



INVESTMENT PTY LTD
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SUBMISSION

Provided to the Australian Competition and Consumer Commission in response to the submission lodged by Molopo Australia Limited in relation to the Access Arrangement for the Dawson Valley Pipeline

1. Introduction

- 1.1 Anglo Coal (Dawson) Limited, Mitsui Moura Investment Pty Ltd and Anglo Coal (Dawson Management) Pty Ltd are Service Providers for the Dawson Valley Pipeline (**DVP**).
- 1.2 On 5 February 2007, the Service Providers submitted a proposed Access Arrangement and Access Arrangement Information for the DVP to the Australian Competition and Consumer Commission (**ACCC**) pursuant to section 2.2 of the National Third Party Access Code for Natural Gas Pipeline Systems (**Code**).
- 1.3 On 15 February 2007, the ACCC invited interested parties to make submissions on any issues relevant to the proposed Access Arrangement by 16 March 2007.
- 1.4 Molopo Australia Limited (**Molopo**) lodged a submission on 9 March 2007.
- 1.5 The submission addresses the four key issues raised by Molopo in the order in which the issues were raised:
 - (a) the capacity of the DVP has been significantly understated;
 - (b) the proposed ICB is exceedingly high;
 - (c) tax liabilities appear to have been overstated; and
 - (d) overheads and direct marketing costs are unreasonable.

2. The capacity of the DVP has been significantly understated

- 2.1 At page 1 of its submission, Molopo states that '*the true capacity of [the] DVP is at least 38TJ/d, or 25% above the stated capacity*'. It bases this contention on two assumptions namely the pressure at which gas is delivered to the Queensland Gas Pipeline (**QGP**) and the heating value at which gas is transported through the DVP.
- 2.2 The theoretical maximum capacity of the DVP based on the simple capacity of the pipeline is, as stated at page 3 of the Access Arrangement Information, 30TJ/day.
- 2.3 The actual maximum flow of the DVP utilising current equipment is 22-24TJ/day. This has been confirmed by detailed flow simulation and modelling. 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.
- 2.4 The Service Providers have not, as alleged by Molopo, inappropriately taken '*unrelated factors or constraints ... into account in [their] assessment of pipeline capacity*'. Rather, the Service Providers have stated the capacity of the DVP to be the simple capacity of the pipeline.

3. The proposed ICB is exceedingly high

- 3.1 Molopo states at pages 1 and 2 of its submission that '*the proposed ICB is exceedingly high*'. Its first key reason for this is that the ICB '*has been derived from an unoptimised replacement cost*'.
- 3.2 In response to Molopo's argument that service to be provided by the DVP could be comfortably achieved by a nominal 100mm diameter pipeline and potentially, by a nominal 75mm diameter pipeline, the Service Providers make the following comments:

- (a) the decision as to what diameter pipeline should be used in any project is always the subject of much debate but is ultimately a commercial decision based upon an expectation of future usage;
- (b) if a pipeline is built with a diameter that is too small, looping will be required to expand capacity and this is significantly more expensive than initially using a pipeline with a larger diameter;
- (c) a rational, reasonable investor who was considering investing in a transmission pipeline of a similar scale to the DVP would choose a 150mm diameter pipeline on the basis that the potential benefits from that diameter outweighed any cost differential;
- (d) 150mm diameter pipelines are common in gas transmission and gas distribution systems across Queensland. The Service Providers are aware of only one 100mm diameter pipeline, the Wide Bay pipeline which travels from Gladstone to Maryborough and provides the gas distribution networks for Hervey Bay and Maryborough;
- (e) the suggestion that a 75mm diameter pipeline could be optimal is commercially unsound. It focuses only on historical throughput and does not allow for any market growth. Further, 75mm diameter pipe is generally used for short pipelines and is not appropriate for a gas transmission pipeline of 47km length;
- (f) while it is correct that a 100mm diameter pipeline could provide sufficient transportation services for both historical and current levels of throughput, a 100mm diameter pipeline does not allow for market growth over the extensive life of the pipeline; and
- (g) the Service Providers consider that there would be only a minimal reduction in the ICB if the Service Providers used a nominal 100mm diameter pipeline rather than a 150mm diameter pipeline in their calculations. The largest component of cost of construction of a pipeline is labour and machinery. The reduction in diameter of 50mm is unlikely to have any significant impact on the overall cost. It may affect input costs, including tonnage of steel, welding and in construction the amount of pipe able to be transported at any one time but would not affect these costs to any significant degree.

3.3 The second key reason stated by Molopo in support of its statement that '*the proposed ICB is exceedingly high*' is that the price paid for purchase of the DVP must be taken into account. Molopo does not explain how it considers that the allegedly low price paid contributes to a proposed ICB which is exceedingly high.

3.4 In relation to the requirement under section 8.10(j) of the Code to consider the '*price paid for any asset recently purchased by the Service Provider and the circumstances of that purchase*', the Service Providers confirm that they purchased the DVP from Oil Company of Australia (Moura) Pty Limited and Oil Company of Australia (Moura) Transmissions Pty Limited in March 2006. However the DVP was purchased as part of a basket of assets and as such there was no 'price paid' for the DVP. The Service Providers submit that the value that was allocated to the DVP as part of the purchase price allocation is not equivalent to the concept of the 'price paid' under section 8.10(j) of the Code. The purchase price allocation has been disclosed to the ACCC on a confidential basis.

4. Tax liabilities appear to have been overstated

4.1 At page 3 of its submission, Molopo states that the application of straight-line depreciation over a remaining 50 year life in determining tax liabilities '*leads to tax liabilities and, in turn, Total Revenue and tariffs being materially overstated in the near term*'.

- 4.2 The Service Providers confirm that they applied straight-line depreciation over the effective life of the DVP in their determination of tax liabilities for the initial calculation of the Reference Tariff. After discussions with the AER, the Service Providers have amended their model and now apply straight-line depreciation over a 19 year remaining tax life (from 1 July 2007) rather than over the effective life of the DVP.
- 4.3 The use of the net present value (**NPV**) methodology, incorporating straight-line depreciation, to calculate Total Revenue is the preferred methodology used by the ACCC in its regulation of Service Providers in the energy industry. It is consistent with the *Statement of principles for the regulation of transmission revenues* (May 1999) and the *Post Tax Revenue Handbook* (October 2001). The Access Arrangement Process Guideline encourages Service Providers to use the models in the *Post Tax Revenue Handbook* to calculate Reference Tariffs.¹
- 4.4 The NPV methodology has been used by the ACCC in various final decisions including:
- (a) Access Arrangement by APT Pipelines (NSW) Pty Ltd for the Central West Pipeline; and
 - (b) Access Arrangement by East Australian Pipeline Limited for the Moomba to Sydney Pipeline System.
- 4.5 The NPV methodology incorporating straight-line depreciation is also consistent with Australian taxation law. The Code places no obligation upon the Service Providers to adopt taxation minimisation strategies.

5. Overheads and direct marketing costs are unreasonable

- 5.1 Molopo makes various statements in relation to costs at pages 3 and 4 of its submission including:
- (a) *'overheads and direct marketing costs are unreasonable'*;
 - (b) *'regulatory costs are modest and are not recurring'*;
 - (c) *"expenditure on unreasonable marketing cannot be justified"*; and
 - (d) *'the only acceptable course of action is, with the exception of bona-fide regulatory costs, to disallow the claimed overheads'*.

The Service Providers submit that these statements, in particular section 5.1(d) indicate that Molopo has a fundamental misunderstanding of the nature of costs which may be included for the purposes of determining a Reference Tariff.

- 5.2 Section 8.4 of the Code provides that Total Revenue should be calculated according to one of three methodologies. Each methodology provides that the Total Revenue should be calculated on the basis of all costs to be incurred in providing the Services. 'Services' is defined in section 10.8 of the Code to mean:
- '(a) a service provided by means of a Covered Pipeline ... including (without limitation);*
(i) haulage services ...; and
(ii) the right to interconnect with the Covered Pipeline, and
(b) services ancillary to the provision of such services,
- but does not include the production, sale or purchase of Natural Gas.'*

¹ Access Arrangement Process Guideline, page 14

- 5.3 Consequently, the costs which are properly to be included in a calculation of Total Revenue are all costs which will be incurred in providing the Services, i.e. all costs which would be incurred by a company owning and operating the pipeline on a stand alone basis.
- 5.4 In relation to Molopo's statement at page 3 that the cost component for overheads and marketing costs included in the Access Arrangement '*extreme and unsustainable*', the Service Providers make the following comments:
- (a) the fact that the cost component for overheads and marketing is a high percentage of the Reference Tariff is a reflection of the lack of benefits of economies of scale and economies of scope in relation to the DVP. The Service Providers consider that the cost estimate of \$488,000 is a reasonable, measured assessment of the true costs of providing the Services and of services ancillary to the provision of the Services;
 - (b) there are many regulatory costs which do recur annually. These include the costs of compliance with the ring fencing obligations in section 4 of the Code including the requirement to keep separate books of account and the requirement to lodge annual Statements of Compliance;
 - (c) marketing costs capture a broad range of costs as evidenced by the definition of 'Marketing Staff' in section 10.8 of the Code; and
 - (d) as noted at page 8 of the Access Arrangement Information, the 'escalating costs' is an annual escalation in line with an expected inflation of 3.2%.
- 5.5 The Service Providers dispute Molopo's statement that '*On the basis of reasonable estimates (prepared by the previous owner of the DVP and set out in an application for revocation of coverage and submitted to the National Competition Council on 10 August 2000) regulatory costs may, after allowing for inflation, amount to around \$120,000 to \$180,000.*' A similar submission was made by Molopo to the National Competition Council (**NCC**) in support of its application for coverage of the DVP.

The NCC dealt with the issue of direct costs of regulation at page 41 of its Final Recommendation of 31 August 2005 where it is stated that:

'the estimated direct (or administrative) costs of regulation (for example, legal and expert fees) provided by the applicant and OCA range from \$100 000 to \$600 000. However the lower bound of this range is only based on costs for a pipeline owner in 2000. The Council considers that the direct costs to parties participating in developing an access arrangement are likely to be towards the upper bound of these estimates or perhaps greater. The Council also notes that the costs of regulation are not limited to these direct costs. The total cost of regulation could be significantly greater when all relevant costs were included.'

These comments are in direct contrast to Molopo's statement referred to above and to Molopo's submission to the NCC.

- 5.6 In relation to Molopo's statement that '*if (which is contested) marketing and contract overheads are allowed to be included in Total Revenue then there should be an expectation of market growth and there should be a tangible benefit (by way of improved tariffs) realised as a consequence*', the Service Providers make two comments:
- (a) the proposal at pages 10 and 11 of the Access Arrangement that the Service Providers retain the benefits of market growth is consistent with sections 8.44 to 8.46 of the Code which permits the Reference Tariff Policy to contain an Incentive Mechanism; and

- (b) the impact of the Incentive Mechanism is tempered by the trigger included in the Access Arrangement whereby the Service Providers will lodge revisions to the Access Arrangement within three months of throughput in excess of 25% of the demand forecast. This ensures that the benefits of any market growth above 25% of the demand forecast will be shared with Users and not retained solely by the Service Provider.

6. Other comments

- 6.1 At row 2 of its Summary of Contents table, Molopo identifies a typographical error in section 5 of the Access Arrangement where '*the proposed residual value at the end of the Access Arrangement Period exceeds the Initial Capital Base (both expressed in July 2006 dollars)*'. The correct Residual Value at the end of the Access Arrangement Period is \$6.113million (2006\$) or \$8.344million (2016\$). As the Access Arrangement will now commence 1 July 2007 the relevant commencement date of the next Access Arrangement is 1 July 2017. At this date the residual asset value will be \$8.393 million (2017\$) or \$5.960 million (2006\$).
- 6.2 Despite Molopo's statement on page 4 of its submission, that it is '*currently paying around \$0.19/GJ for the 'Non-Firm' Service*', the Service Providers confirm that Molopo is not a current customer of transportation services on the DVP. It ceased to be a customer on 31 December 2006.

7. Conclusion

- 7.1 This submission has addressed the four key issues raised by Molopo in its submission. In summary, the Service Providers submit that:
 - (a) the capacity of the DVP has not been significantly understated. The Service Providers have stated the capacity of the DVP to be the simple capacity of the pipeline;
 - (b) the proposed ICB is not exceedingly high. It has been calculated in accordance with the Code and the supporting information has been provided to the ACCC;
 - (c) its tax liabilities have not been overstated. The Service Providers have used the ACCC's preferred methodology in calculating Total Revenue; and
 - (d) the overheads and direct marketing costs are not unreasonable. The costs which have been included in the Total Revenue are a reasonable, measured assessment of the true costs of providing the Services.
- 7.2 For the reasons set out above, the Service Providers submit that the ACCC should give little weight to the concerns raised by Molopo in its submission.