the reserves, which Molopo stated is based on 'industry norms'.[74] Any assessment of the value of the reserves is inherently subjective and could depend on factors such as current prices, perceptions regarding expected future costs and prices, and the risk that at least some of the reserves may never be sold.

The ACCC acknowledges Anglo Coal's stated concerns about the allocation of the bundled purchase price to the DVP and the other assets. It also notes that Anglo Coal has not provided any evidence that the allocation is biased.

If the sale price were to be used to establish the ICB, consideration would need to be given to adjusting that price to take account of the 15 month period between the 31 March 2006 purchase date and the 1 July 2007 date for setting the ICB.

Other factors the regulator considers relevant (s. 8.10(k))

Section 8.10(k) of the code requires the regulator to consider other relevant factors in determining the ICB.

Neither Anglo Coal nor any interested party commented on this section.

As noted in the discussion relating to s. 8.10(c), the ACCC considers that in estimating DAC, depreciation from the commencement of the code to the start of the access arrangement period is a relevant consideration.

Additional considerations

Establishing the ICB relies on the consideration of, and the weight to be given to, each of the factors in s. 8.10. As noted above in relation to s. 8.10(d), the ACCC has

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72 Anglo Coal submission (response to Molopo), 13 April 2007, p. 3.

73 Molopo submission, 9 March 2007, p. 2.

74 Molopo submission (confidential), 27 March 2007, p. 2.

considered each of the s. 8.10 factors in light of the objectives contained in s. 8.1 of the code.

Section 8.1(a) provides that a service provider should be given the opportunity to recover its efficient costs over the life of the assets. The WA Supreme Court of Appeal observed that 'the DAC and DORC methodologies have an acceptability for the purposes of the concept of economic efficiency'.[75] An ICB equal to DAC would allow the recovery of the costs incurred in constructing the assets (assuming that the service provider had achieved at least a normal return on assets until the commencement of regulation). To the extent that DORC is greater than DAC, DORC may allow for the recovery of more than the costs incurred in constructing the assets. An ICB based on a sale price would allow for the recovery of the current owners' costs (regardless of whether they were at efficient levels).

Section 8.1(b) states that the reference tariff and reference tariff policy should be designed to achieve the objective of replicating the outcome of a competitive market. The Court noted the complementary nature of the objectives in ss. 8.1(a) and 8.1(b) in view of the interrelationship between economic efficiency and competition in a market.[76]

Section 8.1(c) states that the reference tariff and reference tariff policy should be designed to achieve the objective of ensuring the safe and reliable operation of the pipeline.

The Court interpreted this provision as requiring that the revenue stream should be sufficient to meet the safety and reliability needs as and when it is necessary.[77] This interpretation suggests to the ACCC that this objective is directed more at future operating expenses and forecast capital expenditure, with little direct relevance to the establishment of the ICB.[78]

The objective of section 8.1(d) of the code is that investment decisions in pipeline transportation services or upstream and downstream industries should not be distorted by the reference tariff or reference tariff policy.

The WA Supreme Court of Appeal dismissed submissions that this provision would be met by setting tariffs solely in accordance with the forward-looking efficient costs without having regard to past investment decisions. According to the Court, to ignore past investment may have adverse effects on future investment. Accordingly, it is open to the regulator to take into account the actual investment of the owner in the pipeline. For this reason both the DAC and the sale price need to be given weight as well as DORC. Upstream and downstream investment decisions would benefit from an ICB at or near DAC as lower tariffs would be generated.

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75 [2002] WASCA 231, par. 176.

76 ibid, par. 143.

77 ibid, par. 146.

78 Nevertheless, a value of the ICB that is set too low, for example below the level of the service provider's investment, may encourage the service provider to cut costs to increase its return on its investment to the detriment of the integrity and safety of the pipeline.

The objective of s. 8.1(e) of the code is efficiency in the level and structure of the reference tariff. Section 8.1(f) requires the reference tariff policy and reference tariff to provide for incentives to the service provider to reduce costs and develop the market for reference and other services.

The ACCC considers that the objectives contained in ss. 8.1(e) and 8.1(f) form part of the broader assessment of the reference tariff and reference tariff policy, rather than the ICB specifically. The Court noted that 'efficiency in the level of the reference tariff' is interrelated with the concept of economic efficiency.[79] If the ICB were set at a level above efficient costs and that which would be observed in a competitive market, and therefore incorporated monopoly rents, a service provider may have less of an incentive to reduce costs and develop the market for reference and other services.

In addition to addressing s. 8.10(d) with the guidance of s. 8.1, the ACCC has considered each ICB methodology from a broader perspective.

Section 8.11 of the code requires that the ICB should not normally be outside the range of the values determined under ss. 8.10(a) and (b). In this instance the range under ss. 8.10(a) and (b) is $4.932m to $7.600m.

A substantial variation in value between historical cost and current replacement cost valuations is to be expected, given the age of the pipeline. A large variation could also be expected given that pipeline construction costs have escalated in recent years consistent with a buoyant resources sector. Unidel advised that pipeline construction costs have increased in the order of 80 per cent over the past five years.[80]

In relation to DORC it is worth noting that the value determined for ORC is a notional value only. The pipeline is not actually being replaced at this time. As the ORC may be an input into a pipeline's ICB (which cannot be revalued at a later date), caution should be exercised in placing too much weight on short-term increases in construction costs that may not be sustained over the medium to long term.

Moreover, in a competitive market assets would not be constructed or replaced if their cost generated prices that would be considerably higher than the prices that users would be willing to pay. Increased construction costs have been cited as reasons for a number of proposed greenfield pipelines (for example, the PNG to Queensland and Trans Territory pipelines) not being built.

Pipeline developers consider a range of factors when making decisions about if and when to construct pipelines, such as projected costs and the expected level of demand and extent of competitive pressures. Potentially, if the DVP did not exist it may not be built in the current climate of high construction costs. In these circumstances, if the high construction costs are expected to be temporary, pipeline developers may defer construction in the expectation that costs will return to more sustainable levels. In effect, part of the optimisation process would be an adjustment to the timing of construction.

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79 [2002] WASCA 231, par. 156.

80 Unidel report, 30 April 2006, p. 4.

The ACCC sought further information on construction costs from Unidel. Unidel indicated that while the pipeline industry has attempted to benchmark pipeline costs for many years, there continues to be debate over published figures. However, Unidel was able to give some comments on cost trends in broad terms for the last couple of decades.

> Around mid to late 1980's costs were around $15k/in/km. There appears to have been little increase over the period to the mid 1990's except some adjustment for the higher cost for the trend from 10 MPag systems to 15 MPag systems, but costs were usually still considered to be less than $20k/in/km. By the early 2000's costs appear to have increased to typically around $25k/in/km. The recent increases in steel, approvals, labour and specialist sub-contracts since that time indicate that it is unlikely any pipeline projects would now cost less than $40k/in/km and in some cases may exceed $45k/in/km.[81]

When the figures in the above quotation are converted to 2007 dollars, they indicate that over the last couple of decades real costs have been relatively stable around the $30 000/in/km mark except for the last few years, and that currently they are about one third above that level. Unidel noted that the recent increases are primarily due to increased steel prices (reflecting world prices) and labour (driven by a labour shortage as a result of the current resources boom).[82] The ACCC considers it unlikely that these costs levels will be maintained in the medium term.

For the reasons given above, the ACCC considers it not appropriate to base the ICB on a valuation that reflects the recent cost increases.

The ACCC notes that the ORC proposed by Anglo Coal is equivalent to $32 500/in/km (in third quarter 2006 dollars) which is similar to the level of the last couple of decades and substantially lower than the current unit cost identified by Unidel. The ACCC also notes that Unidel considers the appropriate current capital cost for the DVP to be higher than that proposed by Anglo Coal.[83] Consequently, the ACCC considers that the ORC proposed by Anglo Coal does not reflect the recent cost increases[84] and thus considers that the current existence of high construction costs that may not be sustainable in the medium term is not a reason to give less weight to the DORC methodology as a basis for the ICB in this instance.

A forward looking methodology such as DORC may not be appropriate if there is uncertainty about the life of the CSM reserves or the extent of future demand for use of the DVP. While downstream demand for natural gas seems assured well into the future in Queensland (including areas such as Gladstone and Rockhampton that are served by the Wallumbilla to Gladstone Pipeline) the life of the CSM reserves needed to supply the DVP is uncertain. As discussed earlier in this section, the economic life of the DVP will depend on the extent of CSM reserves in its vicinity that can be recovered cost effectively and the rate at which the reserves are exploited. Once these reserves are exhausted the DVP would be expected to have little value.

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81 Unidel, *Dawson Valley Pipeline: supplement to the access arrangement review*, 9 May 2007, p. 4.

82 Unidel report, 30 April 2006, p. 9.

83 ibid, p. 4.

84 This is not to say that the ORC proposed by Anglo Coal does not contain components at current costs. It simply concludes that the total level of unit costs reflects the long term level of unit costs rather than the current level of unit costs.

As previously noted, the ACCC has some doubts about the longevity of upstream requirements for the services of the DVP, but on balance proposes to accept Anglo Coal's proposed 60 year life for the purpose of calculating the extent that the asset has already been used when determining the ICB. Whether the pipeline will be replaced after this time cannot be determined at present.

In relation to the DAC approach, the ACCC considers that the figure of $4.932m is of little relevance given the time that has elapsed since 2000 when the code commenced as it fails to take into account depreciation in the intervening period. The ACCC therefore considers that DAC depreciated to 2007 is more appropriate for the current assessment. This produces a DAC as at 1 July 2007 of $4.310m.

In principle, DAC has the advantage of allowing for the recovery of actual costs over the life of the asset (assuming a normal return has been achieved prior to it being regulated). However, in this instance Anglo Coal has not been able to provide sufficient historical information to allow the ACCC to determine whether a normal return has been achieved on the DVP. Indeed, this may not be possible because of uncertainties over the past allocation of costs and revenues between the DVP and the CSM assets. Given the volumes transported in the early years of the pipeline's life, there is some concern that a normal return may not have been achieved in all the years prior to 2007.

As previously noted, and in accordance with s. 8.10(j) of the code, the ACCC has considered the recent purchase price of the DVP. There is the question of whether the sale price appropriately reflected the market value of the assets. This might not be the case if, for example, the transaction was not 'at arms length', or if the purchaser paid a price that embedded monopoly returns. The ACCC would give little weight to any sale price under such circumstances. This is to avoid the risk of parties negotiating a high sale price for pipeline assets in the expectation that the associated costs could be recovered under the regulatory regime.

However, the sale on 31 March 2006 was by OCA, a party unrelated to the current service providers. The ACCC understands that the transaction was at arm's length and likely to represent a competitive market value for the bundle of assets sold. Accordingly, the ACCC considers that the sale price is an appropriate factor to take into account. However, the ACCC accepts that there is some uncertainty as to the methodology used for allocating a proportion of the total sale price of $22m to the DVP. In view of the difficulty in establishing a value for the pipeline assets on this basis, the ACCC does not consider that the 2006 sale price provides a sound basis on which to set the ICB.

Conclusion

For the reason set out in the above discussion, the ACCC does not consider that the ICB should be set at the sale price. Neither does it consider that DAC should be used given the uncertainty over whether a normal return has been achieved in the past and whether it would allow full cost recovery. The ACCC has some reservations about the appropriateness of using DORC to establish the DVP's ICB given the under-utilisation and the uncertainty over replacement of the pipeline at the end of its current life. Nevertheless, it considers in this instance that DORC is more likely to satisfy the requirements of the code than the alternatives of DAC and sale price. It is satisfied that this is the most appropriate methodology to establish the ICB of the DVP.

As noted above, the DORC should be expressed in July 2007 dollars. Accordingly, the ACCC proposes that the ICB be set at $7.600m.

Proposed amendment 3

In order for the DVP access arrangement to be approved, Anglo Coal must set the ICB at $7.600m at 1 July 2007.

4.2 New facilities investment

4.2.1 Code requirements

The code (ss. 8.15-8.16) allows for the capital base to be increased from the commencement of a new access arrangement period where additional capital costs are incurred in constructing or acquiring new facilities for the purpose of providing services. The amount of the increase is the actual capital cost provided that the investment is prudent in terms of efficiency, in accordance with accepted good industry practice and is designed to achieve the lowest sustainable cost of providing services.

The regulator must be satisfied that the anticipated incremental revenue exceeds the cost of the investment, that the new facility either has system wide benefits (justifying higher tariffs for all users), or that the new facility is necessary to maintain the safety, integrity or contracted capacity of services.

Under ss. 8.18 and 8.19 of the code, an access arrangement may state that a service provider may undertake new facilities investment if these criteria are not met. To the extent that an investment does not meet the s. 8.16 criteria or has a speculative element, the addition to the capital base needs to be correspondingly reduced.[85]

4.2.2 Proposal

The proposed access arrangement provides Anglo Coal with the ability to undertake capital expenditure that does not meet the code's requirements set out in s. 8.16. The portion of the new facilities investment that does satisfy the s. 8.16 requirements may be included in the capital base. This amount is the 'recoverable portion'. The portion that does not satisfy s. 8.16 would be placed in a speculative investment fund in accordance with s. 8.19 of the code.[86] If the type or volume of services relating to the new facilities investment subsequently change such that more of the investment meets the requirements of s. 8.16, that amount can be moved from the speculative investment fund to the capital base.

4.2.3 Submissions

No submissions were received on this aspect of the proposed access arrangement.

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[85] That portion of the investment which is of a speculative nature is held in the speculative investment fund and may be added to the asset base at a later date when it meets the criteria of s. 8.16.

[86] AA, section 5, p. 10.

4.2.4 Assessment

The ACCC considers that Anglo Coal's proposed new facilities investment policy is consistent with the requirements of the code and appropriate for the DVP access arrangement.

4.3 Forecast capital expenditure

4.3.1 Code requirements

Reference tariffs may be determined on the basis of forecast investment during the access arrangement period, provided that such investment is reasonably expected to pass the requirements noted above when the investment is forecast to occur (s. 8.20 of the code). However, the inclusion of forecasts does not necessarily mean that the criteria contained in s. 8.16 of the code have been satisfied. This assessment is normally carried out at the time of the subsequent review of the access arrangement. However, the regulator may provide this assessment at any time (s. 8.21).

The code (s. 8.22) also states that the reference tariff policy may specify how the new facilities investment is to be determined for the purposes of s. 8.9, including how discrepancies between forecast and actual investment are to be reflected in the capital base at the commencement of the next access arrangement period (so as to meet the objectives of s. 8.1 of the code). The alternative is for the regulator to determine how the expenditure will be treated for the purpose of s. 8.9 at the time a revision to the access arrangement is submitted to the regulator.

Under the cost of service methodology, once the value of the initial capital base is established, the capital base for each subsequent period is determined as the value of the capital base at the start of the preceding period plus new facilities investment (or the recoverable portion), less depreciation and redundant capital (s. 8.9 of the code). Under the NPV and IRR methodologies, the capital base at the commencement of each subsequent access arrangement period is equal to the residual value determined in the previous access arrangement period less redundant capital.

4.3.2 Proposal

Anglo Coal has not included any forecast capital expenditure in its determination of the reference tariff for the access arrangement period.[87]

Nonetheless, Anglo Coal's reference tariff policy states that 'the capital base at the commencement of the subsequent access arrangement period will be the residual value of $8.344m (in July 2006 dollars) adjusted to reflect actual rather than forecast new facilities investment, redundant capital and inflation as measured by the annual CPI'.[88]

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87 AAI, section 3, p. 5.

88 AA, section 5, p. 10.

4.3.3 Submissions

No submissions were received on this aspect of the proposed access arrangement.

4.3.4 Assessment

Anglo Coal has not included any forecast capital expenditure in its determination of the reference tariff for the access arrangement period. Consequently no assessment is required or possible of forecast new facilities investment against the requirements of the code at this time. It is unusual that no capital expenditure has been included by the service providers, but given the constant forecast demand and the extent of excess capacity, the ACCC considers it is reasonable in this instance.

Anglo Coal has included a statement on the treatment of the cost of new facilities in relation to determining the capital base in the subsequent access arrangement period. The ACCC considers it appropriate that actual rather than forecast costs would be included in the capital base and that this statement meets the requirements of s. 8.22 of the code.

Anglo Coal's broader explanation of how its capital base would be determined at the start of the subsequent access arrangement period is framed in terms of the NPV methodology although Anglo Coal's revenue model accords with the cost of service methodology (which is permitted under s. 8.4). As discussed in section 3.2 of this draft decision, the ACCC has concluded that Anglo Coal has adopted the cost of service methodology and proposed an amendment to the proposed reference tariff policy to make it consistent with the cost of service methodology.

4.4 Capital redundancy

4.4.1 Code requirements

Section 8.27 of the code allows a reference tariff policy to include (and the regulator may require that it include) a mechanism that will remove redundant capital from the capital base. Such an adjustment would occur at the start of the next access arrangement period to:

- ensure that assets which cease to contribute to the delivery of services are not reflected in the capital base, and

- share costs associated with a decline in sales volume between the service provider and users.

Before approving a reference tariff policy which includes such a mechanism, the relevant regulator must take into account the uncertainty such a mechanism would cause and the effect that uncertainty would have on the service provider, users and prospective users. If a reference tariff does include such a mechanism, the determination of the rate of return (under ss. 8.30 and 8.31) and the economic life of the assets (under s. 8.33) should take account of the resulting risk (and cost) to the service provider of a fall in the revenue received from sales of services or part of the covered pipeline.

If assets that are the subject of redundant capital subsequently contribute, or make an enhanced contribution, to the delivery of services, the assets may be treated as a new facility having new facilities investment (for the purpose of ss. 8.16(a), 8.17, 8.18 and 8.19) equal to the redundant capital value increased annually on a compounded basis by the rate of return from the time the redundant capital value was removed from the capital base (s. 8.28).

While the code permits a reference tariff policy to include a mechanism to subtract redundant capital from the capital base, it also allows for other mechanisms that have the same effect on reference tariffs while not reducing the capital base (s. 8.29 of the code).

4.4.2 Proposal

It is proposed by Anglo Coal that, with the commencement of the next access arrangement period, the regulator may remove an amount from the capital base so as to:

- ensure that assets which cease to contribute to the delivery of services are not reflected in the capital base, and
- share costs associated with a decline in the volume of sales of services between Anglo Coal and users.

4.4.3 Submissions

No submissions were received on the capital redundancy aspect of the access arrangement.

4.4.4 Assessment

Anglo Coal's proposed access arrangement contains the provision that the capital base will be adjusted for redundant assets. In accordance with s 8.27 of the code, the ACCC has taken into account the uncertainty arising from the redundant capital policy in the determination of the rate of return and the life of the assets. In particular, the value of the beta for the DVP was determined with reference to the redundant capital policy. Also, the ACCC has accepted the proposed economic life of the pipeline.

The ACCC considers that Anglo Coal's proposed capital redundancy policy is consistent with the requirements of the code and appropriate for the DVP access arrangement.

4.5 Depreciation

4.5.1 Code requirements

A service provider must establish a depreciation schedule for the assets that are included in the capital base. This is to consist of a number of schedules for each asset or group of assets. Pursuant to s. 8.33 of the code, under the cost of service approach used for the DVP, the depreciation schedule must result in:

- reference tariffs that change over time consistent with the efficient growth of the market for the reference service. This may include a substantial portion of depreciation taking place in future periods, particularly where reference tariffs have been set on the assumption of significant market growth

- depreciation occurring over the economic life of the assets with progressive adjustments where appropriate to reflect changes in economic lives of the assets, and

- an asset being depreciated only once so that total depreciation is equivalent to the valuation of that asset at the time when it was initially incorporated in the capital base (subject to an adjustment for inflation, where appropriate).

Pursuant to s. 8.5A of the code, depreciation may be expressed on a nominal basis, a real basis or in any other manner that deals with the effect of inflation provided that it is specified in the access arrangement, applied consistently and approved by the regulator.

4.5.2 Proposal

Anglo Coal stated in its access arrangement information that it has adopted straight line depreciation. The proposed depreciation schedule is presented in Table 4.1.

Table 4.1: Proposed depreciation schedule

Year ending 30 June	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
	$ million								
Depreciation	-0.082	-0.079	-0.076	-0.073	-0.070	-0.066	-0.062	-0.058	-0.053

Source: Anglo Coal revenue model.

4.5.3 Submissions

No submissions were made on this aspect of the access arrangement.

4.5.4 Assessment

The ACCC has confirmed that Anglo Coal has applied straight line depreciation in its revenue model. The ACCC considers that this approach is consistent with Anglo Coal's expectation that demand for the services of the DVP is unlikely to change over time and is consistent with the requirements of the code.

The straight line depreciation method has been retained in the revenue model for this draft decision. However, as a result of amendments relating to the DVP's costs the depreciation schedule now differs from that proposed. The depreciation schedule relevant to this draft decision is set out in Table 4.2.

Table 4.2: Draft decision depreciation schedule

Year ending 30 June	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
	$ million								
Depreciation	-0.083	-0.081	-0.078	-0.075	-0.072	-0.069	-0.065	-0.061	-0.057

Source: ACCC.

5. Rate of return

5.1.1 Code requirements

Section 8.30 of the code states that the rate of return used in deriving a reference tariff should provide a return commensurate with prevailing conditions in the market for funds and the risk involved in delivering the reference service (as reflected in the terms and conditions on which the reference service is offered and any other risk associated with delivering the reference service).

Section 8.31 states that the rate of return may be set on the basis of the weighted average return applicable to each source of funds (for example, equity and debt). These returns may be determined using a well-accepted financial model such as the capital asset pricing model (CAPM). In general, the weighted average of the return on funds should be calculated by reference to a financing structure that reflects standard industry structures for a going concern and best practice. However, other approaches may be adopted if the regulator is satisfied that they would be consistent with the objectives set out in s. 8.1 of the code.

Section 8.2(e) states that the regulator must be satisfied that any forecasts required in setting the reference tariff represent best estimates arrived at on a reasonable basis.

5.1.2 Proposal

Anglo Coal stated that it has adopted a weighted average cost of capital (WACC) approach to determining the appropriate rate of return for the DVP.[89] It adopts the CAPM model to calculate the return on equity which is an input to its WACC calculation. The rate of return it uses for calculating the cost of capital is a post tax nominal WACC of 8.86 per cent. This is based on the parameters values in Table 5.1.

Anglo Coal provided the ACCC with a post-tax revenue model which included allowances for corporate tax in the cash flows.

It has not provided descriptions or arguments in support of its proposed methodology and parameter values.

[89] AAI, section 3, p. 5.

Table 5.1: Proposed CAPM parameters and WACC

Parameter		
Nominal risk free rate	r_f	5.74%
Real risk free rate	rr_f	2.50%
Inflation	f	3.20%
Cost of debt margin	DM	1.20%
Nominal cost of debt	r_d	6.94%
Corporate tax rate	T_c	30.0%
Effective tax rate	T_e	30.0%
Value of imputation credits	γ	50.0%
Market risk premium	MRP	6.0%
Equity beta	β_e	1.0
Cost of capital		
Nominal return on equity	r_e	11.74%
Nominal vanilla WACC		8.86%

Source: Anglo Coal revenue model.

5.1.3 Submissions

In its submission, AGL stated that it had identified an inconsistency in the access arrangement information in that two different values were identified for the proposed post tax nominal cost of equity, 12.74 per cent (sic) and 11.74 per cent. AGL stated that 'given these inconsistencies review of the proposed post tax WACC of 8.86% is warranted'.[90]

5.1.4 Assessment

The WACC is a measure of the total cost of capital, with the cost of debt and return on equity weighted in accordance with a benchmark capital structure. The WACC may be expressed on a post-tax, pre-tax or vanilla basis and within a nominal or real framework. Under the post-tax approach, tax liabilities are accounted for in the cash flows. In contrast, the pre-tax approach generally contains an allowance in the rate of return to cover tax liabilities.

Consistency with recent regulatory decisions

Anglo Coal has provided very little explanation for its proposed approach to estimating a rate of return to be used in determining the reference tariff. The ACCC, however, has found that Anglo Coal's parameter values are generally consistent with recent regulatory decisions and the code. This draft decision focuses on areas where the ACCC considers that Anglo Coal's proposals require amending, rather than providing a

[90] AGL submission, 19 March 2007, p. 2.

detailed explanation of proposed parameter values or methodology where the ACCC has concluded that Anglo Coal's proposals fully comply with code requirements. The ACCC's recent decision on the Roma to Brisbane Pipeline (RBP) provides a detailed explanation of these matters.

Post-tax methodology

Anglo Coal has used a post-tax revenue model to calculate its proposed WACC with the allowance for corporate tax determined through the cash flows. The proposed WACC is expressed on a nominal post-tax basis. The ACCC considers that this approach is broadly consistent with s. 8.30 of the code.

AGL has identified an inconsistency in the value for the post-tax nominal cost of equity. In section 3 of the proposed access arrangement information Anglo Coal has stated two values for the cost of equity, 12.64 and 11.74 per cent.[91] The latter figure is consistent with the revenue model submitted with the proposed access arrangement. As the ACCC is proposing changes to the parameter values that result in a different estimate of the post-tax nominal cost of equity it considers that no separate amendment is warranted to remove this inconsistency, which it expects to be corrected in response to this draft decision.

Parameter values

The values attributed to a number of parameters used to calculate the proposed WACC are consistent with those values determined in recent regulatory decisions such as the ACCC's final decision for the RBP revised access arrangement.[92] These values relate to the equity beta, market risk premium, debt to equity ratio, corporate tax rate and value of imputation credits.

The ACCC identified concerns in its RBP decisions that the proposed parameter values for equity beta (1.0) and market risk premium (6.0 per cent) may be higher than warranted given recent market data. However, it concluded that those values were still appropriate given factors such as proposed developments affecting the regulatory regime. On balance, the ACCC considers that the parameter values proposed by Anglo Coal for the equity beta, market risk premium, debt to equity ratio, corporate tax rate and value of imputation credits are consistent with the requirements of the code for the DVP.

While Anglo Coal has proposed an effective tax rate of 30 per cent (the corporate tax rate) the effective tax rate is not used as an input to the WACC calculation under a post-tax framework. The proposed value of this parameter is unnecessary to this calculation as the required return on capital is generated independently of the effective tax rate. Anglo Coal has not used the effective tax rate in the WACC calculation.

The proposed revenue model indicates that the values proposed by Anglo Coal for the nominal and real risk free rates are based on a 20 day average of nominal and indexed bond rates for the period to 30 June 2006. Anglo Coal's estimate of the inflation rate

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91 AAI, section 3, p. 6.

92 ACCC, *Final Decision*: *Revised access arrangement by APT Petroleum Pipelines Ltd for the Roma to Brisbane Pipeline*, 20 December 2006, p. 120.

was calculated from these bond rates, using the Fisher equation. This approach is likely to be consistent with the requirements of the code. However, Anglo Coal has not provided an explanation of the methodology it has adopted in its access arrangement or access arrangement information and the ACCC has not replicated Anglo Coal's proposed parameter values.

Section 8.30 of the code requires that the rate of return be commensurate with prevailing market conditions. As conditions have changed since 30 June 2006, Anglo Coal's proposed values need to be revised using more up to date market data. Consistent with its understanding of Anglo Coal's proposal, the ACCC proposes using a 20 day average sampling period and 10 year Commonwealth Government bond rates to estimate the risk free rate and inflation. The ACCC's reasons for considering that such an approach is consistent with the requirements of the code were detailed in its final decision on the RBP revised access arrangement.[93]

For the purposes of this draft decision, the ACCC sampled a 20 day moving average yield on government bonds to 14 May 2007 to estimate relevant parameter values. The ACCC proposes to adopt the same approach for the final decision, using updated bond rate data at that time.

The estimate of the cost of debt margin should also be updated using current market data. Anglo Coal did not identify the methodology it used to determine an estimate of the cost of debt margin. Regulatory decisions have generally used information from CBA Spectrum or, more recently, Bloomberg for these estimates. For the purposes of this draft decision the ACCC has used Bloomberg data for daily average yields of the 10 year BBB rated corporate bonds traded on the Australian market. The same sampling period as used to determine the risk free rate was taken.

As a result of the variations to the cost of debt and the nominal risk free rate, the estimate of the nominal cost of debt margin has been also revised.

The estimates of the nominal return on equity and the nominal vanilla WACC have been revised to reflect the updated risk free rate and cost of debt values. The ACCC proposes a nominal return on equity of 11.97 per cent and a nominal vanilla WACC of 9.08 per cent.

This methodology will be applied again at the time of the final decision to ensure that the various parameter values are the 'best estimates arrived at on a reasonable basis' and are consistent with the code.

[93] ACCC, Final Decision: RBP, p. 93.

Table 5.2: Draft decision CAPM parameters and WACC

Parameter		
Nominal risk free rate	r_f	5.97%
Real risk free rate	rr_f	2.70%
Inflation	f	3.19%
Debt to equity ratio	D:E	60:40
Cost of debt margin	DM	1.18%
Nominal cost of debt	r_d	7.15%
Corporate tax rate	T_c	30.0%
Value of imputation credits	γ	50.0%
Market risk premium	MRP	6.0%
Equity beta	β_e	1.0
Cost of capital		
Nominal return on equity	r_e	11.97%
Nominal vanilla WACC		9.08%

Source: ACCC.

Proposed amendment 4

In order for the DVP access arrangement to be approved, Anglo Coal must incorporate the parameter values included in Table 5.2 in its access arrangement. A nominal vanilla WACC of 9.08 per cent must be used as the rate of return.

6. Revenue elements

6.1 Non capital costs

6.1.1 Code requirements

The stream of revenue earned by a service provider should provide the opportunity for the service provider to recover the efficient non capital costs of providing the reference services.

Specifically, ss. 8.36 and 8.37 of the code allow for the recovery of all non capital costs that a prudent service provider, acting efficiently and in accordance with accepted and good industry practice to achieve the lowest sustainable cost, would incur in providing the reference service. Non capital costs are the operating, maintenance and other non capital costs incurred in providing the reference service. They may include, but are not limited to, costs incurred for generic market development activities aimed at increasing long–term demand for the delivery of the reference service.

The regulator must also be satisfied that any forecasts used in setting the reference tariff represent best estimates arrived at on a reasonable basis (s. 8.2(e) of the code) and that the non capital costs comply with the general reference tariff principles in s. 8.1.

6.1.2 Proposal

Anglo Coal proposed non capital costs for the DVP based on actual budget information. No contingency amounts are included and the costs are for a 'typical' year of operation.

Direct costs are not expected to vary with any change in the throughput of the pipeline over the access arrangement period.[94] Accordingly, Anglo Coal has forecast total annual direct costs of $163 000 to apply to each year of the proposed access arrangement period in real terms. This total represents $116 000 for direct labour and $47 000 for direct materials.[95]

The indirect costs relate to the share of general overheads for Anglo Coal (Dawson Management) Pty Ltd and Anglo Coal Australia Pty Ltd that are incurred in 'maintaining, monitoring and administering the DVP, Access Arrangement and customers.'[96] These costs are not expected to vary over the course of the proposed access arrangement period. The indirect costs total $488 000 in 2006-07 and are forecast to remain constant in real terms over the duration of the access arrangement period.[97]

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94 In any event, a constant throughput has been forecast.

95 AAI, section 4, p. 7.

96 ibid.

97 ibid.

A more detailed breakdown of the proposed non capital costs has been provided to the ACCC on a confidential basis. Upon request, Anglo Coal also provided additional information regarding the cost allocation method used for overheads. In essence, a percentage of overhead costs for the two businesses has been allocated to the DVP. Anglo Coal has stated that it considers this approach to be fair and reasonable as:

- due to the recent purchase of the DVP, it does not have any actual data on which to base forecasts
- there was no specific recording of time spent on certain activities relevant to the DVP and other business activities, and
- the individual relevant staff have advised of their expected time to be allocated to the DVP.

In Anglo Coal's opinion, the approach adopted is consistent with the objectives of s. 8 of the code. [98]

The table below sets out the non capital costs as proposed by Anglo Coal for 2006-07 in real (2006-07) dollars. For the purposes of the revenue model the elements are escalated by forecast inflation in each subsequent year. Anglo Coal proposed a forecast inflation rate of 3.2 per cent.

Table 6.1: Proposed non capital costs, 2006-07

	$
Direct labour	116 000
Direct materials	47 000
Total direct non capital costs	163 000
Indirect non capital costs	488 000
Total non capital costs	651 000

Source: AAI, p. 7.

6.1.3 Submissions

The level of proposed overhead costs has attracted comment from interested parties. Molopo noted that the total indirect non capital costs of $488 000 represents $0.167/GJ or 40 per cent of the proposed reference tariff. It also noted that the indirect costs are 'some three times the annual cost of operating and maintaining the DVP'.[99] Molopo concluded that in its view the 'proposal is extreme and unsustainable'. [100]

98 Minter Ellison letter to ACCC, 18 April 2007, pp. 1-2.

99 Molopo submission, 9 March 2007, p. 3.

100 ibid.

Molopo also commented that it expected regulatory costs to be approximately $120 000 to $180 000, a small share of the proposed overhead costs, and that this cost would not recur annually.

Molopo commented that to include an amount relating to the marketing and administration of customers was unreasonable since Anglo Coal, as indicated from the forecast demand information, does not have an expectation of market growth.[101]

WestSide also expressed concern over the proposed overheads. It also noted that the indirect costs are three times the level of the proposed operating costs. It suggested that this was

> … likely to be the result of an arbitrary allocation of corporate overheads from related or associated companies. For allocated Overheads to be admissible as valid costs to be defrayed, the full detail of those costs should be provided in a way which demonstrates the direct linkage of the DVP operation.[102]

This view was supported by Sunshine Gas.

6.1.4 Assessment

Total costs

Both Molopo and WestSide commented that total non capital costs were, in their opinion, excessive. In response, Anglo Coal stated that it considers the proposed costs are a true representation of the costs that would be incurred to provide services. It also stated that as a short pipeline, the DVP would experience some diseconomies in operations. Anglo Coal stated that its proposed total non capital costs are 'broadly comparable' to the costs for the Tubridgi, Riverland and Mildura pipelines.[103] However, each of these pipelines is at least three times the length of the DVP.

Indicative total operating costs for pipelines are used in the industry when investigating new pipeline opportunities. A major Australian pipeline owner and operator submitted to the ACCC in 2006 that, as a percentage of asset replacement cost, indicative total operating expenses (excluding compressor fuel costs) are 1.5 per cent for a large pipeline, 2 per cent for an average pipeline and 2.5 per cent for a small pipeline. In this context, the APA Group submitted that the best indicator of asset replacement cost is ORC.[104] AGL Pipelines (NSW) Pty Ltd had identified the same indicative 'rule of thumb' in 1998 based on its 'experience constructing and operating pipelines'.[105]

In addition, the ACCC previously noted that it considered that operating costs, including compressor fuel, would be expected to be approximately two per cent of

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101 ibid, pp. 3-4.

102 WestSide submission, 21 March 2007, p. 2.

103 Anglo Coal submission (response to WestSide), 20 April 2007, p. 3.

104 APT Petroleum Pipelines Limited, *Access arrangement information for Roma to Brisbane Pipeline*, 31 January 2006, p. 33.

105 AGL Pipelines (NSW) Pty Ltd, *Access arrangement information for the Central West Pipeline*, December 1998, p. 23.

capital assets employed for uncompressed pipelines and five per cent for compressed pipelines with total capital assets employed being measured by ORC.[106]

Using these 'rules of thumb', and the proposed ORC of the DVP of $9.169 million (in third quarter 2006 dollars), the indicative total non capital costs for the DVP would be between $183 000 and $230 000 (in 2006 dollars). These estimates are significantly less than the proposed total non capital costs of $651 000 which is 7.1 per cent of the proposed ORC.

The ACCC has also considered this performance indicator for a number of access arrangement approval processes which are set out in the table below for a sample of pipelines.

Table 6.2: Non capital costs as a percentage of ORC

Pipeline	Non capital costs as % of ORC
Large pipelines	
Moomba to Adelaide	2.41
Moomba to Sydney	1.82
Dampier to Bunbury	2.18
Goldfields Gas	3.20
Roma to Brisbane	2.05
Small pipelines	
Central West	2.77
Riverland[(a)]	3.48
Mildura[(a)]	3.43

Source: ACCC, Final Decision: RBP, p. 230; ACCC calculations.
Note: (a) These calculations are based on proposed costs. Coverage of these pipelines was revoked prior to the establishment of the access arrangements.

The ACCC sought expert advice from RCC in relation to Anglo Coal's proposed non capital costs for the DVP. RCC accepted that for the DVP 'certain economies of scale and scope are absent due to its short length'.[107] Nevertheless, the report stated that the proposed total non capital costs were excessive and as, in RCC's opinion, direct costs appeared reasonable, this was the result of corporate overheads. RCC advised that, based on conservative views on benchmark information and allowing for the particular circumstances of the DVP, reasonable total annual non capital costs for the DVP would be $300 000 (for 2006-07).[108]

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106 ACCC, *Final Decision: Access arrangement proposed by Epic Energy South Australia Pty Ltd for the Moomba to Adelaide Pipeline System*, 12 September 2001, p. 57.

107 RCC report, April 2007, p. 18.

108 ibid, p. 15.

In addition, Unidel has advised that in its opinion, the proposed allowance for Anglo Coal's non capital costs is relatively high due to the overheads component.[109]

It is apparent from the general 'rule of thumb' indicators used by the industry, the performance indicators relating to selected pipelines and information from consultants that the proposed total non capital costs for the DVP are significantly higher than what would be expected from industry experience. The degree to which the proposed DVP costs are greater than the benchmarks suggests that the proposed total non capital costs are not consistent with the code requirement to be prudent and efficient costs incurred in accordance with accepted good industry practice.[110]

The value of $300 000 for total non capital costs noted above represents 3.3 per cent of the ORC proposed for the DVP. This is higher than the 'rule of thumb' indicators and the measures for the majority of pipelines identified in Table 6.2 above.[111] The ACCC has concluded that total non capital costs of $300 000 (for 2006-07) would be a conservative estimate of appropriate total non capital costs for the DVP which would be consistent with the requirements of the code.

In addition to considering the total non capital costs proposed by Anglo Coal, the proposed direct and indirect costs have been assessed separately.

Direct costs

Anglo Coal provided a breakdown of direct costs on a confidential basis to the ACCC. The ACCC is satisfied that this information should be treated as being confidential given the nature and level of detail provided. Both consultants to the ACCC have reviewed the detailed direct cost items and the relevant amounts. RCC has advised that the direct costs are likely to be appropriate in terms of code requirements.[112] Unidel considers that the proposed operating costs have been estimated by a sound approach and in accordance with industry rules of thumb.[113]

The ACCC considers 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. However, although additional information has been provided to the ACCC regarding direct and indirect costs, the allocation of tasks and costs between the two categories is unclear.

Molopo's submission implies that the forecast marketing costs are too high and notes that Anglo Coal does not anticipate achieving any growth in demand or customers over the access arrangement period.

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109 Unidel report, 30 April 2007, p. 10.

110 See s. 8.37 of the code.

111 While $300 000 represents a slightly smaller share of ORC than that calculated for the Riverlands and Mildura pipelines, the indicators for these pipelines have been calculated from proposed data rather than data approved by a regulator.

112 RCC report, April 2007, p. 14.

113 Unidel report, 30 April 2007, p. 9.

Subsequent information provided to the ACCC on a confidential basis reveals that to date there have been no costs incurred for marketing activities related to the DVP.[114] However, Anglo Coal did not reveal what, if any, marketing expenses it has included in its forecast non capital costs although it did note that it regards 'marketing costs' as capturing a broad range of costs.[115]

While Anglo coal did not identify its forecast regulatory costs, Molopo commented on its expectations about the level of these and the likely frequency. The ACCC agrees that the majority of regulatory costs would not be incurred annually. The annual tasks required of a service provider are, as noted by Anglo Coal, presently, reference tariff resets and ring fencing compliance reports.[116] These matters involve comparatively little expense. It is the ACCC's experience that these processes do not usually require the assistance of consultants or other external advisers. This is not inconsistent with past NCC comments (as highlighted by Anglo Coal) on total costs of regulation.[117]

Overall, the ACCC is satisfied that the proposed direct costs for the DVP are likely to be reasonable and satisfy the objectives of s. 8 of the code (providing that these costs cover all the tasks normally associated with direct costs).

The ACCC is also satisfied that the proposed amount for the first year of the access arrangement period is applied (with indexation) to each subsequent year on the basis that there are few costs that are influenced by variations in throughput and, in any event, the forecast throughput is flat over the access arrangement period.

Indirect costs

The level of indirect costs (or overheads) proposed by Anglo Coal has raised concerns for interested parties. Further information on these costs was provided to the ACCC on a confidential basis. The ACCC agrees that it is appropriate to treat the additional information provided as confidential. However, in the ACCC's view, this information does not address the concerns of interested parties that the proposed overheads are too high.

On the basis that the appropriate level of total non capital costs is $300 000 (as proposed by RCC and noted above) and of these the direct costs are $163 000 then the appropriate overhead costs would be $137 000. This is significantly less than Anglo Coal's proposed overhead costs of $488 000.

On this basis the ACCC is concerned that that Anglo Coal's proposed overhead costs are not consistent with the code. The level of overheads does not represent a cost that would be incurred by a prudent service provider acting efficiently and in accordance with accepted and good industry practice.

Anglo Coal did not provide a detailed explanation of its proposed methodology for allocating a share of joint overhead costs as part of it proposal. It subsequently advised

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114 Minter Ellison letter to ACCC, 18 April 2007, p. 2.

115 Anglo Coal submission (response to Molopo), 13 April 2007, p. 5.

116 ibid, p. 5.

117 ibid, p. 5.

that the allocation was based on 'management time and effort'. It also explained that it considered this approach was consistent with the objectives of s. 8 of the code.

The ACCC considers that such an approach may in principle provide a reasonable basis for allocating management costs. However, there can be major one off costs for management when a service provider first addresses its regulatory obligations that are unlikely to be on-going. The ACCC acknowledges that Anglo Coal has stated that the costs are for a representative year. However, it was reliant on staff estimated time to determine overheads. The ACCC considers that despite best efforts, staff inexperienced with regulatory processes and, in particular, the ongoing relationship between the regulated entity and the regulator, may report an over estimate of time due to the substantial time and effort recently spent on regulatory matters.[118] Anglo Coal has not provided any information to demonstrate that its proposed allocation is likely to accurately reflect 'management time and effort' over the proposed duration of the access arrangement period.

More importantly, 'management time and effort' is unlikely to provide a reasonable indication of broader costs. There is likely to be a range of drivers of overhead costs which do not coincide with those of 'management time and effort'. Anglo Coal has not provided any information to demonstrate that the proposed allocation accurately reflects overheads incurred by the pipeline operations.

The ACCC accepts that the circumstances of the DVP (being part of a larger business producing, transporting and selling CSM) may make it difficult to estimate its non capital costs. However, it considers that the proposed approach is flawed and unlikely to result in a reasonably accurate estimate. Moreover, as noted above, Anglo Coal's proposed allowance for non capital costs is much higher than would be consistent with general gas transmission industry practice even if allowance is made for the diseconomies that may arise from operating a small pipeline. Anglo Coal's forecast non capital costs are unlikely to be estimates arrived at on a reasonable basis as required by s. 8.2(e) of the code.

In conclusion, the ACCC is not satisfied that the proposed indirect costs, or overheads, are reasonable. The ACCC considers that in the absence of information from Anglo Coal, the benchmark information discussed above should be used to provide Anglo Coal with an amount of overhead costs that satisfies the objectives of s. 8 of the code.

Accordingly, the ACCC proposes that the following amendment be made to the DVP access arrangement.

[118] Initial access arrangement approval costs include costs such as for establishing the ICB that will not recur. In addition, Anglo Coal recently proposed (and the ACCC agreed) that certain ring fencing obligations be waived. This process would have required significant management involvement that is unlikely to be on-going. The waivers would be expected to substantially reduce expected on-going regulatory costs.

Proposed amendment 5

In order for the DVP access arrangement to be approved, Anglo Coal must include total non capital costs of $300 000, with indirect costs (overheads) of $137 000 (for 2006-07) in its calculation of total revenue.

6.2 Inflation

6.2.1 Code requirements

Section 8.5A of the code provides that the amount of total revenue can be determined under a nominal or real approach or 'on any other basis in dealing with the effects of inflation' provided that it is specified in the access arrangement, approved by the regulator, and applied consistently.

The regulator must also be satisfied that any forecasts used in setting the reference tariff represent best estimates arrived at on a reasonable basis (s. 8.2(e) of the code).

6.2.2 Proposal

The proposed access arrangement information states that the total revenue is calculated under a nominal approach, as provided by s. 8.5A of the code.

The approach used to determine the reference tariff over the access arrangement period is essentially a price path with annual CPI-X adjustment. While the tariff path uses a forecast inflation rate, reference tariffs will be adjusted for actual inflation during the course of the access arrangement period.[119]

For the purposes of its proposed access arrangement and access arrangement information, Anglo Coal has used a forecast inflation rate of 3.2 per cent for the tariff path, calculation of WACC and the escalation of certain costs.[120]

6.2.3 Submissions

No submissions were received on this aspect of the proposed access arrangement.

6.2.4 Assessment

The ACCC has confirmed that the revenue model provided by Anglo Coal utilises a nominal framework in the manner described above. The nominal framework has been applied in a consistent manner across the various elements such as the rate of return, the calculation of costs and depreciation.

The use of a nominal framework rather than a real one does not impact on the total revenue for the access arrangement period. There is some benefit of simplicity in terms

[119] AAI, section 2, p. 4.

[120] For example, non capital costs. AAI, section 4, p. 7.

of using a nominal framework for the entire model as the calculation of tax liabilities must be carried out in nominal terms.

While the choice of nominal or real terms can be selected by the service provider, the code does require the regulator to be satisfied that estimates, of which forecast inflation is one, are the best estimates arrived at on a reasonable basis.

Anglo Coal has not identified the methodology it has applied in proposing an annual inflation adjustment of 3.20 per cent. The ACCC considers that an up to date estimate is required to satisfy the requirements of the code. As discussed in section 5.1.4 of this draft decision, the ACCC considers that the best estimate of forecast inflation for the proposed duration of the access arrangement is currently 3.19 per cent.

As there is a period of time between this draft decision and the final decision, the rate of forecast inflation will be recalculated for the final decision in the same manner as for this draft decision. This will ensure that it remains a best estimate arrived at on a reasonable basis, satisfying the code requirements.

6.3 Volumes

6.3.1 Code requirements

Section 8.2(e) of the code requires that any forecasts required in setting the reference tariff represent best estimates arrived at on a reasonable basis.

6.3.2 Proposal

Anglo Coal proposed a forecast of 2.92 PJ per year for the years 2006-07 to 2015-16 inclusive.[121] With the assumed load factor of 100 per cent, this is equivalent to 8 TJ per day.[122]

As the DVP has a maximum capacity of approximately 11 PJ per year, the forecast annual throughput is approximately 27 per cent of total nominal pipeline capacity. As discussed in section 4.1.4 of this draft decision, Anglo Coal subsequently submitted that while the theoretical capacity of the pipeline is 30 TJ/day, the actual maximum capacity using current equipment is 22-24 TJ/day. The proposed throughput is approximately one third of this revised capacity.

These forecast volumes relate to the reference service of firm forward haul. They reflect Anglo Coal's own expected usage of the pipeline. Anglo Coal is currently the only user of the DVP.[123] It does not expect that situation to alter in the foreseeable future.[124]

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121 AAI, section 5, p. 8.

122 Anglo Coal considers that a 100% load factor is an appropriate assumption for the future given the recent performance of the pipeline. Minter Ellison letter to ACCC, 18 April 2007, p. 2.

123 AAI, section 1, p. 3.

124 Anglo Coal, *Confidential supporting information*, 5 February 2007, p. 2.

6.3.3 Submissions

Little comment has been received in regard to the forecast demand for the DVP over the proposed access arrangement period although parties have noted that it appears to be significantly less than the capacity of the pipeline.[125] WestSide suggested that information on current and forecast throughput by user would be valuable in understanding Anglo Coal's proposal.[126]

More specifically, AGL has stated that it regards it as 'possible that activity in the Moura, Mungi and Dawson Valley coal seam fields will increase over the medium term'.[127] This is based on:

- the general continuing development of Queensland CSM
- the prospect of more wells being sunk in the nearby fields
- the delay of the PNG pipeline (which would have provided an alternative supply to CSM), and
- the overall increasing demand for gas in Queensland.

6.3.4 Assessment

The ACCC understands that the forecast demand is based on the service providers' appraisal of the market and their expectations for the medium term. As the owners of the DVP are also CSM producers, and at present the sole user of the pipeline, they are likely to have a good understanding of the factors that will affect demand for the services of the DVP over the access arrangement period.

The forecast demand reflects the owners' usage of transportation services needed for its own supply of gas and that supplied by the Lowell-Helm Joint Venture. The service providers have indicated that they do not expect any new users to emerge during the proposed access arrangement period. Nor do they expect any other circumstances to arise where more gas will be transported on the DVP over this period.

Nevertheless, AGL has noted the overall demand for gas in Queensland and the increasing development, and importance, of CSM. In 2000, CSM production was approximately 2 PJ per year which was less than five per cent of Queensland's gas needs. It is expected that in 2007 CSM will supply approximately 65-70 per cent of Queensland's gas.[128]

While there is an expectation that CSM will continue to play an increasing role in meeting Queensland's gas needs, the ACCC must consider these expectations with

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125 The capacity of the DVP itself has attracted some comment. This matter is considered in chapter 4 of this draft decision as part of the determination of the initial capital base.

126 WestSide submission, 21 March 2007, p. 2.

127 AGL submission, 19 March 2007, p. 1.

128 Queensland Department of Mines and Energy, *Gas in Queensland*, 31 October 2006, viewed 1 March 2007, <http://www.energy.qld.gov.au/gas_in_queensland.cfm>

particular reference to the DVP. Molopo has advised that it regards upstream demand from the region to be higher than the proposed 2.9 PJ/year. Molopo's development plans for its interests in three permits in the region anticipate demand rising.[129]

The ACCC understands that local demand for gas is limited and this is likely to remain the case. The only significant gas user in the area is Queensland Nitrates Pty Ltd. This business operates an ammonium nitrate facility near Moura and uses approximately 3 PJ/year. The majority of gas sold and transported via the DVP and the AMP is for use in Gladstone.

In addition to the existing interested parties, the ACCC is aware that demand for services on the DVP could grow in the future.[130] It notes that since the NCC coverage process in 2005, expectations of the demand in the Dawson Valley area and the use of the DVP appear to have improved. In 2005 the NCC stated that 'the Council considers that the maximum foreseeable demand is unlikely to exceed 6.5 PJ per annum over the next 15 years'.[131]

WestSide has indicated that it, with its partner Sunshine Gas, will be commencing a CSM appraisal program in a tenement located near the DVP. It has stated that if this is successful, it will be seeking to transport gas to the Wallumbilla to Gladstone Pipeline via the DVP.[132]

The plans of WestSide and Sunshine make them potential users of the DVP. However, at this stage, their CSM production and marketing capabilities are uncertain, and Anglo Coal has not included any potential usage of the DVP by these parties in the proposed forecast demand. While there is some risk that this assumption by Anglo Coal will result in its demand forecasts proving to be understated, the major event trigger discussed in section 8.7 of this draft decision would allow revised forecasts to be incorporated if actual demand is more than 25 per cent higher than forecast.

The ACCC considers that, while there are differences of opinion about likely demand for the services of the DVP over the access arrangement period and beyond, its owners are likely to have a good understanding of the drivers behind that demand. The ACCC is not aware of any reason to suggest that the forecasts are not sound or that they are biased in either direction. In any event, as noted above, even if these forecasts prove to be incorrect, the trigger mechanism in the access arrangement provides an opportunity to review the DVP's demand in the future.

The ACCC has concluded that it is reasonable to regard the basis of the forecasts as sound and that the forecasts are reasonably likely to satisfy the code requirement of being the 'best estimates arrived at on a reasonable basis'. The inclusion of the trigger mechanism in the access arrangement provides a 'safety net' for users if demand forecasts prove to be substantially understated. Conversely, Anglo Coal can submit

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129 Molopo submission (confidential), 27 March 2007, p. 1

130 See RCC report, April 2007, pp. 15-16.

131 NCC, *Dawson Valley Pipeline coverage application under the national gas code: final recommendation*, August 2005, p. 21.

132 WestSide submission, 21 March 2007, p. 1.

revisions to the access arrangement prior to the revisions submission date if the demand forecasts prove to be substantially overstated. The ACCC proposes to accept the forecast demand information provided by Anglo Coal for the calculation of the reference tariff.

6.4 Revenue

6.4.1 Code requirements

Section 8.4 of the code states that the total revenue is to be calculated by one of three methodologies – cost of service, internal rate of return (IRR) or net present value (NPV). Whichever of these is used, it is to be applied in accordance with generally accepted industry practice.

While these methodologies are different ways of assessing the total revenue, their outcomes should be consistent. For example, it is possible to express any NPV calculation in terms of a cost of service calculation by the choice of an appropriate depreciation schedule. In addition, other methodologies (such as a method that provides a real rate of return on an inflation-indexed capital base) are acceptable under s. 8.5 of the code provided they can be expressed in one of these forms.

6.4.2 Proposal

The proposed reference tariff policy states that the reference tariff has been derived by a price path approach based on the application of the NPV methodology.[133]

In addition, the proposed access arrangement information states that total revenue has been determined under an NPV methodology. A nominal approach has been adopted such that total revenue is based on a nominal rate of return applied to a nominal capital base. Depreciation, capital costs and non capital costs are all expressed in nominal terms.[134]

The table below sets out the revenue elements as proposed by Anglo Coal for 2006-07 in real (2006-07) dollars. For the purposes of the revenue model the elements are escalated by forecast inflation in each subsequent year. Anglo Coal proposed a forecast inflation rate of 3.2 per cent.

[133] AA, section 5, p. 10.

[134] AAI, section 2, p. 4.

Table 6.3: Proposed total revenue, 2006-07

	$
Return on assets	677 000
Depreciation	-84 000
Non capital costs	651 000
Total revenue	1 244 000

Source: Anglo Coal revenue model.

6.4.3 Submissions

No submissions have been received on the total revenue proposed by Anglo Coal.

6.4.4 Assessment

The total revenue is determined by the various elements. Each of the revenue elements has been assessed by the ACCC and incorporated in the revenue model. As some elements will change at the time of the final decision, the total revenue for the DVP will be calculated again at that time. Nevertheless, the table below provides an indication of the total revenue proposed by the ACCC for the DVP for 2007-08, the first year of the access arrangement period.

Table 6.4: Draft decision total revenue, 2007-08

	$
Return on assets	690 000
Depreciation	-83 000
Non capital costs	310 000
Total revenue	916 000
Smoothed total revenue	893 000

Source: ACCC.

As discussed in section 3.2.4 of this draft decision, it is the ACCC's assessment that Anglo Coal has proposed a cost of service approach rather than the NPV approach described in its access arrangement information. The ACCC considers that, in principle, Anglo Coal's approach is consistent with code principles.

The ACCC's assessment of Anglo Coal's proposal is that various elements of its proposed costs do not comply with code requirements. Accordingly, it has proposed a number of changes to be made to these costs. As a consequence, an amendment is required to Anglo Coal's proposed total revenue.

Proposed amendment 6

In order for the DVP access arrangement to be approved, Anglo Coal must revise its proposed revenue consistent with this draft decision.

6.5 Revenue modelling

Anglo Coal provided the ACCC with a model which calculates the proposed revenue requirement. Anglo Coal has requested that the model be considered to be confidential and the ACCC has agreed.

The model provides forecast cash flow and tariffs over the life of the access arrangement, based on its assumptions concerning matters such as the ICB, the remaining life of the pipeline, rate of return on capital, non capital expenditure, inflation, corporate tax rate and throughput volumes. The forecast cash flow and tariffs are on a nominal basis.

The ACCC has audited this model and has found some errors and some other areas where it considers adjustments are appropriate.

For example, Anglo Coal's projected cash flow starts in the financial year 2006-07. To coincide with the start of the access arrangement the projection should start at the financial year 2007-08. This adjustment means that the cash flow projection is over 9 years instead of 10 years corresponding to the initial access arrangement period. The expected remaining life of the pipeline is altered from 50 to 49 years.

The ACCC has discussed most of these matters with Anglo Coal which subsequently provided a revised model which addressed most of the issues raised at that time. The ACCC will provide Anglo Coal with the ACCC's amendments to Anglo Coal's model along with this draft decision.

As discussed in section 3.2.4 of this draft decision, Anglo Coal has described the total revenue being calculated in the revenue model as being based on the NPV methodology although it is based on the cost of service methodology where total revenue is the sum of return on capital, the depreciation of the capital base and non capital costs. Relevant proposed amendments to the access arrangement are included in section 3.2.4 of this draft decision.

7. Reference tariffs

7.1 Cost allocation and tariff structure

7.1.1 Code requirements

Section 8.38 of the code requires that reference tariffs should, to the maximum extent that is commercially and technically reasonable, recover costs directly attributable to the reference service and a fair and reasonable share of joint costs while meeting the objectives of s. 8.1 of the code. Section 8.42 requires that recovery of a particular user's contribution to revenue also follows these principles. These requirements must be met, regardless of the methodology used to calculate total revenue.

7.1.2 Proposal

Anglo Coal is proposing one reference service to be offered on the DVP. All of the total revenue is allocated to the reference service over the access arrangement period. In determining the total revenue no allowance has been made for revenues derived from charges other than the reference tariff as Anglo Coal considers those revenues to be immaterial.[135]

All costs are allocated to the reference service over the access arrangement period. These include all direct costs attributed to the DVP and an allocation of joint costs shared with the CSM production business. Anglo Coal states that the costs of providing the reference service are fixed and do not vary with the quantity of gas transported as there is no compression. [136] It has not proposed any allocation of costs between users or categories of users.

The proposed reference tariff consists solely of a capacity charge based on forecast maximum daily quantity (MDQ) volumes. Anglo Coal has not differentiated between classes of potential customers or implemented a commodity element to its tariff structure. The tariff is structured on a single zone, or postage stamp, basis reflecting the short length of the DVP and Anglo Coal's desire to have a simple and transparent pricing approach.

7.1.3 Submissions

No submissions were received on this aspect of the proposed access arrangement.

7.1.4 Assessment

In view of the expected level of usage of the DVP over the access arrangement period, the ACCC agrees with Anglo Coal that revenues accrued from other charges (such as for overruns) are not likely to be material. Accordingly, the ACCC proposes to accept

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135 ibid.

136 ibid.

this aspect of Anglo Coal's proposal. This approach can be reassessed at the next access arrangement review process when the service providers will have a record of other revenues received over an extended period of time.

A related issue is whether all the claimed costs have been correctly allocated to the covered pipeline and included in the calculation of the reference tariff. This is a particularly important consideration in this instance as the DVP is part of a much larger operation that mainly produces CSM and a substantial portion of the claimed costs have been determined on the basis of Anglo Coal's proposals for sharing joint costs. These cost allocations are considered as part of the assessment of capital costs (chapter 4) and non capital costs (chapter 6).

In relation to s. 8.42 of the code, Anglo Coal has proposed one reference service with a single reference tariff for the length of the pipeline (that is, a single zone). However, there are two delivery points on the pipeline – at the end (at the Wallumbilla to Gladstone Pipeline) and at the middle (for the Queensland Nitrates plant). The Queensland Nitrates plant is not a direct user of the DVP. It currently has a long term contract with AGL which buys a bundled product from the DJV, the only user of the DVP. Presently there is no indication that there would be any other party requiring delivery of gas near the nitrates plant or at any other point along the DVP (except for the delivery of gas to the Wallumbilla to Gladstone Pipeline).

Under these circumstances, and as the pipeline is relatively short (47 km), the ACCC considers that a single tariff zone is more appropriate than alternatives such as distance based pricing which would seem unnecessarily complicated.

The ACCC also considers that the proposed allocation of revenues between services and users is consistent with the provisions of the code to the extent that is commercially and technically reasonable.

7.2 Tariff path

7.2.1 Code requirements

As discussed in section 3.2 of this draft decision, s. 8.3 of the code provides discretion to service providers in how the reference tariffs may be varied during an access arrangement period. The service provider may elect to use a price path approach, a cost of service approach, a reference tariff control formula approach, a trigger event adjustment approach or any variation or combination of these methods.

Section 8.3A of the code states that reference tariffs may vary within an access arrangement period only through the implementation of the approved reference tariff variation method as provided for in ss. 8.3B to 8.3H.

7.2.2 Proposal

Anglo Coal stated that it has adopted a price path approach where the reference tariffs are to follow a path determined to deliver the forecast total revenue over the access arrangement period. [137]

The proposed initial reference tariff for the year ending 30 June 2007 is $0.406/GJ (excluding GST).[138]

The reference tariffs for each of the remaining years of the access arrangement period will be adjusted in accordance with the CPI-X formula.[139]

The tariff path proposed by Anglo Coal indicates a constant tariff in real terms over the access arrangement period (that is, the proposed value for X is zero).

7.2.3 Submissions

First, in relation to the reference tariff path, WestSide expressed concern regarding the proposed full CPI escalation of the reference tariff. It suggested that an escalation rate of 50 per cent would be more appropriate.[140] In response, Anglo Coal noted that input cost pressures for the mining industry have been significant in recent years and if these pressures were to continue the full CPI escalation would not ensure that the reference tariff recovered efficient costs in the future.[141]

Comments were also made on the level of the reference tariff proposed.

Molopo stated that 'the proposed Reference Tariffs are several times more than has been historically charged for a firm service'. According to Molopo, historically it has been charged $0.135/GJ ('firm gas') to $0.182/GJ ('non firm gas'). Molopo stated that it is currently paying around $0.19/GJ for the 'non firm' service.[142] In a further submission Molopo clarified that this was the tariff it was paying to Anglo Coal and Mitsui several months earlier, before the contract it had with the previous pipeline owner (OCA) had expired.[143]

Molopo contrasts these historical charges with the reference tariff of $0.406/GJ proposed by Anglo Coal which is based on reserved capacity. Molopo noted that the actual cost of transporting gas will be dependent upon the load factor. It cited examples of a load factor of 90 per cent giving an effective tariff of $0.45/GJ, and a load factor of 80 per cent giving an effective tariff of $0.51/GJ.

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137 ibid. As discussed in section 3.2.4 of this draft decision the approach also combines elements of the cost of service and trigger event approaches.

138 AA, section 4.1, p. 7.

139 ibid.

140 WestSide submission, 21 March 2007, p. 2.

141 Anglo Coal submission (response to WestSide), 20 April 2007, pp. 3-4.

142 Molopo submission, 9 March 2007, p. 4.

143 Molopo submission (confidential), 27 March 2007, p. 3.

Molopo further states that '[t]he enormity of the tariff increase sought by the present owners of the DVP demonstrates that the Minister for Industry, Tourism and Resources' 10 May 2006 decision (that the DVP should be covered by the Code) was well grounded'.

In conclusion, Molopo envisages that the reference tariff when established in accordance with the code, will be below the level charged historically for use of the pipeline. [144]

WestSide also expressed reservations about the level of the reference tariff. WestSide submitted that the level of the proposed tariff is much higher than would be reasonable on a benchmark basis, creating a barrier to competition and discouraging the efficient use of infrastructure.[145]

WestSide stated that 'the proposed Reference Tariff appears disproportionately high in comparison with tariffs charged for access to other pipelines, and at the level proposed would provide a significant impediment to the development and commercialisation of gas resources in the region'.[146] WestSide submitted that at the proposed tariff level potential producers may find it economic to build and operate their own pipeline. This WestSide argued would 'only serve to reinforce underutilised capacity and industry wide inefficiency.' It also stated that inefficient and underutilised assets lead to increased costs and act as an impediment to wider industry development and efficient competition.[147]

Sunshine Gas stated that it agrees with submissions made by Molopo and WestSide.[148]

7.2.4 Assessment

As discussed in section 3.2.4 of this draft decision, while Anglo Coal has described its form of regulation as a price path approach it also contains elements of a reference tariff control formula approach and a trigger event adjustment approach.

Once the price path has been determined, the reference tariff is varied at 1 July each year during the access arrangement period in accordance with the CPI-X formula. As Anglo Coal has proposed that the value of X would be zero, the tariff would be constant in real terms over the access arrangement period.

Molopo and WestSide have submitted that the proposed reference tariff is too high. Sunshine Gas submitted that it agrees with their views. The ACCC acknowledges these views. In particular, it considers that the overstated non capital costs proposed by Anglo Coal would result in a reference tariff that may deter the development of CSM fields in the Dawson Valley area.

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144 Molopo submission, 9 March 2007, p. 4.

145 WestSide submission, 21 March 2007, p .2.

146 ibid.

147 ibid, p. 3.

148 Sunshine Gas submission, 21 March 2007, p. 1.

Under the cost of service methodology proposed by Anglo Coal and accepted by the ACCC, the reference tariff is determined by dividing the total revenue by the forecast demand. As the ACCC has accepted Anglo Coal's demand forecasts but has proposed a number of amendments which will reduce the total revenue, the overall level of the reference tariff will be lower than that proposed by Anglo Coal.

In considering efficiency and equity concerns and the balancing of the service providers' interests with those of users and prospective users, there are in principle arguments for a tariff path that is either constant in real terms over the access arrangement period or declines slightly in real terms to reflect declining costs relative to output. In this instance, demand and real costs are forecast to remain constant over the access arrangement period. This suggests that Anglo Coal expects the input cost pressures it has identified will abate or that these will be offset by productivity improvements. The ACCC proposes to accept Anglo Coal's proposal that the reference tariff stay constant in real terms over the access arrangement period.

Anglo Coal has proposed an initial reference tariff for the year ending 30 June 2007, with CPI-X adjustments coming into effect each subsequent year on1 July. However, the ACCC expects that the access arrangement will be not be approved and come into effect until August 2007 with reference tariffs commencing at that time. Anglo Coal's proposal is inconsistent with this timing.

Accordingly, the ACCC proposes an amendment to alter the initial reference tariff to reflect the lower total revenue, and to be consistent with a constant real tariff commencing in the year ending 30 June 2008.

Proposed amendment 7

In order for the DVP access arrangement to be approved, Anglo Coal must amend the description of the reference tariff (section 4.1 of the access arrangement) to state that the reference tariff for the reference service for the year ending 30 June 2008 is $0.306/GJ of MDQ/day (excluding GST).

7.3 Tariff variation policy

7.3.1 Code requirements

Section 8.3 of the code states the manner in which a reference tariff may vary within an access arrangement period is within the discretion of the service provider. This is subject to s. 8.3A (reference tariff variation method) and the regulator being satisfied that methodology is consistent with the objectives of s. 8.1. The tariff variation methods open to the service provider are: cost of service; price path; reference tariff control formula; trigger event; and any variation or combination of these.

Further, s. 8.3A states that if a reference tariff varies within an access arrangement period then it must do so in accordance with the requirements and procedures set out in ss. 8.3B to 8.3H as follows:

- the service provider is required to provide a notice to the regulator if a special event occurs or it otherwise wishes to vary the reference tariff in accordance with the approved reference tariff variation method

- information must be provided by the service provider that sets out the proposed variation of the reference tariff and the effective date of those variations as well as providing an explanation of how the variations proposed are consistent with the approved reference tariff variation method

- before the effective date the regulator may disallow the variation of the reference tariff if it considers that the variation is inconsistent with the approved variation method

- if by the effective date the regulator has not provided notice to the service provider of its decision to allow or disallow the proposed reference tariff variation, then the reference tariff will automatically be varied

- once a decision is made by the regulator it must publish its reasons for either allowing or not allowing a reference tariff variation

- the regulator may vary the reference tariff itself if a specified event has occurred and the service provider has not provided notice of such an event occurring, and

- the regulator may grant time extensions on application by the service provider to any period of time in ss. 8.3B to 8.3G that applies to the service provider. It may also extend any time period in s. 8.3G that applies to the regulator.

7.3.2 Proposal

Anglo Coal proposed two mechanisms for varying the reference tariff during the access arrangement period.

The first mechanism or tariff variation method is the CPI-X formula. In this method the proposed reference tariff is to be adjusted on 1 July 2007 and on 1 July each year thereafter in accordance with the formula shown below.[149]

$$RT_n = RT_{n-1} \times \left\{ 1 + \left[\left(\frac{\text{CPI}_{\text{n-1}} - \text{CPI}_{\text{n-2}}}{\text{CPI}_{\text{n-2}}} \right) \times (1 - X) \right] \right\}$$

In this formula:

- $\text{CPI}_{\text{n-1}}$ means the value of the CPI for the March quarter in $\text{year}_{\text{n-1}}$

- $\text{CPI}_{\text{n-2}}$ means the value of the CPI for the March quarter in $\text{year}_{\text{n-2}}$

- RT_{n} means the Reference Tariff in year_{n}

[149] AA, section 4.1, p. 7.

- RT_{n-1} means the Reference Tariff in $year_{n-1,}$ and

- X has a value of zero implying a constant real tariff.

The second tariff variation method (which is a trigger event adjustment mechanism) is to adjust the reference tariff if there is a material change in the rate or amount of any new or existing impost (tax, duty, excise, levy or fee) during the access arrangement period.[150] Anglo Coal may adjust the reference tariff to recover from users any increase payable by Anglo Coal, or to refund users any reduction resulting from such a variation. Before adjusting the reference tariff, Anglo Coal must notify the regulator that a specified event under s. 8.3B of the code has occurred, specifying the proposed variations to the reference tariff and the effective date of these variations.

7.3.3 Submissions

AGL submitted that the formula adopted in the proposed access arrangement for increasing the reference tariff appeared to have some anomalies.[151] AGL did not specify what these anomalies were but queried the CPI formula used and the residual value of the asset base at the end of the access arrangement period.

WestSide submitted that 'the proposed 100% CPI escalation cannot be supported by pipeline access tariff precedents or the expected nature of the pipeline cost structure'.[152] WestSide suggested that 50 per cent would be a more appropriate CPI escalation rate after taking into account the recovery of capital costs already expended which it says are not affected by future CPI increases.

7.3.4 Assessment

Anglo Coal proposed a reference tariff variation method which incorporates a CPI-X price path and a trigger event adjustment mechanism within the initial access arrangement period. The ACCC considers that under the terms of the code, the proposal put forward by Anglo Coal represents a combined price path, reference tariff control formula and trigger event tariff variation methodology. The ACCC has assessed this approach and is of the view that such an approach is broadly consistent with the provisions set out in s. 8.3 of the code. However, the ACCC has a number of concerns with respect to the proposed reference tariff variation methodology.

Anglo Coal proposed that the reference tariff would be varied annually using a CPI-X formula with the initial adjustment to the reference tariff to be effective from 1 July 2007.[153] However, as discussed in section 7.2.4 of this draft decision, this timing is inconsistent with the expected completion of the access arrangement approval process. Accordingly, the ACCC proposes an amendment to alter the date of this adjustment to 1 July 2008.

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150 AA, section 4.8, p. 9.

151 AGL submission, 19 March 2007, p. 1.

152 WestSide submission, 21 March 2007, p. 2.

153 AA, section 4.1, p. 7.

Proposed amendment 8

In order for the DVP access arrangement to be approved, Anglo Coal must amend the description of the reference tariff (section 4.1 of the access arrangement) to state that:

'On 1 July 2008 and on 1 July each year thereafter, the reference tariff will be adjusted as follows:'

The above proposed amendment has been discussed with Anglo Coal. It has confirmed that it will implement this proposed amendment.[154]

Anglo Coal's proposed price path mechanism does not set out the approval method that is to be followed at each annual tariff variation and if a specified event occurs. Section 8.3A of the code requires that a reference tariff may only vary within an access arrangement period in accordance with the implementation of an approved reference tariff variation method.

In accordance with ss. 8.3B to 8.3H of the code and consistent with the method adopted in previous ACCC approved access arrangements, Anglo Coal must adopt the following amendments which set out provisions concerning the procedures to be followed to vary tariffs in accordance with its proposed reference tariff variation method consistent with its reference tariff control formula approach and when a specified event occurs.

Proposed amendment 9

In order for the DVP access arrangement to be approved, Anglo Coal must include the following provisions in section 4 of the access arrangement:

- Anglo Coal must provide a notice to the regulator of its proposed revised reference tariff in accordance with the reference tariff formula at least 30 days business days prior to 30 June for each year of the access arrangement period
- this notice must specify that the proposed variations to the reference tariff applies from 1 July of the relevant year
- the regulator will assess the proposed reference tariff provided by Anglo Coal and determine if they comply with the relevant CPI-X formula. The regulator will publish its decision at least 10 business days before 1 July of each year of the access arrangement period.
- if the regulator does not provide a notice at least 10 business days before 1 July, the regulator will be taken to have approved the revised reference tariff, which will come into effect on 1 July of the relevant year
- in the period before 10 business days prior to 1 July (the assessment period), the regulator may request additional information if it considers that such information

[154] Minter Ellison letter to ACCC, 15 May 2007, p. 1.

will assist its assessment. This will extend the relevant assessment period by the number of days commencing on the day on which the regulator gave notice to Anglo Coal and ending on the day on which Anglo Coal submits the required information.

- the regulator may grant an extension on application by Anglo Coal of any of the time periods associated with this process.

The ACCC has discussed this issue with Anglo Coal.

Proposed amendment 10

In order for the DVP access arrangement to be approved, Anglo Coal must include the following provisions in section 4 of the access arrangement:

- for each year of the access arrangement period Anglo Coal must provide written notice to the regulator that a specified event has either occurred or not occurred. If such an event has occurred, Anglo Coal must notify the regulator as to the scope of the financial impact, how the claim is consistent with the trigger event adjustment mechanism, the proposed variations to the reference tariff and an effective date for the changes. The notification must also include all relevant supporting information to substantiate Anglo Coal's proposal.

- Anglo Coal must submit only one pass through notice a year, which must be submitted at least 50 business days prior to 30 June. This notice may incorporate a number of pass through claims or may specify that none of the specific events defined in the reference tariff policy have occurred.

- in the period before 10 business days prior to 1 July (the assessment period), the regulator may request additional information if it considers that such information will assist its assessment. This will extend the relevant assessment period by the number of days commencing on the day on which the regulator gave notice to Anglo Coal and ending on the day on which Anglo Coal submits the required information.

- the regulator will provide its decision at least 10 business days before 1 July of each year of the access arrangement period.

- if the regulator does not provide a decision at least 10 business days before 1 July, the regulator will be taken to have approved the revised tariffs, which will come into effect on 1 July of the relevant year

- the regulator may grant an extension on application by Anglo Coal of any of the time periods associated with this process.

The ACCC has discussed this issue with Anglo Coal.

7.4 Reference tariff principles

7.4.1 Code requirements

Section 3.5 of the code requires the access arrangement to include a policy describing the principles that are to be used to determine a reference tariff (a reference tariff policy). This reference tariff policy must, in the regulator's opinion, comply with the reference tariff principles set out in s. 8 of the code.

The reference tariff policy and reference tariffs should be designed to achieve a number of objectives that are set out in s. 8.1 of the code:

(a) providing the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in that Service;

(b) replicating the outcome of a competitive market;

(c) ensuring the safe and reliable operation of the Pipeline;

(d) not distorting investment decisions in Pipeline transportation systems or in upstream and downstream industries;

(e) efficiency in the level and structure of the Reference Tariff; and

(f) providing an incentive to the Service Provider to reduce costs and to develop the market for Reference and other Services.

To the extent that any of these objectives conflict in their application to a particular access arrangement, the regulator is to determine the manner in which they can best be reconciled or which of them should prevail by reference to the factors in s. 2.24 of the code. Section 2.24 states:

> ... In assessing a proposed Access Arrangement, the Relevant Regulator must take the following into account:
>
> (a) the Service Provider's legitimate business interests and investment in the Covered Pipeline;
>
> (b) firm and binding contractual obligations of the Service Provider or other persons (or both) already using the Covered Pipeline;
>
> (c) the operational and technical requirements necessary for the safe and reliable operation of the Covered Pipeline;
>
> (d) the economically efficient operation of the Covered Pipeline;
>
> (e) the public interest, including the public interest in having competition in markets (whether or not in Australia);
>
> (f) the interests of Users and Prospective Users;
>
> (g) any other matters that the Relevant Regulator considers are relevant.

The WA Supreme Court of Appeal decision provides guidance as to the appropriate application of ss. 8.1 and 2.24 by a regulator. The Court stated:

> ... The last paragraph of s8.1 recognises that the objectives of (a) to (f) in s8.1 may conflict in their application to a particular reference tariff determination, in which event the Regulator may determine the manner in which they can best be reconciled or which of them should prevail. Contrary to the submissions of the Regulator and Alinta, the discretionary task of seeking to reconcile conflicting objectives within s8.1, and even more significantly of determining which of them should prevail, cannot be decided by reference to s8.1 itself. Of necessity, the Regulator must have guidance outside of s8.1 in exercising those discretions. In this regard it appears from the

> structure and provisions of the Code that have been canvassed that s2.24(a) to (g) would most naturally guide the Regulator in the exercise of these discretions, and was intended to do so. That is, in exercising the discretions contemplated by the last paragraph of s8.1 the Regulator should take into account the factors in s2.24(a) to (g).[155]

In addition, s. 8.2 stipulates that when approving a reference tariff and reference tariff policy the regulator must be satisfied that:

> (a) the revenue to be generated from the sales (or forecast sales) of all Services over the Access Arrangement Period (the Total Revenue) should be established consistently with the principles and according to one of the methodologies contained in this section 8;
>
> (b) to the extent that the Covered Pipeline is used to provide a number of Services, that portion of Total Revenue that a Reference Tariff is designed to recover (which may be based upon forecasts) is calculated consistently with the principles contained in this section 8;
>
> (c) a Reference Tariff (which may be based upon forecasts) is designed so that the portion of Total Revenue to be recovered from a Reference Service (referred to in paragraph (b)) is recovered from the Users of that Reference Service consistently with the principles contained in this section 8;
>
> (d) Incentive Mechanisms are incorporated into the Reference Tariff Policy wherever the Relevant Regulator considers appropriate and such Incentive Mechanisms are consistent with the principles contained in this section 8; and
>
> (e) any forecasts required in setting the Reference Tariff represent best estimates arrived at on a reasonable basis.

The reference tariff principles outlined in ss. 8.1 and 8.2 are designed to provide flexibility so that reference tariffs and reference tariff policies can be designed to meet the specific needs of each pipeline.

7.4.2 Assessment

The ACCC considers that Anglo Coal has complied with the threshold issue in s. 3.5 of the code by providing a reference tariff policy in the access arrangement. A discussion on the reference tariff policy and the reference tariff methodology is located at chapter 3 of this draft decision.

Each of the aspects of the reference tariff and reference tariff policy has been assessed in the relevant sections of this draft decision together with a discussion of why the proposed amendments are necessary given the relevant provisions of the code. The following discussion draws together the ACCC's conclusions within the framework of ss. 8.1 and 8.2 of the code.

As noted above, the ACCC must take into account the factors set out in s. 2.24 when assessing the proposed access arrangement. The ACCC has given due consideration to each of these factors in assessing Anglo Coal's proposed reference tariff and reference tariff policy, particularly where the objectives in s. 8.1 conflict and the ACCC as the regulator, must balance and reconcile these objectives.

The following discussion specifically comments on the application of these factors in respect of the reference tariff and reference tariff policy.

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[155] [2002] WASCA 231, par. 85.

Section 8.1 objectives

Recovery of efficient costs associated with the provision of reference services (8.1(a))

Section 8.1(a) provides that one objective which a reference tariff and a reference tariff policy should be designed to achieve is to provide the service provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the reference service over the expected life of the assets used in delivering that service.

In Re Michael the Court noted that this objective does not necessarily set a ceiling or floor of the revenue that a service provider may earn. That is to say, the objective is not to establish a revenue stream that recovers no more than efficient costs or at least efficient costs.[156] In assessing Anglo Coal's proposed rate of return (see chapter 5 of this draft decision) against this objective the ACCC has also had regard to the factors (a), and (d) to (f) in s. 2.24 of the code. The ACCC notes that the Court took the view that 'legitimate' business interests are not limited to the recovery of normal profits or an economically efficient revenue stream.

In assessing the proposed ICB the ACCC noted the Court's view that this objective is not limited to forward-looking costs alone. Hence a regulator should give weight to historical cost based approaches, such as DAC and any recent sale price, as well as current cost based approaches such as DORC. By optimising the current replacement costs, it is assured that only efficient costs are included as any redundant assets are excluded.

The ACCC does not consider this criterion guarantees a right for a service provider to recover monopoly profits. Criterion (a), to the extent that it allows such recovery, must be weighed against other criteria in s. 2.24. While weight must be given to each of these criteria, it ultimately falls to the ACCC as the regulator to decide how they should be balanced.

The ACCC has applied this framework to its consideration of the proposed reference tariff policy. It has also considered the non capital costs proposed by Anglo Coal (see chapter 6 of this draft decision). Anglo Coal has proposed no capital expenditure over the access arrangement period. While the ACCC considers that the direct non capital costs may not be unreasonable costs for a prudent service provider, it does have reservations with regard to the proposed forecast of indirect non capital costs.

The ACCC considers that, consequent to the amendments it proposes to be made to the determination of the reference tariff and tariff variation policy, Anglo Coal will have the opportunity to generate a revenue stream that will be more comparable with the efficient costs of providing the reference service and be consistent with the objective in s. 8.1(a) and the factors in s. 2.24 of the code.

Replicating the outcome of a competitive market (8.1(b))

Setting the regulated rate of return consistent with CAPM benchmarks results in a forecast return that is expected to be similar to those achieved by firms facing similar

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[156] ibid, par. 142.

commercial risks operating in a competitive environment. The return will be based on only those assets necessary to deliver the services required, consistent with s. 2.24(d).

The reference tariff will also allow Anglo Coal to achieve a return in excess of a normal return from increased efficiencies and growth in sales, as occurs in a competitive market.

Efficiency, equity considerations and a balancing of a service provider's interests with those of users and prospective users generally support a tariff path with a levelised real tariff over time, or one that declines slightly in real terms to reflect declining costs relative to output. The tariff path proposed by Anglo Coal is a constant tariff in real terms over the access arrangement period (see section 7.2 of this draft decision).

Pricing reflective of efficient costs is also a feature of competitive markets and, as noted in reference to s. 8.1(a) above, the ACCC aims to ensure that tariffs are reflective of efficient costs to the extent that this is practicable and reasonable.

Tariffs based on DORC are the maximum that would be observed in a competitive market. Tariffs in excess of DORC would encourage new entrants (that is, by-pass of the pipeline) and the price would eventually return to a competitive level.

Ensuring the safe and reliable operation of the pipeline (8.1(c))

The reference tariff is based on cost forecasts that are sufficient for the safe and reliable operation of the pipeline. Anglo Coal will have an opportunity to increase its revenue if the safety and reliability of the pipeline demands it, at the time of the review of the access arrangement. Anglo Coal may also submit early revisions to the access arrangement if desired. In addition, the access arrangement includes a trigger mechanism which will allow for an early review of the access arrangement if actual throughput exceeds forecast demand by more than 25 per cent.

The ACCC considers that with the amendments proposed in this draft decision the costs for the DVP will remain appropriate for the safe operation of the pipeline system and are consistent with the objectives in ss. 8.1(c) and 2.24(c) of the code.

Not distorting investment decisions (8.1(d))

Efficient investment decisions upstream and downstream will be facilitated by transmission pricing based on an allocation of costs to users which approximates long run costs of providing the service. This is approximated by the adoption of tariffs which are consistent with ss. 8.38 to 8.43 of the code.

Efficient investment decisions for pipeline systems are also likely to follow if an appropriate rate of return is applied to the asset. The return should be neither excessively high so as to encourage over investment, nor so low as to discourage efficient investment in the pipeline. In addition, excessive returns and tariffs may discourage efficient investment in upstream (limiting the development of CSM fields in the Dawson Valley area) and downstream markets. Conversely, inadequate returns and tariffs may encourage upstream and downstream over investment in the short term (but may lead to lower investment levels in the longer term).

The return and tariffs should be considered in conjunction with other aspects of the access arrangement to understand the full regulatory framework in which the business operates. In the case of the DVP, over investment is unlikely to be encouraged given the expected excess capacity of the pipeline and the redundant capital policy provisions in the access arrangement.

In addition, the risk of inefficient investment by another service provider by-passing the DVP is diminished if the DVP's ICB is set at a level that does not exceed DORC.

Accordingly, the ACCC considers that with the required amendments in place, the access arrangement will not have a tendency to distort investment decisions in upstream and downstream markets or in regard to the DVP in particular and is consistent with the objectives in s. 8.1(d) and the factors set out in s. 2.24.

Efficiency in the level and structure of reference tariffs (8.1(e))

The ACCC has assessed the proposed approach to the allocation and recovery of costs. It proposes a number of amendments, in particular, one to the non capital costs forecast by Anglo Coal.

The ACCC considers that the resulting approach strikes a balance between Anglo Coal's legitimate business interests (s. 2.24(a)), the efficient operation of the pipeline (s. 2.24(d)) and the interests of users (s. 2.24(f)) and satisfies the code (in particular ss. 8.1(e), 8.2(a) and 8.2(b)).

The tariff path proposed by Anglo Coal (after the adjustment to the starting point proposed by the ACCC) is considered to be appropriate. The ACCC considers that a level tariff path in real terms is in the interest of users and prospective users (s. 2.24(f)) and considers that it is not inconsistent with Anglo Coal's legitimate business interests (s. 2.24(a)).

Anglo Coal has proposed a one-part tariff which would be charged on the basis of contracted capacity whereas the more usual transmission pipeline practice is to use a two-part tariff that also has a throughput component. In these cases, the capacity charge is intended to recover fixed costs and the throughput charge is intended to recover variable costs. The ACCC understands that Anglo Coal's costs are unlikely to vary to any significant extent with changes in throughput over the access arrangement period. It considers that the proposed tariff design is consistent with expected costs and appropriate given the circumstances of the DVP. The tariff design is consistent with Anglo Coal's legitimate business interests (s. 2.24(a)), the interests of users and prospective users (s. 2.24(f)) and the economically efficient operation of the pipeline (s. 2.24(d)).

Incentives to reduce costs and expand the market (8.1(f))

Anglo Coal's exposure to potential changes in total demand on the DVP, unused capacity and the use of forecast costs provide an incentive to develop the market for gas and achieve efficiencies in operations and maintenance. The prospect of Anglo Coal retaining improved returns from the DVP over the access arrangement period provides an incentive for Anglo Coal to increase the volume of sales and to minimize the overall costs of providing services. In the longer term the initial benefits of achieving

efficiencies will be passed onto users and prospective users in determining the reference tariff at the commencement of revisions to the access arrangement.

The ACCC has proposed that amendments be made to the forecast costs set out in the access arrangement information and used to determine the reference tariff. These amendments are not expected to reduce Anglo Coal's incentives to reduce costs and develop the market as required by s. 8.1(e) of the code. The ACCC considers that the ensuing benefits from this approach are in the interest of users and prospective users.

Section 8.2 factors

Section 8.2 of the code contains the following five factors about which the regulator must be satisfied in determining whether to approve a reference tariff or reference tariff policy.

Total revenue is established consistently with the principles and according to one of the methodologies contained in s. 8 of the code (8.2(a))

Total revenue is to be determined by the cost of service, IRR or NPV methods (or a variation or combination of these approaches). As discussed in section 3.2.4 of this draft decision, Anglo Coal has applied the cost of service method.

The cost of service approach is permitted under s. 8 of the code and the ACCC concludes that, subject to the proposed amendments, Anglo Coal will have satisfied this requirement of the code.

The proportion of total revenue that any one reference tariff is designed to recover is calculated consistent with the principles of s. 8 of the code (8.2(b))

For the reasons given in section 7.1 of this draft decision, the ACCC considers that the allocation of capital and non capital costs to the reference tariff is consistent with the principles of s. 8 of the code and satisfies s. 8.2(b) given the current and expected operating environment of the DVP.

The proportion of total revenue recovered from users of a service is calculated consistent with the principles of s. 8 of the code (8.2(c))

For the reasons given in section 7.1 of this draft decision, the ACCC considers that the allocation of costs between users is appropriate for the DVP at this time and is consistent with the principles of s. 8 of the code and satisfies s. 8.2(c).

Incentive mechanisms that are incorporated are consistent with the principles of section 8 of the Code (8.2(d))

The ACCC has assessed Anglo Coal's proposed incentive mechanism and has concluded that it satisfies the relevant principles contained in s. 8 of the code.

Forecasts are best estimates arrived at on a reasonable basis (8.2(e))

The ACCC has specified amendments to the determination of the rate of return and the forecast non capital costs for the access arrangement period (see chapters 5 and 6 of this draft decision). It considers that these amendments will result in the access arrangement using forecasts that are best estimates arrived at on a reasonable basis.

Conclusion

The ACCC considers that with the adoption of the specified amendments, the reference tariff and reference tariff policy will satisfy the factors in s. 8.2 and be consistent with the objectives in s. 8.1 (as applied with reference to s. 2.24 of the code).

8. Non-tariff elements

8.1 Services policy

8.1.1 Code requirements

The code requires an access arrangement to contain a policy regarding the services to be offered by the service provider (the services policy). Section 3.2 of the code requires the services policy to include a description of one or more services that the service provider will make available to users and prospective users. The policy must contain one or more services which are likely to be sought by a significant part of the market, and any service or services that in the regulator's opinion should be included.

To the extent that it is practicable and reasonable, a service provider should also make available only those elements of a service required by users and prospective users and apply a separate tariff for each element if this is requested.

8.1.2 Proposal

Section 3 of the proposed access arrangement sets out the services offered by Anglo Coal to users and prospective users of the DVP. Two services are offered: the reference service and a negotiated service.

The reference service is a firm forward haul service and is available from any agreed receipt point to any agreed delivery point on the pipeline.[157]

The negotiated service is described as an agreement for a service negotiated between the parties to meet the needs of a user which differ from the needs met in the reference service.

8.1.3 Submissions

WestSide suggested that an 'as available' service should also be offered by Anglo Coal to help promote the development of reserves and production in the area. It commented:

> Generally, an As Available service should be available for around the same tariff as the authorised overrun tariff, in this case 120% of the 100% load factor firm tariff. A new developer of production capacity faces uncertainty about levels of production and as such there is no reasonable basis to require a firm commitment to pipeline capacity, particularly during start up and potential ramp up stages. There is a strong argument, in the interests of promoting further resource development and encouraging additional market suppliers, to require an As Available service.[158]

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[157] The pipeline has two receipt points and two delivery points. The receipt points are at the outlets from the Moura and Dawson compression and dehydration stations. The delivery points are at the inlet to the Wallumbilla to Gladstone Pipeline and the inlet to the Queensland Nitrates plant. Minter Ellison letter to ACCC, 29 March 2007, p. 3.

[158] WestSide submission, 21 March 2007, p. 1.

8.1.4 Assessment

One or more of the services included in an access arrangement must be likely to be sought by a significant part of the market. At present the only user of the DVP is the Dawson Joint Venture (DJV). The DJV transports CSM it has produced and CSM it has purchased from the Lowell-Helm Joint Venture. A small amount of this gas is delivered to the Queensland Nitrates plant with the remainder being transported over the full length of DVP to its interconnection with the QGP. The ACCC understands that the key end user market for gas from the Dawson Valley is presently Gladstone. Anglo Coal does not expect this demand pattern to change over the course of the access arrangement period. The additional service offered (a negotiated service) provides for Anglo Coal and users or prospective users to negotiate a service on terms and conditions that differ from the firm forward haul reference service. In providing this service Anglo Coal acknowledges that services other than the reference service may be sought.

An example of an alternative service is the 'as available' service sought by WestSide. The ACCC agrees, in the context of a new supplier starting up, an as available service may be more appropriate than the firm forward haul service. The ACCC understands that the previous owner of the DVP did provide a non-firm service to Molopo.[159] The information provided by Molopo indicates that the tariff was greater than 120 per cent of the firm forward haul tariff, the rate suggested by WestSide.

In response, Anglo Coal noted that there was no reasonable basis to forecast demand for an 'as available' service. It acknowledges that gas producers face many uncertainties but stated that an access arrangement is not intended to manage these uncertainties.[160]

The ACCC considers that the inclusion of the broader negotiable service in the access arrangement provides opportunities for prospective users and the service provider to develop a non-firm service that meets the needs of the prospective user without limiting the development of the CSM fields. The users' needs may change over time and the needs of one user may differ from those of another. The negotiated service can accommodate such changes and differences where a specific non-firm service may not. As stated by Anglo Coal, the access arrangement does not restrict a prospective user from approaching the service provider to provide an alternative to the reference service.[161]

The ACCC also notes that, as the negotiated service is included in the access arrangement, disputes that may arise may be resolved by arbitration as provided by section 6 of the code.

Overall, the ACCC supports the inclusion of the negotiated service in the proposed access arrangement. It considers this is an appropriate mechanism to allow for future, but unknown, requests from users and prospective users.

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159 Molopo submission, 9 March 2007, p. 4.

160 Anglo Coal submission (response to WestSide), 20 April 2007, p. 2.

161 ibid.

The code provides the regulator with the ability to require any service in an access arrangement that it considers should be included. The ACCC has considered the current and expected operating circumstances of the DVP and the services currently proposed for the access arrangement. In light of the uncertain and potentially limited demand over the term of the access arrangement period for services other than firm forward haul, the ACCC considers it would not be practical or desirable to require any additional reference services at this time. Similarly, it does not propose to require any other non-reference services be included in the DVP services policy. A future review of the access arrangement (including that initiated by the trigger event) may include consideration of the services covered by the access arrangement.

A services policy must, to the extent practicable and reasonable, allow users and prospective users to only use (and a tariff be calculated for) certain elements of a service as they require. The proposed service policy does not include this facility. However, the ACCC has concluded that is not practical or reasonable to require Anglo Coal to offer only some elements of the proposed services as a service. It is unlikely that there would be any user or prospective user that would require such a service. In addition, the nature of the services offered do not lend themselves to being provided at an element level. Nor would it be practical to calculate a separate tariff for such a service.

The ACCC has concluded that the proposed services policy satisfies the requirements of the code. It proposes to accept the policy.

8.2 Terms and conditions

8.2.1 Code requirements

Section 3.6 of the code requires an access arrangement to include the terms and conditions on which a service provider will supply each reference service. These terms and conditions must, in the regulator's opinion, be reasonable. In assessing whether the proposed revised terms and conditions are reasonable, the regulator is guided by s. 2.24 of the code.

8.2.2 Proposal

The general terms and conditions are set out in schedule 2 of the proposed access arrangement. The following discussion is limited to those elements identified by interested parties, the ACCC or its technical consultant as potentially raising concerns.

System use gas

System use gas is a user's share of gas used for the operation of a pipeline. It is used to operate compressors and other equipment that is installed on a pipeline. Clause 3.1 of the terms and conditions states that a user must provide system use gas to the service provider. This may amount to 1.5 per cent of the user's MDQ and will be owned and used by the service provider.

Nominations

Clause 4.3 of the terms and conditions require users to provide nominations of their gas use 10 days in advance and variations to this require at least 48 hours notice. Anglo Coal has stated that it considers this to be consistent with industry standards.[162]

Operational flow orders

Operational flow orders are issued by Anglo Coal to users to require them to alter their receipt and delivery of gas in certain circumstances. The orders will first apply to users whose actions or omissions have resulted in the need for an order. According to clause 3.5 of the terms and conditions, notice of at least two hours before an operational flow order commences is required. Anglo Coal considers this to be reasonable operating practice.[163]

Overruns and allocations

An overrun is a delivery or withdrawal of gas by a user that is in excess of its MHQ or MDQ. Clause 7 of the terms and conditions specifies that users are to be responsible for control and adjustment of nominations and vary receipts and deliveries of gas on the DVP.

Payment for capital improvements

Clause 6 of the terms and conditions provide for the use of alternative receipt and delivery points. The use of such receipt and delivery points is subject to a number of conditions which includes the user paying for the actual cost of any required capital improvements as well as the associated operating costs.

Testing of metering facilities

Clause 11 of the terms and conditions include a specification that witness testing of metering facilities be carried out at intervals of 12 months. Anglo Coal regards this as being consistent with industry standards.[164] Anglo Coal also advised that more frequent testing can occur if the user funds the additional cost.[165]

MAOP

Clause 10.1 of the terms and conditions for the DVP specifies that users shall not supply gas at more than the specified maximum allowable operating pressure (MAOP).

The ACCC understands that the pipeline itself has a MAOP of 14.6 MPa. However, other elements of the DVP provide a constraint. As a result of these constraints the current MAOP is 10 MPa.

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162 Minter Ellison letter to ACCC, 29 March 2007, p. 2.

163 Minter Ellison letter to ACCC, 19 April 2007, p. 2.

164 AA, schedule 2, pp. 27-28.

165 Minter Ellison letter to ACCC, 29 March 2007, p. 3.

8.2.3 Submissions

Nominations

WestSide stated that it considers the nominations requirements are heavy handed. It acknowledged that monthly and weekly nominations are useful planning tools but suggested that daily nominations would better reflect the operating nature of a pipeline.[166]

AGL submitted that the industry norm for notice to vary nominations is 24 hours rather than the proposed 48 hours.[167] Unidel concurred with this view.[168]

Overruns and allocations

AGL noted that users are to be responsible for control and adjustment of nominations for the DVP. It also noted that the DVP does not have flow controls on the pipe. AGL considers that this raises two issues. First, users may be charged for overruns even though they are not best placed to manage flows on the pipeline. Second, allocations between multiple users would be problematic.[169]

Other

No submissions were received on other aspects of the proposed terms and conditions.

8.2.4 Assessment

System use gas

The level of system use gas may amount to 1.5 per cent of a user's MDQ. As noted by the ACCC's technical consultant, this level would be unnecessarily high for a free flow pipeline like the DVP.[170] However, this is a maximum level and the ACCC considers it satisfactory. It does not propose to require an amendment to clause 3.1 of the terms and conditions.

Nominations

Clause 4.3 of the terms and conditions requires users to provide nominations of their use 10 days in advance and variations to this with at least 48 hours notice. Advice received from its technical consultant indicates to the ACCC that these requirements are more stringent than normal industry standards.

The ACCC, RCC and the service provider have discussed this matter. Anglo Coal has advised that it will amend the notice period for variations to nominations to 24 hours.[171]

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166 WestSide submission, 21 March 2007, p. 1.

167 AGL submission, 19 March 2007, p. 2.

168 Unidel report, April 2007, p. 11.

169 AGL submission, 19 March 2007, p. 2.

170 RCC report, April 2007, p. 6; Unidel report, April 2007, p. 8.

171 Minter Ellison letter to ACCC, 15 May 2007, p. 1; RCC report, April 2007, p. 8.

In regard to specifying a daily nominations regime for the DVP, RCC has noted that the monthly and weekly nominations are indicative. Variations to these nominations can be made. In view of the advice provided by RCC, the ACCC does not proposed to require a daily nomination regime for the DVP.

Operational flow orders

Following discussions between Anglo Coal and the ACCC's technical consultant, Anglo Coal has stated that it is prepared to amend clauses 3.5(a) and 16(e) of the terms and conditions.[172] These amendments will have the effect of providing that:

- a written copy of an operational flow order would be provided to a user within a reasonable time prior to the effective commencement of the order, and

- interruption to supply may occur in the event of force majeure or a failure by a user to comply with an operational flow order in circumstances where Anglo Coal considers it necessary to ensure that the integrity of the service or the safety or integrity of the DVP.

Overruns and allocations

AGL expressed concern that users may be charged for overruns even though they do not manage flows. As noted by RCC, as the DJV is both the owner of the pipeline and the user, it would be unlikely that it would operate the DVP in a manner that would disadvantage users. Nevertheless, a user could install a control value upstream of a receipt point if desired.[173]

AGL also submitted that allocations between multiple users may be problematic. This issue has been raised with Anglo Coal. It noted that as it is the only user of the DVP, the likelihood of this occurring is small.[174] Nevertheless, it has agreed to alter the terms and conditions to state that allocations between multiple users are to be determined in accordance with an agreed methodology.[175]

Payment for capital improvements

Given the forecast operations of the DVP, Anglo Coal has stated that it does not consider that construction of capital improvements on inlet and outlet facilities will be required during the proposed access arrangement period. Nevertheless, payment by users for such capital improvements would be on terms negotiated between the parties. Anglo Coal has indicated that monthly payments may be appropriate.[176]

Testing of metering facilities

The proposed access arrangement provides for annual testing of metering facilities. However, there may be circumstances where users would require testing more

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172 Minter Ellison letter to ACCC, 26 April 2007.

173 RCC report, April 2007, p. 9.

174 Anglo Coal submission (response to AGL), 20 April 2007, p. 2.

175 Minter Ellison letter to ACCC, 15 May 2007, p. 1.

176 Minter Ellison letter to ACCC, 29 March 2007, p. 2.

frequently. It would be reasonable for the terms and conditions to provide that more frequent testing would be carried out as requested by a user. The current non capital costs include costs associated with annual testing. Anglo Coal agreed to amend clause 11 of the terms and conditions to state:

> … the reasonable costs of any testing of the metering facilities requested by the User are to be paid by the User unless the facilities are found to be faulty in which event Anglo Coal will pay the costs of testing.[177]

The ACCC considers that this amended clause is appropriate.

MAOP

While the DVP itself has a MAOP of 14.6 MPa, it does not operate at this pressure due to the constraints of other equipment. The ACCC has discussed this issue with Anglo Coal and requested that the terms and conditions be altered to include a clause that acknowledges the current effective maximum pipeline pressure, that current operations are constrained and what modifications would be required to allow the DVP to operate at its nominal MAOP of 14.6 MPa.[178] Anglo Coal has agreed to include such information in the terms and conditions. It has proposed the following:

> The current MAOP of the DVP is limited to approximately 11.5-12 MPag. The MAOP is constrained by the design pressure of the discharge pulsation bottles and the design pressure of the discharge coolers on the existing compressors at both the Dawson and Moura compression stations. Both the discharge pulsation bottles and the discharge coolers have a design pressure of 12750kPag. To operate the DVP at 14.6 MPag, both the compressors and the TEG units would need to be replaced.[179]

The ACCC is satisfied that the above addresses the concerns raised.

8.3 Capacity management policy

8.3.1 Code requirements

Section 3.7 of the code requires an access arrangement to include a statement that the covered pipeline is either a contract carriage pipeline or a market carriage pipeline.

8.3.2 Proposal

Section 9 of the proposed access arrangement states that the DVP is a contract carriage pipeline.

8.3.3 Submissions

No submissions were received on this aspect of the proposed access arrangement.

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177 Minter Ellison letter to ACCC, 15 May 2007, p. 1.

178 For further discussion see RCC report, April 2007, pp. 9-10.

179 Minter Ellison letter to ACCC, 15 May 2007, pp. 1-2.

8.3.4 Assessment

The ACCC is satisfied that the statement contained in section 9 of the proposed access arrangement complies with the requirements of s. 3.7 of the code.

8.4 Trading policy

8.4.1 Code requirements

Sections 3.9 to 3.11 of the code set out the requirements for a trading policy. If a pipeline is a contract carriage pipeline the access arrangement must include a trading policy that explains the rights of a user to trade its right to obtain a service to another user.

The trading policy must allow a user to transfer or assign all or part of its contracted capacity without the service provider's consent if the obligations and terms under the contract between the user and the service provider are unaltered by the transfer or assignment (a bare transfer).

In addition, a user must be allowed to transfer or assign all or part of its contracted capacity in any other case with the prior consent of the service provider.

Third, the trading policy is to provide users with the ability to change the delivery or receipt point from that specified in a contract with the prior written consent of the service provider.

In both the latter instances, consent may be withheld only on reasonable commercial or technical grounds and the trading policy may specify conditions under which consent will be granted and any conditions attached to that consent.

Section 3.11 of the code provides examples of what would be reasonable service provider conduct for the purpose of the 'reasonable commercial or technical grounds' specified in ss. 3.10(b) and (c). It indicates that the service provider may:

- refuse a request to change a delivery point where the reduction in service to the original delivery point will not correspond to an increase in services to the alternative delivery point, and

- refuse a request to change a delivery or receipt point unless it receives the same revenue as it did before the change.

8.4.2 Proposal

The proposed trading policy provides users with the ability to alter their rights under three circumstances. These are:

- a user may make a 'bare transfer' without the consent of Anglo Coal if, prior to the transfer or assignment, it notifies Anglo Coal of the portion and nature of the contracted capacity that is the subject of the bare transfer

- a user may otherwise transfer or assign all or part of its contracted capacity with the prior consent of Anglo Coal. Anglo Coal may refuse or consent with conditions on 'reasonable commercial or technical grounds', and

- a user may change a receipt or delivery point with the prior written consent of Anglo Coal. Anglo Coal may refuse or consent with conditions on 'reasonable commercial or technical grounds'.

The term 'bare transfer' is defined with reference to s. 3.10 of the code. A transfer or assignment of contracted capacity is a 'bare transfer' if the obligations and terms under the contract between the user and the service provider are unaltered by the transfer or assignment.

The phrase 'reasonable commercial or technical grounds' is not defined.

Schedule 2 of the proposed access arrangement also specifies, among other things, certain terms and conditions relevant to alternative receipt and delivery points. Relevantly, it confirms the trading policy requirement of the user providing written notice to the service provider in requesting an alternative receipt or delivery point. It also requires a user to agree to 'reasonable commercial and technical conditions' as required by Anglo Coal.[180]

8.4.3 Submissions

No submissions were received from interested parties on this aspect of the proposed access arrangement.

8.4.4 Assessment

The proposed trading policy closely follows the provisions of s. 3.10 of the code. The ACCC considers that the proposed trading policy is largely compliant with the requirements of the code.

However, the ACCC is concerned that the phrase 'reasonable commercial or technical grounds' is not defined in the access arrangement. It considers that the inclusion of a definition of this term would assist users in understanding the process of trading and assigning capacity and changing delivery and receipt points on the DVP.[181] This has been discussed with Anglo Coal. It has confirmed that it will incorporate the following amendment in the access arrangement.[182]

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[180] AA, schedule 2, pp. 24-25.

[181] RCC report, April 2007, pp. 3-4.

[182] Minter Ellison letter to ACCC, 15 May 2007, p. 1.

Proposed amendment 11

In order for the DVP access arrangement to be approved, Anglo Coal must amend its trading policy to specify that in relation to a transfer or assignment of capacity, reasonable grounds for a rejection of a request may be:

- a failure of a transferee to satisfy the service provider of its credit worthiness, and
- if acceptance of the request would have a material adverse impact upon the service provider's revenue stream.

In addition, the trading policy must specify that in relation to changing a user's receipt or delivery point, reasonable grounds for a rejection may be:

- where a reduction in the amount of the service provided to the original delivery point will not result in a corresponding increase in the service provider's ability to provide that service to the alternative delivery point, and
- if acceptance of the request would have a material adverse impact upon the service provider's revenue stream.

8.5 Queuing policy

8.5.1 Code requirements

Section 3.12 of the code requires that a queuing policy be included in an access arrangement for a transmission pipeline. A queuing policy is to set out a policy for determining the priority that a prospective user has to obtain access to the spare and developable capacity of the pipeline and to seek dispute resolution (under section 6 of the code). Section 3.13 of the code provides that the queuing policy must:

- set out sufficient detail to enable users and prospective users to understand how the policy will operate
- accommodate, to the extent reasonably possible, the legitimate business interests of the service provider, users and prospective users, and
- generate, to the extent reasonably possible, economically efficient outcomes.

The code also specifies that:

- the regulator can, taking into account s. 2.24 of the code, require a queuing policy 'to deal with any other matter' it considers appropriate, and
- the service provider must comply with the queuing policy incorporated in an access arrangement regardless of any other requirements of the code.

8.5.2 Proposal

The queuing policy set out at section 7 of the proposed access arrangement states that the priority of access requests (requests for reference and negotiated services) will be determined according to the order in which they are received. Requests may be dealt with out of order if higher priority requests are not disadvantaged.

A prospective user will be advised of its place in the queue when its access request is first placed in the queue, when its place in the queue changes and at any time as requested.

An access request may be rejected by Anglo Coal on 'reasonable commercial or technical grounds'. Upon rejection, the priority of that access request is lost.

An access request can be withdrawn at any time by the prospective user.

8.5.3 Submissions

No submissions from interested parties were received on this aspect of the proposed access arrangement.

8.5.4 Assessment

A queuing policy is used when there is insufficient pipeline capacity to satisfy requests for services from users or prospective users. A queue will be formed and will include all relevant requests for services that cannot be met. A queuing policy sets out how to allocate spare and developable capacity.

The ACCC notes that Anglo Coal's forecast demand for the proposed access arrangement period indicates that there will be substantial spare capacity available on the DVP at least for the first access arrangement period. Under such circumstances, it may be reasonable to expect that any request for transportation services will be readily satisfied by Anglo Coal and that a queue will not be formed.

Nevertheless, the ACCC considers that it is important to ensure that the queuing policy meets the requirements of the code and is clear to users and prospective users as to its operation.

The ACCC is concerned that the phrase 'reasonable commercial or technical grounds' is not defined in the access arrangement. It considers that the inclusion of a definition of this term would assist users in understanding the grounds upon which their access request could be rejected by Anglo Coal.[183] This issue has been discussed with Anglo Coal and it has confirmed that it will implement the following amendment in the DVP queuing policy.[184]

[183] RCC report, April 2007, pp. 4-5.

[184] Minter Ellison letter to ACCC, 15 May 2007, p. 1.

Proposed amendment 12

In order for the DVP access arrangement to be approved, Anglo Coal must amend its queuing policy to specify that reasonable grounds for rejecting an access request may be:

- a failure of a transferee to satisfy the service provider of its credit worthiness, and
- if acceptance of the request would have a material adverse impact upon the service provider's revenue stream.

In addition, the queuing policy is to specify timeframes for the relevant actions undertaken under the queuing policy.

8.6 Extensions and expansions policy

8.6.1 Code requirements

Section 3.16 of the code requires an access arrangement to have an extensions and expansions policy. The policy must set out the method to determine whether any extension to, or expansion of, the system's capacity will be treated as part of the covered pipeline for the purposes of the code.

The policy is also required to specify the impact on reference tariffs of treating an extension or expansion as part of the covered pipeline.

If the service provider agrees to fund new facilities if certain conditions are met, the extensions and expansions policy must describe those new facilities and outline the conditions under which they will be funded.

Finally, the regulator may not, without the agreement of the service provider, require the policy to state that new facilities will be funded by the service provider.

8.6.2 Proposal

The proposed extensions and expansions policy states that an extension to the DVP will become part of the covered pipeline and be subject to the access arrangement unless the regulator agrees that this should not be the case.

The policy also states that an expansion to the capacity of the pipeline above 30 TJ/day will become part of the covered pipeline and be subject to the access arrangement upon commencement of operation unless the regulator agrees that this should not be the case.

Where an expansion is part of the covered pipeline, access to the additional capacity will be offered at the reference tariff.

Anglo Coal has not undertaken to fund any new facilities as permitted by s. 3.16(c) of the code.

8.6.3 Submissions

No submissions were received from interested parties on this aspect of the proposed access arrangement.

8.6.4 Assessment

The ACCC notes that there is no expectation by Anglo Coal that the DVP will be expanded or extended during the proposed access arrangement period. If the growth of CSM supply is substantial, it may generate a climate where an expansion or extension to the DVP is required. However, if such substantial growth were to occur then the trigger to review the access arrangement (which triggers when actual demand is greater than forecast by more than 25 per cent) would come into play. This would provide an opportunity to review the extensions and expansions policy.

The ACCC considers it reasonable that an extension to the DVP will, in general, become part of the covered pipeline. It also agrees with the proposal to retain some discretion in regard to an extension's coverage to allow for particular circumstances as they may arise.

Section 3.16(b) requires an extensions and expansions policy to specify how any extensions and expansions that are treated as part of the covered pipeline will affect reference tariffs. Anglo Coal has not provided such information with respect to potential extensions. Accordingly, the proposed policy must be amended to enable it to comply with the requirements of the code.

Proposed amendment 13

In order for the DVP access arrangement to be approved, Anglo Coal must specify how an extension that is to be treated as part of the covered pipeline will affect the reference tariff.

The ACCC considers it reasonable that a capacity expansion to the DVP will, in general, become part of the covered pipeline. It also agrees with the proposal to retain some discretion in regard to an expansion's coverage to allow for particular circumstances as they may arise.

However, the ACCC notes that the proposed policy applies where 'Anglo Coal expands the capacity of the DVP above 30 TJ/day'. While Anglo Coal has stated that its nominal capacity is currently 30 TJ/day, it has advised that its actual capacity is 22-24 TJ/day. The ACCC considers that this wording is potentially ambiguous and is unnecessary. This has been discussed with Anglo Coal who has agreed to replace 'above 30 TJ/day' with 'above current capacity'.[185] The ACCC is satisfied that this change addresses its concerns.

Anglo Coal has proposed that if an expansion is to become part of the covered pipeline then services using the new capacity will be offered at the reference tariff. The ACCC considers that this is consistent with relevant code provisions.

[185] ibid.

At present there is no mechanism in the access arrangement to provide notification to the ACCC of any expansions or extensions to the DVP that come into service. The ACCC considers that, as a general principle and to fulfil the intent of s. 3.16(b), the regulator should be alerted to the commissioning of extensions and expansions to aid in its role as a regulator. Accordingly, the following amendment is required to the extensions and expansions policy. This issue has been discussed with Anglo Coal.

Proposed amendment 14

In order for the DVP access arrangement to be approved, Anglo Coal must specify that it will notify the regulator of the commencement of services provided through an expansion or extension to the DVP within 30 business days of the commencement of those services.

8.7 Review of the access arrangement

8.7.1 Code requirements

Section 3.17 of the code requires an access arrangement to include a date when the service provider must submit revisions to the access arrangement (revisions submission date) and the date when the revisions are expected to take effect (revisions commencement date).

In deciding whether these two dates are appropriate, the regulator must consider the objectives contained in s. 8.1 of the code. Having done so, the regulator may require an amendment to the proposed access arrangement to include earlier or later dates. The regulator may also require that specific major events be defined as a trigger that would require the service provider to submit revisions before the revisions submission date (s. 3.17(ii)).

The code (s. 3.18) states that an access arrangement period accepted by the regulator may be of any duration. However, if the period is longer than five years, the regulator must consider whether mechanisms should be included to address the potential risk that forecasts, on which terms of the proposed access arrangement are based, could subsequently prove to be incorrect. The code provides examples of such mechanisms that may be adopted:

- triggers for early submission of revisions based on a divergence of the service provider's profitability or the value of services reserved in contracts
- triggers for early submission of revisions based on changes to the type or mix of services provided, or
- requiring the service provider to return to users some or all of revenue or profits in excess of a certain amount.

If a trigger for early submission of revisions is incorporated into an access arrangement then the regulator is required to investigate, at least every five years, whether a review event as specified has occurred.

8.7.2 Proposal

Section 10 of the proposed access arrangement sets out the following:

- revisions to the access arrangement are to be submitted by 30 September 2015 or within three months of a change in excess of 25 per cent in annual throughput compared with forecast demand, and

- revisions to the access arrangement will commence, at the earliest, nine months after the revisions submission date.

The trigger event specified in section 10.2(b) of the proposed access arrangement is activated if actual annual throughput varies from the forecast demand (which is 2.9 PJ/year) by more than 25 per cent. However, if such a change in throughput is likely to be temporary (and the regulator agrees) then revisions to the access arrangement will not be required.

8.7.3 Submissions

In noting that the DVP is currently operating at less than its nominal total capacity, AGL stated that the access arrangement should provide for a 'review of the reference tariff if there is a material increase in use on the DVP'.[186]

8.7.4 Assessment

The final decision for this proposed access arrangement is currently anticipated to be made in August 2007, being six months after its lodgement.[187] Accordingly, the proposed revisions submission date and revisions commencement date would provide Anglo Coal with an initial access arrangement period of approximately nine years. This would be almost double the five year period approved for most access arrangements under the code.

In response to Molopo's submission, Anglo Coal indicated that it might be seeking a 10 year access arrangement period. However, it has not proposed this term to the ACCC. It is open to Anglo Coal to make such a proposal in response to this draft decision. The ACCC's assessment of the currently proposed period of approximately nine years would generally be expected to also apply to a 10 year period.

Section 8.1 objectives

As required by s. 3.17 of the code, the ACCC has considered the proposed revisions submission date and revisions commencement date with reference to s. 8.1 of the code. An extended access arrangement period for the DVP:

- provides Anglo Coal with a greater opportunity to recover a stream of revenue that covers efficient costs (s. 8.1(a)), and

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186 AGL submission, 19 March 2007, p. 1.

187 Section 2.21 of the code.

- provides Anglo Coal with a greater incentive to reduce costs and develop the market (s. 8.1(f)).

While both of these aspects of s. 8.1 are important for the DVP, given the pipeline's expected excess capacity, Anglo Coal would have a strong incentive to seek to promote and take up any opportunities to improve throughput as they arise.[188] An extended access arrangement period increases these incentives as any improvements that Anglo Coal can achieve can be retained for a longer period.

The ACCC has also considered the other objectives set out in s. 8.1 of the code:

- replicating the outcome of a competitive market (s. 8.1(b)),
- the safe and reliable operation of the pipeline (s. 8.1(c)),
- not distorting investment decisions (s. 8.1(d)), and
- efficiency in the level and structure of the reference tariff (s. 8.1(e)).

It considers that an extended access arrangement period does not conflict with these objectives.

Major events trigger

In addition to these considerations, the ACCC must have regard to whether mechanisms should be included in the access arrangement to address the possibility that forecasts included in the access arrangement prove to be incorrect.[189] In this regard, Anglo Coal has proposed a trigger mechanism based on actual volumes deviating from those forecast.

The trigger mechanism in Anglo Coal's proposed access arrangement is potentially ambiguous. It is not clear whether Anglo Coal intends it to operate when actual demand is either more than 25 per cent greater or less than the forecast demand, or only if demand is more than 25 per cent higher. Anglo Coal has clarified that the trigger is intended to operate only if actual throughput is in excess of forecast demand by more than 25 per cent.[190] That is, the trigger is intended to operate asymmetrically.

Under Anglo Coal's proposal, if throughput exceeds forecast demand in a year by no more than 25 per cent it is able to retain the associated benefits. This provides Anglo Coal with an incentive to improve its performance. However, if the forecasts on which the access arrangement is based prove to be substantially incorrect and Anglo Coal out performs its forecast demand by more than 25 per cent then it must submit revisions to its access arrangement.[191]

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188 Section 8.1(f) of the code.

189 Section 3.18 of the code.

190 Minter Ellison letter to ACCC, 29 March 2007, p. 3.

191 The ACCC's assessment of the reasonableness of Anglo Coal's demand forecasts is discussed in section 6.3.4 of this draft decision.

A major event trigger needs to be designed to balance the interests of users and prospective users with those of the service provider.[192] In this instance, the balance is between providing users with the benefits of any throughput out performance achieved by Anglo Coal and providing an incentive for Anglo Coal to improve this aspect of its performance. The ACCC has also considered the likely costs to the service providers and other parties of more frequent regulatory reviews.

The ACCC considers that these provisions of the code do not necessarily lead to a single, unambiguous outcome. The ACCC has considered a range of alternative hurdles. In short, it considers that a much lower threshold (for example, 12.5 per cent) would be too likely to be reached and a much higher threshold (for example, 50 per cent) would provide too little protection for the interests of prospective users. The ACCC has concluded that the proposed threshold of over 25 per cent strikes a suitable balance between competing interests. It considers that a permanent change in the volume of gas transported through the DVP compared with the forecasts used to calculate the reference tariff of more than 25 per cent would generate a scenario where the benefits of the increased throughput should be shared with users.

The code provides for alternative approaches to a major event trigger. The ACCC considered whether an alternative such as a revenue sharing mechanism might be appropriate. However, such an approach may not be practical in the circumstances of the DVP where the bulk of the gas expected to be transported over the access arrangement period is owned by the service providers. In addition, gas transported on behalf of third parties may be on a negotiated basis and not be charged at the reference tariff.

As noted above, the proposed trigger mechanism is intended to be asymmetric. That is, the obligation to submit revisions to the access arrangement will only arise when actual demand is greater than forecast demand (and is not temporary in nature) and not in the event that actual demand is less. If actual demand does fall below the forecast, Anglo Coal will receive less revenue than forecast. The code (s. 2.28) does provide service providers with the opportunity to submit revisions to an access arrangement at any time. Anglo Coal could revise its demand forecasts or other aspects of the total revenue calculation if its forecasts prove to be optimistic.

In general, a service provider may choose to submit revisions if the deviation of actual demand from forecast is substantially to its disadvantage. However, there would be little incentive to voluntarily submit revisions early if the deviation of actual from forecast demand proved to be in its favour. For this reason, the ACCC considers that the asymmetric trigger is consistent with the code and a suitable mechanism that balances the interests of users and the service provider.

In conclusion, having had regard to the s. 8.1 principles, the ACCC considers that an access arrangement period longer than the typical five years is suitable for the DVP at this time. When combined with the major event trigger, the ACCC considers that Anglo Coal has the opportunity to earn a greater return than suggested by the benchmark rate

[192] Sections 2.24(a) and (f) of the code.

of return specified in this draft decision while the interests of prospective users are reasonably protected.

No amendments to the proposed revisions submissions date or revisions commencement date are proposed. Anglo Coal may, however, vary its major event trigger in response to this draft decision to make its operation unambiguous.

9. Key performance indicators and access arrangement information

9.1 Key performance indicators

9.1.1 Code requirements

The code requires service providers to disclose key performance indicators (KPIs). Category 6 of Attachment A of the code lists the following relevant items:

- industry KPIs used by the service provider to justify 'reasonably incurred' costs, and
- the service provider's KPIs for each pricing zone, service or category of asset.

9.1.2 Proposal

In section 6 of the proposed access arrangement information Anglo Coal has provided comparative information and a single performance indicator for seven pipelines (including the DVP).[193] Included in this information are data on pipeline length, diameter, construction material, construction date and total non capital costs. The performance indicator Anglo Coal has used is non capital costs per 1000 km. All dollar values are expressed in 2006 dollars.

Anglo Coal submits 'that given the differences between the pipelines (with respect to size, length, capacity, usage, compression levels, remoteness, etc) it is difficult to draw any conclusions based on this data'. It is further stated by Anglo Coal that 'it is considered that the DVP's non-capital costs are relatively fixed and would not vary with throughput or with an increase in pipeline length. As such, the short length of the DVP results in the pipeline exhibiting relatively high non-capital costs per km of length.'[194]

Table 9.1 presents the key data underpinning Anglo Coal's benchmarking exercise. Anglo Coal subsequently commented that the costs for the Riverland, Parmelia and Tubridgi pipelines are proposed costs and that the costs for the Mildura Pipeline are those approved by the regulator.[195]

193 AAI, section 6, p. 9.

194 ibid, pp. 9-10.

195 Minter Ellison email to ACCC, 1 May 2007.

Table 9.1: Proposed benchmarking data and performance indicator

Pipeline	Riverlands	Mildura	Central West	TPA	Parmelia	Tubridgi	DVP
Pipeline details							
Year	2000-01	2000-01	1998-89	1997-98	1999-00	1998-99	2006-07
Length (km)	237	149	255	1 609	438	175	47
Predominant diameter (mm)	100	100	150 & 200	various	350	250	163
Construction material	steel	steel	steel	steel	steel	steel	steel
Construction date	1995	1999	1998	n/a	1971	1991-1993	1996
$ 000 (in 2006 dollars)							
Total non capital costs	707	529	913	24 725	4 745	625	651
Performance indicator							
Non capital costs per 1000 km	2 981	3 548	3 582	15 366	10 833	3 569	13 851

Source: AAI, section 6, p. 9.
Note: Non capital costs exclude SUG.

9.1.3 Submissions

WestSide suggested that contrary to Anglo Coal's submission (which suggests putting little weight on a benchmark assessment for the DVP), it can be argued that 'there is a very strong alignment between the sub 255 km pipelines and that the DVP non capital cost per 1,000 km benchmark demonstrates a DVP cost structure which is at least 4 times its closest rival'.[196]

9.1.4 Assessment

The ACCC recognises the limitation of KPI information as noted by Anglo Coal, but considers that the information can still provide a useful guide in benchmarking operating performance across pipelines. In view of the concerns identified in chapter 6 of this draft decision about the reasonableness of Anglo Coal's forecast non capital costs the ACCC commissioned RCC to provide expert advice on Anglo Coal's proposed KPIs. RCC's report comments on the service providers' proposed KPIs and recommends adoption of an additional measure.

[196] WestSide submission, 21 March 2007, p. 2.

The table of performance measures for various pipelines provided by Anglo Coal has included information supplied by service providers. Some of the proposed costs have been assessed by the relevant regulator as appropriate. Others have not.[197]

Anglo Coal has included data for the Victorian gas transmission system that was operated by Transmission Pipelines Australia (TPA) and is now owned by GasNet (which is now ultimately owned by the APA Group) and for the Parmelia Pipeline in WA. RCC advises that both of these systems are inappropriate comparators for the DVP. The Victorian system is considered inappropriate for comparison because of its length, diversity of included pipelines and its complexity; while the Parmelia Pipeline is considered inappropriate as its diameter is much larger than the DVP and it is of longer length.[198]

The ACCC agrees with this assessment. It also notes that Anglo Coal appears to have overstated the non capital costs of the Victorian gas transmission system by including all the costs incurred by VENCorp in undertaking its functions as the independent gas market operator. The ACCC assessed GasNet's costs in 2002 and concluded that only the portion of VENCorp's costs that relate to its gas control function ($620 000) should be added to GasNet's non capital costs when undertaking comparisons.[199] Including all of VENCorp's gas related non capital costs has the effect of substantially overstating GasNet's costs.

The proposed non capital costs of the DVP ($651 000) are approximately the same as for the Tubridgi Pipeline ($625 000). However, the Tubridgi Pipeline consists of two parallel pipelines which are considerably longer than the DVP (175 km versus 47 km for the DVP). Because the Tubridgi pipelines are run in parallel there are certain savings in operational and maintenance costs with reduced operators' travel time and easements being either common or adjacent. The Riverland and Mildura pipelines are smaller in diameter but much longer than the DVP and have quoted non capital costs of similar magnitude to the DVP.

On the only performance indicator measure proposed by Anglo Coal (non capital costs per 1000 km) the DVP compares poorly with the remaining four pipelines (Riverland, Mildura, Central West and Tubridgi pipelines). The ACCC concurs with WestSide that the proposed DVP cost structure is at least four times greater than its nearest rival (Central West Pipeline) on a non capital cost per 1000 km basis. RCC notes that the short length of DVP disadvantages it in any comparison of non capital costs per unit length because certain economies of scale are absent but concludes:

> [T]here is clearly enough evidence to conclude that the DVP non capital costs are excessive by comparison with other pipelines. [200]

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197 Coverage of the Mildura and Riverland pipelines was revoked during the ACCC's assessment of the proposed access arrangements. The ACCC has not formed a view on compliance with code requirements of the proposed costs that are used in this comparison. The costs relating to the Mildura Pipeline were established through a competitive tender process.

198 RCC report, April 2007, p.17.

199 ACCC, *Final Decision: GasNet Australia access arrangement revisions for the Principal Transmission System*, 13 November 2002, pp. 296-297.

200 RCC report, April 2007, p. 19.

The ACCC agrees with RCC's assessment but considers that Anglo Coal's proposed KPI is of limited value as it gives no weight to pipeline diameter (a proxy for pipeline capacity). The ACCC considers that a better performance indicator would be the ratio of non capital costs to ORC. This measure has been used in a number of regulatory assessments, most recently in the ACCC's approval of the RBP revised access arrangement. As stated by RCC, this measure 'eliminates the bias against short pipelines which is inherent in a comparison based on pipeline length'.[201] The ACCC is of the view that with the inclusion of this measure Anglo Coal would satisfy its obligation to provide KPIs in its access arrangement information.

The ACCC has included this performance indicator for five pipelines including the DVP in Table 9.2. On the basis of this performance indicator, the DVP performs poorly when compared with the other four pipelines. The DVP's proposed cost structure is more than double that of its nearest rival (the Mildura Pipeline) on a non capital cost as a percentage of ORC basis.

Table 9.2: Draft decision performance indicator

Pipeline	Riverlands	Mildura	Central West	Tubridgi	DVP
Pipeline details					
Non capital costs ($ 000)	384	375	708	495	651
ORC ($m)	16.1	12.2	25.5	24.5	9.2
Performance indicator					
Non capital costs as % of ORC	2.4	3.1	2.8	2.0	7.1

Source: RCC report, April 2007. p. 18.
Note: Non capital costs exclude SUG.

To help meet Anglo Coal's obligations under Category 6 of Attachment A of the code, the ACCC proposes that it include the performance indicator non capital costs as a proportion of ORC in section 6 of the access arrangement information.

As noted earlier, the ACCC recognises the limitations of benchmark studies given the difficulties of comparing pipelines that exhibit different characteristics such as pipeline diameter, number of compressors, throughput, number of off-takes and different system operations. In this instance it has reduced the potential influence of these factors by focusing on comparisons with similar, small capacity free flow pipelines.

The ACCC considers that there is sufficient evidence from the two performance indicators discussed above to conclude that the DVP's proposed non capital costs are excessive when assessed against information available with regard to other Australian transmission pipelines. The ACCC's more detailed analysis of the proposed non capital costs is provided at chapter 6 of this draft decision. The ACCC found that the forecast non capital costs (in particular, the indirect costs) have been determined using a methodology that is unlikely to provide a reasonable basis for estimating these costs

[201] ibid, p. 18.

and is unlikely to comply with the relevant provisions of the code. The ACCC has concluded that Anglo Coal's forecast non capital costs are not best estimates arrived at on a reasonable basis.

The ACCC has proposed the following amendment to address its concerns about the adequacy of Anglo Coal's proposed KPIs. This has been discussed with Anglo Coal and it has confirmed that it will include this performance indicator in the AAI.[202]

Proposed amendment 15

In order for the DVP access arrangement to be approved, Anglo Coal must incorporate the performance indicator non capital cost as a percentage of ORC, in its access arrangement information.

9.2 Access arrangement information

9.2.1 Code requirements

Section 2.6 of the code states that the service providers' access arrangement information must contain sufficient information in the opinion of the relevant regulator to enable users and prospective users to:

- understand the derivation of the elements in the proposed access arrangement, and
- form an opinion as to the compliance of the proposed access arrangement with the provisions of the code.

According to s. 2.7 of the code, the access arrangement information provided may include any relevant information, but must at least contain the categories of information described in Attachment A to the code (see Appendix A of this draft decision).

9.2.2 Proposal

Anglo Coal submitted an access arrangement information in support of its proposed access arrangement for the DVP.

9.2.3 Submissions

Submissions from interested parties have not raised any concerns that relate specifically to the adequacy of the access arrangement information. However, they have raised concerns about the adequacy of information provided by Anglo Coal with respect to the maximum capacity of the pipeline, the level of the ICB, the optimised diameter of the pipeline, the level of tax liabilities, overheads and direct marketing costs, the value of the nominal cost of equity, and the assessment of key performance indicators.

[202] Minter Ellison letter to ACCC, 15 May 2007, p. 1.

9.2.4 Assessment

Under the code, the ACCC is required to assess the access arrangement information for compliance with the requirements of ss. 2.6 and 2.7. According to s. 2.7, the access arrangement information must at least contain the categories of information described in Attachment A to the code. The ACCC's views with regard to the issues raised by interested parties are provided in relevant sections of this draft decision.

After assessing the proposed access arrangement information, the ACCC has concluded that the access arrangement information is only partly compliant with s. 2.7 of the code.

The ACCC considers that data relevant to the six categories of information listed in Attachment A of the code have been included in the access arrangement information. Some of the information listed under these categories in Attachment A to the code has also been included in the access arrangement. However, a number of items are assessed as having not been included because they have been included in the access arrangement, they are not relevant to the DVP or they have simply been omitted. For example, no break up has been provided between zones, services or classes of asset. This is consistent with Anglo Coal's proposals for only one reference service to be provided and only one pricing zone. In addition, some of the information has only been included in Anglo Coal's revenue model, which the ACCC generally agrees should be considered as confidential.

Some items that have not been included in the access arrangement information refer to the allocation of costs 'between regulated/unregulated'. For the DVP, these categories require information about allocations between the pipeline and CSM businesses of the DJV. The ACCC has concluded that Anglo Coal has not adequately explained its allocation of costs between regulated and unregulated services in its proposed access arrangement information.

The items that are relevant to the DVP but have not been included in the proposed access arrangement information are set out in the table below.

Table 9.3: Required data for AAI

Category	Item
2	accumulated depreciation
3	cost allocation between zones, services or categories of asset and between regulated/unregulated
	gas used in operations – unaccounted for gas to be separated from compressor fuel
4	allocation of costs between regulated/unregulated segments
5	map of piping system – pipe sizes, distances and maximum delivery capability
	average daily and peak demand at 'city gates' defined by volume and pressure
	system load profile by month in each pricing zone, service or category of asset

Source: ACCC.

The ACCC has assessed the contents of the proposed access arrangement information and is not satisfied that it meets the requirements of s. 2.6 of the code. Without amendment the access arrangement information does not contain such information that

would enable users and prospective users to understand the derivation of the elements in the proposed access arrangement and to form an opinion as to the compliance of the access arrangement with the provisions of the code.

In order for Anglo Coal to fully comply with ss. 2.6 and 2.7 of the code, the ACCC considers that it should amend its access arrangement information to include the omitted items listed above. Anglo Coal will also need to amend its access arrangement information so that it is consistent with the other amendments proposed in this draft decision. This matter has been discussed with Anglo Coal and it has confirmed that it will implement this proposed amendment.[203]

Proposed amendment 16

In order for the DVP access arrangement to be approved, Anglo Coal must incorporate the items listed below in its access arrangement information. Anglo Coal must also amend its access arrangement information so that it is consistent with the other amendments proposed in this draft decision.

- accumulated depreciation,
- allocation of operation and maintenance costs between regulated and unregulated,
- gas used in operations,
- allocation of overhead and marketing costs between regulated and unregulated,
- map of piping system,
- average daily and peak demand, and
- system load profile by month

[203] ibid.

10. Draft decision

Under s. 2.13(b) of the Code, the ACCC proposes not to approve Anglo Coal's access arrangement for the DVP in its present form. This draft decision states the amendments (or nature of amendments, as appropriate) which would have to be made in order for the ACCC to approve the proposed access arrangement at the relevant sections of the document. The proposed amendments are also listed below.

Proposed amendment 1

In order for the DVP access arrangement to be approved, Anglo Coal must amend the reference tariff policy to state that the total revenue is calculated according to the cost of service methodology.

Proposed amendment 2

In order for the DVP access arrangement to be approved, Anglo Coal must amend the reference tariff policy (section 5 of the access arrangement) to state that the reference tariff may be varied during an access arrangement period through the application of a combination of the price path, reference tariff control formula and trigger event adjustment approaches.

Proposed amendment 3

In order for the DVP access arrangement to be approved, Anglo Coal must set the ICB at $7.600m at 1 July 2007.

Proposed amendment 4

In order for the DVP access arrangement to be approved, Anglo Coal must incorporate the parameter values included in Table 5.2 in its access arrangement. A nominal vanilla WACC of 9.08 per cent must be used as the rate of return.

Proposed amendment 5

In order for the DVP access arrangement to be approved, Anglo Coal must include total non capital costs of $300 000, with indirect costs (overheads) of $137 000 (for 2006-07) in its calculation of total revenue.

Proposed amendment 6

In order for the DVP access arrangement to be approved, Anglo Coal must revise its proposed revenue consistent with this draft decision.

Proposed amendment 7

In order for the DVP access arrangement to be approved, Anglo Coal must amend the description of the reference tariff (section 4.1 of the access arrangement) to state that the reference tariff for the reference service for the year ending 30 June 2008 is $0.306/GJ of MDQ/day (excluding GST).

Proposed amendment 8

In order for the DVP access arrangement to be approved, Anglo Coal must amend the description of the reference tariff (section 4.1 of the access arrangement) to state that:

'On 1 July 2008 and on 1 July each year thereafter, the reference tariff will be adjusted as follows:'

Proposed amendment 9

In order for the DVP access arrangement to be approved, Anglo Coal must include the following provisions in section 4 of the access arrangement:

- Anglo Coal must provide a notice to the regulator of its proposed revised reference tariff in accordance with the reference tariff formula at least 30 days business days prior to 30 June for each year of the access arrangement period
- this notice must specify that the proposed variations to the reference tariff applies from 1 July of the relevant year
- the regulator will assess the proposed reference tariff provided by Anglo Coal and determine if they comply with the relevant CPI-X formula. The regulator will publish its decision at least 10 business days before 1 July of each year of the access arrangement period.
- if the regulator does not provide a notice at least 10 business days before 1 July, the regulator will be taken to have approved the revised reference tariff, which will come into effect on 1 July of the relevant year

- in the period before 10 business days prior to 1 July (the assessment period), the regulator may request additional information if it considers that such information will assist its assessment. This will extend the relevant assessment period by the number of days commencing on the day on which the regulator gave notice to Anglo Coal and ending on the day on which Anglo Coal submits the required information.

- the regulator may grant an extension on application by Anglo Coal of any of the time periods associated with this process.

Proposed amendment 10

In order for the DVP access arrangement to be approved, Anglo Coal must include the following provisions in section 4 of the access arrangement:

- for each year of the access arrangement period Anglo Coal must provide written notice to the regulator that a specified event has either occurred or not occurred. If such an event has occurred, Anglo Coal must notify the regulator as to the scope of the financial impact, how the claim is consistent with the trigger event adjustment mechanism, the proposed variations to the reference tariff and an effective date for the changes. The notification must also include all relevant supporting information to substantiate Anglo Coal's proposal.

- Anglo Coal must submit only one pass through notice a year, which must be submitted at least 50 business days prior to 30 June. This notice may incorporate a number of pass through claims or may specify that none of the specific events defined in the reference tariff policy have occurred.

- in the period before 10 business days prior to 1 July (the assessment period), the regulator may request additional information if it considers that such information will assist its assessment. This will extend the relevant assessment period by the number of days commencing on the day on which the regulator gave notice to Anglo Coal and ending on the day on which Anglo Coal submits the required information.

- the regulator will provide its decision at least 10 business days before 1 July of each year of the access arrangement period.

- if the regulator does not provide a decision at least 10 business days before 1 July, the regulator will be taken to have approved the revised tariffs, which will come into effect on 1 July of the relevant year

- the regulator may grant an extension on application by Anglo Coal of any of the time periods associated with this process.

Proposed amendment 11

In order for the DVP access arrangement to be approved, Anglo Coal must amend its trading policy to specify that in relation to a transfer or assignment of capacity, reasonable grounds for a rejection of a request may be:

- a failure of a transferee to satisfy the service provider of its credit worthiness, and
- if acceptance of the request would have a material adverse impact upon the service provider's revenue stream.

In addition, the trading policy must specify that in relation to changing a users receipt or delivery point, reasonable grounds for a rejection may be:

- where a reduction in the amount of the service provided to the original delivery point will not result in a corresponding increase in the service provider's ability to provide that service to the alternative delivery point, and
- if acceptance of the request would have a material adverse impact upon the service provider's revenue stream.

Proposed amendment 12

In order for the DVP access arrangement to be approved, Anglo Coal must amend its queuing policy to specify that reasonable grounds for rejecting an access request may be:

- a failure of a transferee to satisfy the service provider of its credit worthiness, and
- if acceptance of the request would have a material adverse impact upon the service provider's revenue stream.

In addition, the queuing policy is to specify timeframes for the relevant actions undertaken under the queuing policy.

Proposed amendment 13

In order for the DVP access arrangement to be approved, Anglo Coal must specify how an extension that is to be treated as part of the covered pipeline will affect the reference tariff.

Proposed amendment 14

In order for the DVP access arrangement to be approved, Anglo Coal must specify that it will notify the regulator of the commencement of services provided through an expansion or extension to the DVP within 30 business days of the commencement of those services.

Proposed amendment 15

In order for the DVP access arrangement to be approved, Anglo Coal must incorporate the performance indicator non capital cost as a percentage of ORC, in its access arrangement information.

Proposed amendment 16

In order for the DVP access arrangement to be approved, Anglo Coal must incorporate the items listed below in its access arrangement information. Anglo Coal must also amend its access arrangement information so that it is consistent with the other amendments proposed in this draft decision.

- accumulated depreciation,
- allocation of operation and maintenance costs between regulated and unregulated,
- gas used in operations,
- allocation of overhead and marketing costs between regulated and unregulated,
- map of piping system,
- average daily and peak demand, and
- system load profile by month

Appendix A: Attachment A to the code

Pursuant to section 2.7 the following categories of information must be included in the access arrangement information.

The specific items of information listed under each category are examples of the minimum disclosure requirements applicable to that category but, pursuant to sections 2.8 and 2.9, the relevant regulator may:

- allow some of the information disclosed to be categorised or aggregated; and
- not require some of the specific items of information to be disclosed

if in the relevant regulator's opinion it is necessary in order to ensure the disclosure of the information is not unduly harmful to the legitimate business interests of the service provider or a user or prospective user.

Category 1: Information Regarding Access & Pricing Principles

Tariff determination methodology
Cost allocation approach
Incentive structures

Category 2: Information Regarding Capital Costs

Asset values for each pricing zone, service or category of asset
Information as to asset valuation methodologies - historical cost or asset valuation
Assumptions on economic life of asset for depreciation
Depreciation
Accumulated depreciation
Committed capital works and capital investment
Description of nature and justification for planned capital investment
Rates of return - on equity and on debt
Capital structure - debt/equity split assumed
Equity returns assumed - variables used in derivation
Debt costs assumed - variables used in derivation

Category 3: Information Regarding Operations & Maintenance

Fixed versus variable costs
Cost allocation between zones, services or categories of asset & between regulated/unregulated
Wages & Salaries - by pricing zone, service or category of asset
Cost of services by others including rental equipment
Gas used in operations - unaccounted for gas to be separated from compressor fuel
Materials & supply
Property taxes

Category 4: Information Regarding Overheads & Marketing Costs

Total service provider costs at corporate level
Allocation of costs between regulated/unregulated segments
Allocation of costs between particular zones, services or categories of asset

Category 5: Information Regarding System Capacity & Volume Assumptions

Description of system capabilities
Map of piping system - pipe sizes, distances and maximum delivery capability
Average daily and peak demand at "city gates" defined by volume and pressure
Total annual volume delivered - existing term and expected future volumes
Annual volume across each pricing zone, service or category of asset
System load profile by month in each pricing zone, service or category of asset
Total number of customers in each pricing zone, service or category of asset

Category 6: Information Regarding Key Performance Indicators

Industry KPIs used by the service provider to justify "reasonably incurred" costs
Service provider's KPIs for each pricing zone, service or category of asset

Appendix B: Submissions

Molopo Australia Limited	9 March 2007
AGL Sales (Queensland) Pty Limited	19 March 2007
Sunshine Gas Limited	21 March 2007
WestSide Corporation Ltd	21 March 2007
Molopo Australia Limited (confidential)	27 March 2007
Anglo Coal/Mitsui Moura response to Molopo's submission	13 April 2007
Anglo Coal/Mitsui Moura response to AGL's submission	20 April 2007
Anglo Coal/Mitsui Moura response to WestSide's submission	20 April 2007
Anglo Coal/Mitsui Moura response to Sunshine Gas's submission	26 April 2007

Appendix C: Consultant reports

Ross Calvert Consulting Pty Ltd *Report on Dawson Valley Pipeline Access Arrangement and Access Arrangement Information*	April 2007
Unidel Group *Dawson Valley Pipeline: access arrangement review*	30 April 2007
Unidel Group *Dawson Valley Pipeline: supplement to the access arrangement review*	9 May 2007

Appendix D: Pipeline map