MOLOPO AUSTRALIA LIMITED

ABN 79 003 152 154

March 9th, 2007

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

Dear Mr Walsh,

Re: Dawson Valley Pipeline – Proposed Access Arrangement

Thank you for the opportunity to comment on this matter.

The Access Arrangement that has been proposed for the Dawson Valley Pipeline is erroneous and potentially pernicious. The Service Provider has not taken into account key principles of the *National Third Party Access Code for Natural Gas Pipeline Systems* and has proposed Reference Tariffs that seem:

- incorrectly formulated
- several times greater than has been historically offered for services equivalent to the Reference Service; and
- if allowed to prevail, will be a backward step both for development of the gas resources of the region served by the pipeline and for competition in (at least) the Gladstone gas market.

I have enclosed herewith a Submission that provides a concise overview of concerns and issues that we hope will be researched and considered by the ACCC. A summary of comments, identifying relevant sections of the proposed Access Arrangement documentation, is also provided in the attached table.

Yours faithfully,

Stephen Mitchell
Managing Director

Registered Office:
Level 14, 31 Queen Street, Melbourne, Victoria 3000, Australia
G.P.O. Box 223, Melbourne, Victoria 3001, Australia

Telephone: (61 3) 9618 8722, Facsimile: (61 3) 9620 2804
Website: www.molopo.com.au, Email: slord@lowell.net.au

NSW Office:
Suite 1006, Level 10, 50 Clarence Street, Sydney, NSW 2000, Australia
G.P.O. Box 7075, Sydney, NSW 2001, Australia

Telephone: (61 2) 9290 2267, Facsimile: (61 2) 9290 2099

Summary of Comments

Reference	Comment
Access Arrangement	
§4	The proposed Reference Tariff is excessive. It is around three times the level that was charged for a firm service by the previous owners of the DVP.
§5	- The costs covered are inefficient or excessive - The Service Provider retains the benefits of greater throughput but treats marketing costs as recoverable from Users. - The proposed residual value at the end of the Access Arrangement Period exceeds the Initial Capital Base (both expressed in July 2006 dollars). This appears to be inconsistent with the use of a nominal NPV methodology and suggests the Service Provider may have treated inflation incorrectly in its modelling.
Access Arrangement Information	
§1	The capacity of the DVP is likely understated. Anglo Coal should substantiate its capacity calculation.
§2	Anglo Coal's modelling cannot be duplicated by us. The approach to modelling should be more fully explained and audited. For example, section 8.5A of the Code provides for a nominal rate of return to be applied to a Capital Base and Depreciation expressed in historic (rather than nominal) terms.
§3	- Anglo Coal's approach to determination of the ICB is inappropriate. It is based upon an <u>unoptimised</u> pipeline configuration, it ignores historic costs and has no regard for the price paid for the pipeline. - An optimised pipeline configuration would be smaller in diameter than the existing pipeline, and would therefore have a lower DORC. - Anglo Coal should disclose the price paid for the pipeline two years ago, and the price paid should be taken into account in determining the Initial Capital Base. - Anglo Coal's treatment of tax needs to be reviewed.
§4	- Overhead and marketing costs are excessive. - Regulatory costs do not recur annually and also seem excessive. - In circumstances where no load growth is expected it is counter-intuitive that provision be made for marketing costs.
§5	The proposed Reference Tariff is excessive. It is around three times the level that was charged for a firm service by the previous owners of the DVP.

Submission
to
Australian Competition and Consumer Commission

Comments
on
Proposed Access Arrangement
and
Access Arrangement Information
for the
Dawson Valley Pipeline

Submitted by
Molopo Australia Limited
March 2007

This document provides an overview of concerns in relation to the Access Arrangement and Access Arrangement Information as proposed for the Dawson Valley Pipeline by Anglo Coal (Dawson) Limited, Anglo Coal (Dawson Management) Pty Ltd and Mitsui Moura Investment Pty Ltd.

The capacity of the DVP has been significantly understated

The maximum capacity of the DVP is represented by the Service Provider (see page 3 of AAI) as being 30 TJ/d. This appears to us to be understated.

Using standard pipeline modelling techniques incorporating the following conservative assumptions, the true capacity of DVP seems at least 38 TJ/d, or 25% above the stated capacity.

Assumptions:

- Gas will be delivered to the Queensland Gas Pipeline ("QGP") at a pressure of 10.5 MPa. This exceeds the Maximum Allowable Operating Pressure of the QGP by a margin sufficient to accommodate pressure losses through custody transfer facilities. In reality, the typical operating pressure of the QGP at the DVP connection location is publicly stated by Alinta Infrastructure Holdings to be 8.06 MPa.
- Gas transported through the DVP will have a Higher Heating Value of 35.0 MJ/m^3, being the minimum value that will be accepted into the QGP. In contrast, the Higher Heating Value of pure methane is 37.7 MJ/m^3.

It may be that the Service Provider is inappropriately taking unrelated factors or constraints, such as the availability of compression power, into account in its assessment of pipeline capacity. Whatever the case, the pipeline capacity statement needs to be corrected as erroneous information or calculation methodologies may have consequential impacts (for example, when assessing capital redundancy).

The proposed ICB is exceedingly high

The Initial Capital Base ("ICB") as proposed by the Service Provider is exceedingly high for two key reasons, as follow.

The existing 150mm diameter pipeline is not optimal

First, the ICB has been derived from an unoptimised replacement cost. The Service Provider's statement (page 5 of AAI) that "the current configuration of the DVP is considered the minimum design for a transmission pipeline and as such no optimisation has been undertaken" is unreasonable. The service to be provided by the DVP (namely, transportation of 2,920 TJ/a of gas, as stated on page 8 of the AAI) could be comfortably achieved by a nominal 100 mm diameter pipeline and, potentially, by a nominal 75 mm diameter pipeline. This is illustrated in Table 1.

Nominal Size, mm	150	100	75
Pipeline OD, mm	168.3	114.3	88.9
Inlet Pressure, MPa	14.6	14.6	15.3
Internal Roughness, µm	25	25	7
Capacity TJ/d	38	14	8.5
Capacity TJ/a	14,000	5,000	3,000

Table 1: Pipeline Capacities

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. To adopt any other approach is contrary to the principles and requirements of the *National Third Party Access Code for Natural Gas Pipeline Systems* (the "Code").

The price paid for purchase of the DVP must be taken into account

Second, an explicit requirement of the procedure for determination of the ICB, as set out in the Code, is that "the price paid for any asset purchased by the Service Provider and the circumstances of that purchase" be taken into account.

The Service Provider purchased the DVP in March 2006 as part of a process that was conducted without duress by fully informed gas industry participants, the count-party to the transaction being an Origin Energy subsidiary. The Service Provider should be obliged to disclose the amount allocated for purchase of the DVP when the Origin transaction was completed. The relevant value would likely have been declared to the Australian Taxation Office.

In the absence of disclosure it is suggested the amount allocated for purchase of the DVP was very little. The confidential Attachment to this submission provides background for this view.

The methodology adopted for calculation of the Reference Tariff is unclear.

The Service Provider has adopted a post tax nominal WACC of 8.86% and has used a NDV methodology, incorporating straight-line depreciation, to calculate Total Revenue.

Tax liabilites appear to have been overstated.

In the absence of a full explanation of the modelling approach, it would appear that straight-line depreciation (over a remaining 50 year life) has been used in the determination of tax liabilities. This leads to tax liabilities and, in turn, Total Revenue and tariffs being materially overstated in the near term.

The Service Provider's NPV approach to modelling should be adequately explained or, at the very least, scrutinised by the AER to ensure it conforms with accepted regulatory practices.

Overheads and Direct Marketing Costs are unreasonable

The Service Provider has proposed inclusion of an escalating cost component (commencing at $488,000 in 2006/07) to cover the costs of "maintaining, monitoring and administering the DVP, Access Arrangement and customers". The proposed amount:

- represents, on average over the proposed Access Arrangement Period, 16.7 c/GJ, or 40% of the proposed Reference Tariff; and

- is some three times the annual cost of operating and maintaining the DVP.

In our view, the Service Provider's proposal is extreme and unsustainable.

Contrary to the Service Provider's suggestion, Regulatory costs are modest and are not recurring

On the basis of reasonable estimates (prepared by the previous owner of the DVP and set out in an application for revocation of coverage 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. This is but a small portion of the claimed overhead provision and, perhaps more significantly, the cost in question does <u>not</u> recur annually.

Expenditure on unreasonablerketin g cannot be justified

As is obvious from the Service Provider's estimate of gas throughputs (see page 8 of the AAI) there is no expectation of market growth. Accordingly, provision of an excessive amount for 'maintaining, monitoring and administering the .... Access Arrangement and customers" is unreasonable.

The Overheads claim must be disallowed

The only acceptable course of action is, with the exception of bona-fide regulatory costs, to disallow the claimed overheads.

Reinforcing the above view are the following observations:

- Reference Tariffs for provision of services in the DVP should only provide for recovery of the efficient costs of service provision; and
- 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 <u>and</u> there should be a tangible benefit (by way of improved tariffs) realised as a consequence. On the contrary, there is no expectation of market growth or, if there is, the Service Provider proposes (see pages 10 and 11 of the Access Arrangement) that those benefits will be retained by the Service Provider and not shared with Users.

The proposed Reference Tariffs are several times more than has been historically charged for a firm service.

The previous owner of the DVP (Oil Company of Australia) charged around $0.135/GJ ("Firm Gas") to $0.182/GJ ("Non Firm" gas) for use of the DVP. Molopo is currently paying around $0.19/GJ for the "Non Firm" service.

In contrast with the above, the owners of the DVP have sought approval for a Reference Tariff of $0.406/GJ payable on the basis of reserved capacity. The actual cost of transporting gas through the DVP will be dependent upon the load factor at which gas is transported. By way of example, at a load factor of 90% the effective tariff will be $0.45/GJ and at a load factor of 80% it will be $0.51/GJ.

The 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.

It is envisaged that Reference Tariffs for the DVP, when established in accordance with the Code and with regard for the matters outlined above, will be below the level charged historically for use of the DVP.