

APPLICATION FOR COVERAGE OF THE DAWSON VALLEY PIPELINE

DECISION

I, the Hon Ian Macfarlane, MP, Minister for Industry, Tourism and Resources, being the Relevant Minister for coverage decisions for Queensland Transmission Pipelines under the National Third Party Access Code for Natural Gas Pipeline Systems, make the following decision in relation to the Application for Coverage of the Dawson Valley Pipeline.

26 April 2006

DECISION

In accordance with section 1.13 of the National Third Party Access Code for Natural Gas Pipeline Systems (Code) as applied in Queensland by the *Gas Pipelines Access (Queensland) Act 1998*, I have decided that the Dawson Valley Pipeline is Covered.

DESCRIPTION OF THE PIPELINE

My decision relates to the Dawson Valley Pipeline (DVP), which is the pipeline in Diagram 1 at Appendix 1 covered by Queensland pipeline licence PPL 26 extending from the Dawson Valley to the Wallumbilla to Gladstone Pipeline (otherwise referred to as the Queensland Gas Pipeline) which is owned by Alinta Infrastructure Holdings.

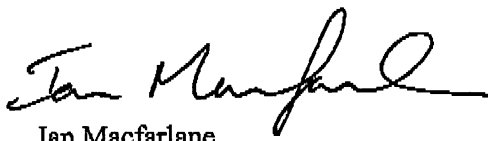
STATEMENT OF REASONS

The reasons for my decision, which incorporate an assessment of the Council's final recommendation and supplementary advice, are set out in the attached Statement of Reasons. The coverage criteria have been assessed in the same order that they were provided to me by the Council, namely Criterion (b), followed by Criteria (a), (c), and (d).

I am satisfied that the DVP meets all of the coverage criteria set out in paragraphs (a) to (d) of section 1.9 of the Code, and that the pipeline should be covered.

RIGHT TO REVIEW AND DATE OF EFFECT

Pursuant to section 1.19 of the Code, this decision is subject to review by the Australian Competition Tribunal. The decision has effect from 10 May 2006, being not earlier than 14 days after the date of this decision.

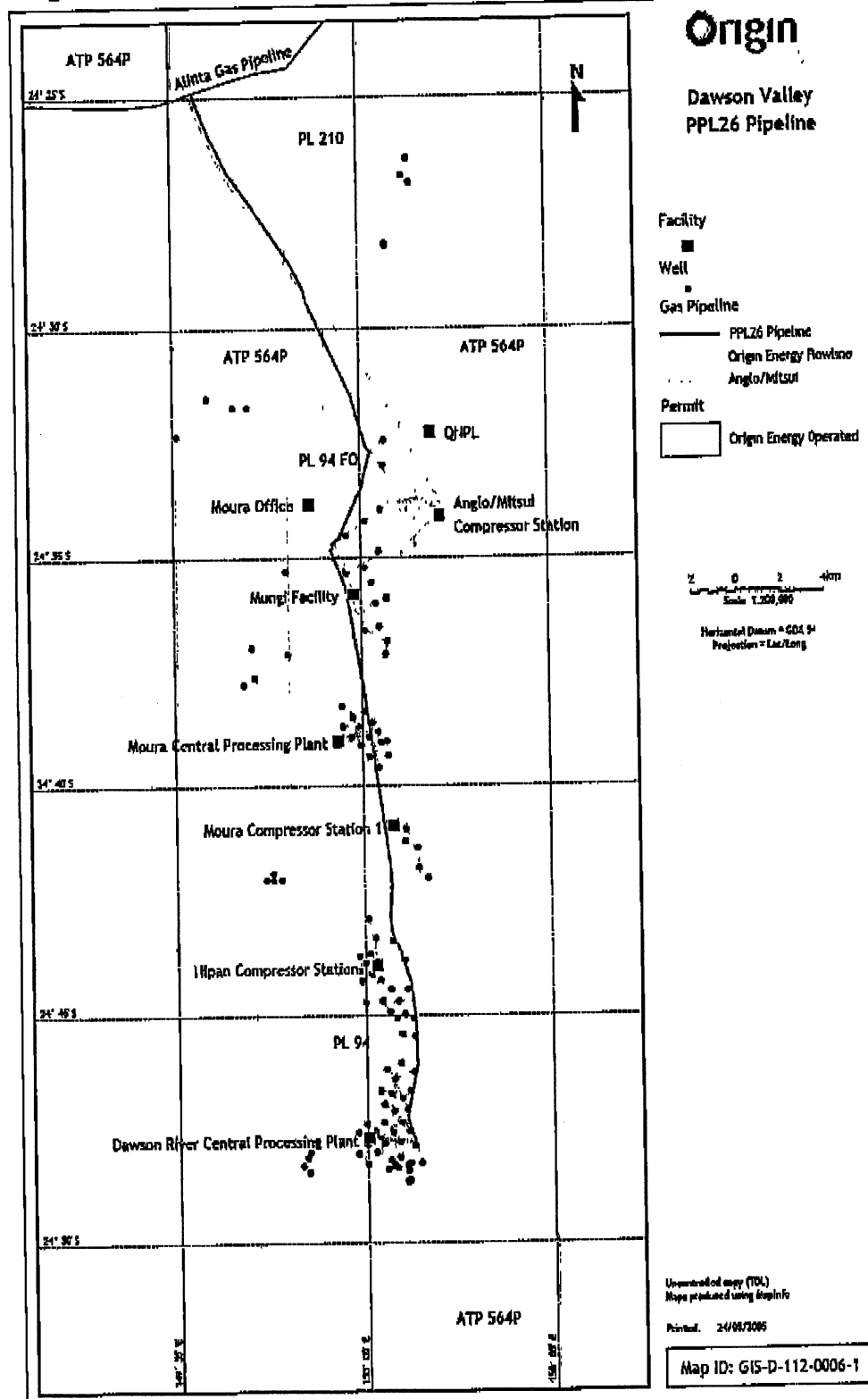


Ian Macfarlane

26 April 2006

Appendix 1

Diagram 1 – Illustration of the Dawson Valley Pipeline and surrounds



Source: Oil Company of Australia (Moura) Transmissions Pty Ltd: submission

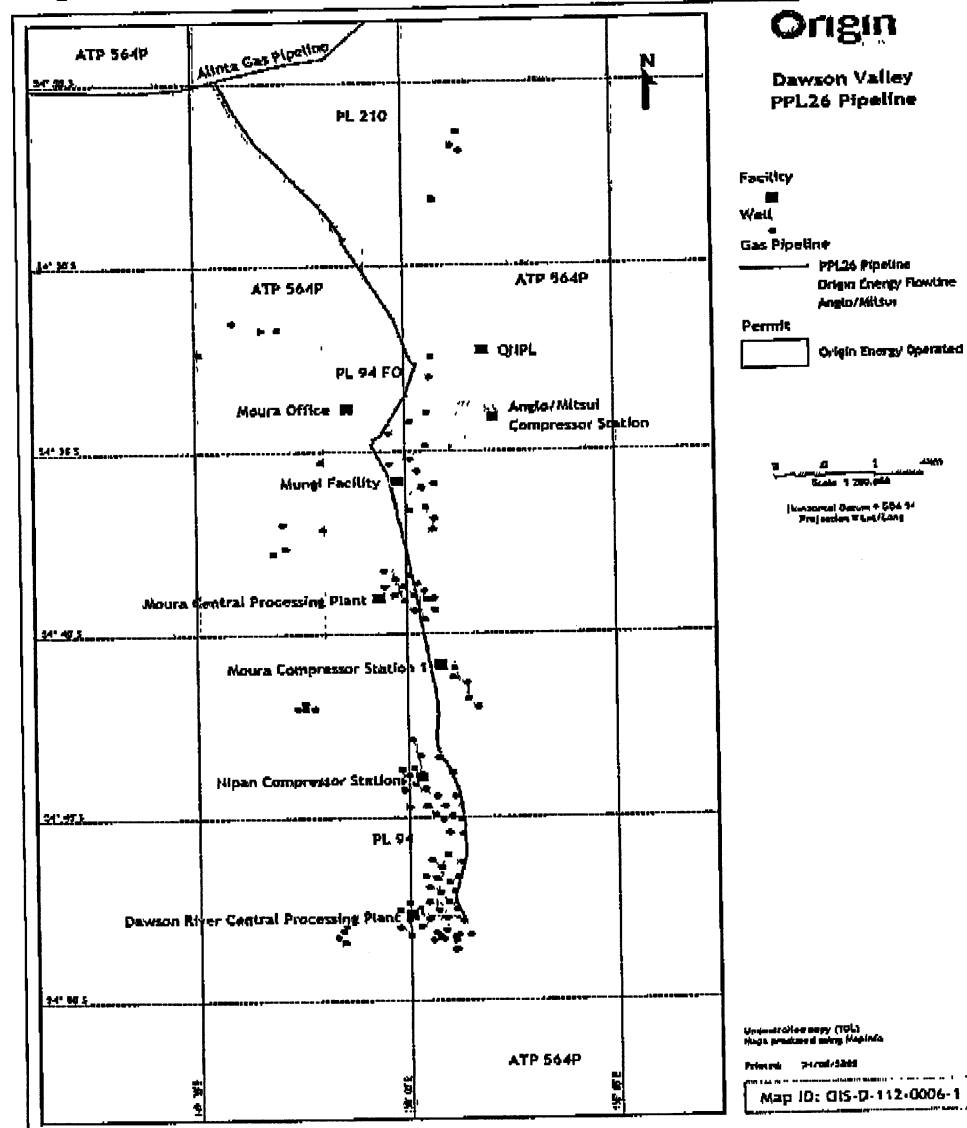
APPLICATION FOR COVERAGE OF THE DAWSON VALLEY PIPELINE

STATEMENT OF REASONS FOR DECISION

On 16 March 2005, the National Competition Council (Council) received an application for coverage of the Dawson Valley Pipeline (DVP) under the National Third Party Access Code for Natural Gas Pipeline Systems (Code) from Molopo Australia Limited (Molopo). The *Gas Pipelines Access (Queensland) Act 1998* applies the Code to gas pipelines in Queensland.

The DVP is the pipeline in Diagram 1 covered by Queensland pipeline licence PPL 26 extending from the Dawson Valley to the Wallumbilla to Gladstone Pipeline (otherwise referred to as the Queensland Gas Pipeline) which is owned by Alinta Infrastructure Holdings.

Diagram 1 – Illustration of the Dawson Valley Pipeline and surrounds



Source: Oil Company of Australia (Moura) Transmissions Pty Ltd: submission

I have authority to make the decision on whether the DVP is covered under the Code. Under section 2 of Schedule 1 to the *Gas Pipelines Access (South Australia) Act 1997*, the Relevant Minister for transmission pipeline decisions is the 'designated Minister'. Section 11 of the *Gas Pipelines Access (Queensland) Act 1988* provides that the 'designated Minister' is the Commonwealth Minister.

I have assessed the coverage application in accordance with the coverage criteria of section 1.9 of the Code. These criteria are set out at **Appendix 1**. The Minister's role in the decision making process is set out at **Appendix 2**.

Coverage Process

On 16 March 2005, the Council received an application for coverage of the DVP under the Code from Molopo.

Following a public consultation process, the Council released its draft recommendation on 8 June 2005. The Council subsequently received several submissions. On 4 August 2005, the Council provided its final recommendation which recommended that the DVP should not be covered. The Council's recommendations and the submissions it received are available on the Council's website www.ncc.gov.au.

The basis of the Council's recommendation was that the DVP did not satisfy Criterion (d) - relating to public interest. The Council considered that the presence of the Anglo-Mitsui Pipeline in close proximity to the DVP acted as a significant constraint on the DVP's ability to exercise market power.

On 16 August 2005, I received a letter from Molopo in response to the Council's recommendation. Molopo believed the recommendation was made in error, raising concerns in relation to transportation costs and incentives for Origin Energy (the DVP owner) to restrict or overprice capacity in the DVP. On 7 September 2005, I requested the Council to consider the issues raised by Molopo and advise me whether they affected the recommendation in any way.

On 9 September 2005, the Council advised that Origin Energy had announced its intention to sell its Moura interests, including the DVP, to the owners of the Anglo-Mitsui Pipeline. In light of this new information, the Council advised that I should refrain from making a decision in relation to its recommendation.

Pursuant to section 1.14 of the Code, I may require the Council to provide such information, reports and other assistance as I consider appropriate for the purpose of considering the application. Accordingly, on 5 October 2005 I requested the Council to examine the new ownership arrangements of the DVP in the context of its 4 August 2005 recommendation, with a view to revising it, where appropriate.

In formulating its advice to me, the Council wrote to Molopo, Origin Energy, Anglo Coal and Mitsui Moura seeking information in relation to the sale of the DVP and for submissions on the effect of the sale on the Council's final recommendation.

On 31 October 2005, the Council provided me with its supplementary advice indicating that the new ownership arrangements removed a key rationale for its original recommendation and that the pipeline should now be covered. The Council's supplementary advice was also made publicly available on its website.

The Council's conclusions in their supplementary advice on Criteria (b), (c) and (a) (with respect to the downstream gas sales market in Queensland) were not affected by the change in the proposed ownership of the DVP. However, the Council revised its conclusions with respect to promotion of competition in the upstream markets for gas production and sales for Criteria (a) and (d).

I gave notice of 12 extensions of time for my decision in accordance with section 7.16 of the Code. On 2 December 2005, I also decided to defer my decision on coverage until I had received advice that the DVP sale process had been completed. In this regard, I also wrote on 2 December 2005 to Anglo Coal (Moura) Limited, Mitsui Moura Investment Pty Ltd and Origin Energy Limited requesting that they keep my office abreast of progress with the sale and of its completion.

I also wrote to the Council on 2 December 2005 advising of the deferral of my decision until the DVP sale process had been completed, and also requested advice on the estimation of the benefits for pipeline users from coverage of the DVP. The Council replied on 21 December 2005 indicating that the change of ownership of the DVP which would see the DVP and the Anglo-Mitsui pipeline in common ownership, raises the costs of building a bypass pipeline to a level significantly higher than developing an access arrangement.

I received advice from Anglo Coal (Moura) Limited and Origin Energy Limited on 31 March and 5 April 2006 respectively that the sale process for

In making my decision, I considered the Council's final recommendation, supplementary advice, and letter of 21 December 2005, and issues raised by Molopo, Oil Company of Australia (Moura) Transmissions Pty Limited, Anglo Coal (Dawson) Limited and Mitsui Moura, with respect to the coverage criteria.

I am satisfied that the DVP meets all of the coverage criteria set out in paragraphs (a) to (d) of section 1.9 of the Code, and decide that the pipeline should be covered.

My reasons for this decision are set out below in the same order that they were assessed by the Council, namely Criterion (b), followed by Criteria (a), (c) and (d) and incorporate an assessment of the Council's final recommendation and supplementary advice.

CRITERION (b)

I considered criterion (b), that is:

that it would be uneconomic for anyone to develop another Pipeline to provide the Services provided by means of the Pipeline.

Council's Final Recommendation

1. The Council concluded *"that it would not be economic to develop a pipeline to provide the services of the DVP at current and reasonably foreseeable levels of future demand. If the capacity of the DVP exceeds foreseeable demand for the service, significant additional gas could be accommodated on the existing pipeline without the need to construct a new pipeline. If foreseeable demand is greater than the capacity on the existing pipeline it is still likely to be more cost effective to expand the capacity of the existing pipeline than build a new pipeline. So, from a social perspective, it is likely to be more efficient to utilise the existing assets effectively, rather than duplicating those assets."*

2. On the basis of these findings, the Council found *“that the DVP satisfies Criterion (b)”*.¹

Ministerial Findings

3. I found the following material facts, based on the evidence relied on by the Council in its findings in the Final Recommendation in relation to criterion (b).
- Both Molopo and the Oil Company of Australia (Moura) Transmissions Pty Ltd (OCA), (former owner of the DVP), accept that it is uneconomic to develop another pipeline to replicate the services of the DVP. Both companies accept that the existing spare capacity, the expense of building another pipeline, and the existence of the Anglo-Mitsui Pipeline in close proximity to the DVP creates significant difficulties for development of another pipeline.
 - The forecast spare capacity of the DVP is likely to meet maximum foreseeable demand. OCA indicates that the maximum capacity of the DVP is 20 TJ per day (7.3 PJ per annum) with 50% (10 TJ per day or 3.65PJ per annum) currently contracted. OCA has also indicated that the level of throughput of the DVP is expected to drop to 3 PJ per year for the foreseeable future.
 - Only 50 per cent (10 TJ per day or 3.65PJ per annum) of OCA’s estimation of the DVP’s capacity is currently contracted, Molopo has an agreement with Ergon Energy Pty Ltd to supply a further 3.5 PJ per annum over 15 years.
 - Based on figures provided by both OCA and Molopo, the cost of constructing a 20 kilometre pipeline, 88.9 mm diameter, including metering and regulating equipment, from the Mungi gas field to the Queensland Gas Pipeline would range between \$1.4 and \$2.5 million.
 - While there are no capacity constraints on the nearby Anglo-Mitsui pipeline, an interconnection pipeline of several kilometers would be required to enable it to provide services to the Mungi gas fields.
4. On the basis of these findings, I reasoned as follows:
- The DVP typically exhibits natural monopoly characteristics – the cost of constructing and operating the pipeline are predominately sunk and fixed whilst the variable costs of increasing output are considerably lower. This means that the marginal cost of transporting a unit of gas is generally low.
 - Demand is unlikely to exceed 6.5 PJ per annum over the next 15 years bringing it within the confines of both OCA’s and Molopo’s estimations for maximum capacity. Given the construction cost range (between \$1.4 and \$2.5 million) for a bypass pipeline, I believe it would be uneconomic to develop another pipeline to provide the services of the DVP at current or projected levels of demand.
 - I therefore consider that it would be more efficient and economic to utilise the capacity of the DVP, or expand its capacity, to meet current or reasonably foreseeable levels of future demand than develop another pipeline to provide the services of the DVP.

¹ The Council, as stated in its supplementary advice, found that the sale of the DVP did not impact on its consideration of the issues for Criterion (b), thus the DVP continued to satisfy Criterion (b).

- I therefore agree with the Council that the DVP satisfies Criterion (b).

CRITERION (a)

I considered criterion (a), that is:

that access (or increased access) to the Services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for the Services provided by means of the Pipeline.

Council's Final Recommendation And Supplementary Advice

5. In its Final Recommendation, the Council considered that there were two "dependent markets of relevance to its criterion (a) assessment":
 - (a) *an upstream market for gas production and gas sales from any field (including the Mungi gas field) that is within the feasible scope of connection with the DVP*
 - (b) *a downstream Queensland gas sales market."*
6. The Council concluded "that coverage of the DVP:
 - (a) *would be unlikely to materially promote competition in the downstream Queensland gas sales market as a consequence of the lack of ability and incentive of the pipeline to distort competition in those markets through vertical leveraging*
 - (b) *would be likely to promote competition in the upstream gas production and sales markets as a consequence of the ability and incentive of the pipeline to charge monopoly prices for transport services. However, the Council notes, that the upstream market is small with little participation, and the impact of any declaration would be limited due to market power already being constrained by the presence of another transmission service."*
7. In its Supplementary Advice, the Council considered that under the new ownership arrangements where the Moura joint venture controls both the DVP and the Anglo-Mitsui pipelines, the Moura joint venture would have "an incentive and ability to leverage transmission market power into the upstream market". This included "the ability to exercise monopoly pricing up to the cost of building another pipeline to connect to the Queensland Gas Pipeline (complete bypass), rather than only to the point at which building an interconnection pipeline and seeking access to the adjacent Anglo-Mitsui Pipeline is a commercially viable option."
8. On the basis of these findings, the Council found that "the change in ownership of the DVP therefore strengthens the Council's 4 August 2005 conclusion that Criterion (a) is met with respect to the upstream market for gas production and gas sales".²

Ministerial Findings

9. I found the following material facts, based on the evidence relied on by the Council in its findings in the Final Recommendation and Supplementary Advice in relation to criterion (a).

² In its final recommendation, the Council found that the presence of the Anglo-Mitsui Pipeline acted as a constraint on the exercise of market power by the owners of the DVP - under common ownership this is no longer an issue.

- The downstream market refers to the predominantly interconnected Queensland gas sales market, except for the Townsville region.
- The interconnected downstream market is supplied by eight gas producers who produce and sell gas from nine different fields. The number of gas producers together with some evidence that swaps are occurring should dilute the ability of the DVP to exercise market power. The relatively small volume of gas transported on the DVP (up to 6.5 PJ per annum³) is unlikely to materially change the state of competition in the downstream market⁴.
- The upstream gas sales market relevant to the DVP comprises those producers situated in any gas field (including the Mungi gas field where Molopo Australia operates) in the vicinity of the DVP which are served or potentially served by the pipeline. These gas producers would either require access to the DVP or need to connect to the nearby Anglo-Mitsui gas pipeline in order to transport their gas.
- The sale of the Origin's Moura interests, including upstream gas production facilities and the DVP, to Anglo Coal (Moura) Ltd and Mitsui Moura Investment Pty Ltd (the Moura joint venture) has brought the DVP, the upstream gas production facilities in the southern part of the Dawson Valley and the Anglo-Mitsui gas pipelines under common ownership.
- The new owners of the DVP – the Moura joint venture – currently operate in a number of functional levels of the gas market, including production, transmission and gas sales.

10. On the basis of these findings, I reasoned as follows:

- I consider that there are two functional markets besides the market for DVP services – the upstream market comprising gas producers in the catchment of the DVP, and the downstream market comprising gas users serviced by the interconnected Queensland gas transmission network.
- Coverage of the DVP would be unlikely to materially promote competition in the downstream Queensland gas sales market. This market is already supplied by 8 gas producers and the maximum foreseeable volume of 6.5 PJ per annum to be supplied by the DVP represents only around 5.8% of Queensland's current gas demand.
- I consider that the gas producers in the catchment of the DVP are reliant on access to the DVP to transport their gas to the downstream market. The alternative would be to construct a bypass pipeline to either the Anglo-Mitsui pipeline or the Queensland Gas Pipeline at considerable expense.
- The new owner of the DVP, the Moura joint venture, has vertical linkages in gas production (including in the feeder catchment of the DVP), transmission and gas sales, and also owns the DVP and the Anglo-Mitsui gas pipelines. These vertical linkages provide the Moura joint venture with an ability and incentive to leverage its transmission market power into the upstream market in the absence of coverage.

³ Current OCA contracted volume plus the volume Molopo's has contracted with Ergon Energy.

⁴ Queensland Office of Energy has advised that Queensland gas demand is around 307 TJ per day or 112 PJ per annum.

- In respect of the upstream gas production and sales markets, I therefore consider that coverage of the DVP would materially promote competition by constraining the ability and incentive of the pipeline owner to charge monopoly prices for transport services.
- I therefore conclude that coverage would materially promote competition in at least one market (the upstream market) and I agree with the Council that the DVP satisfies Criterion (a).

CRITERION (c)

I considered criterion (c), that is:

that access (or increased access) to the Services provided by means of the Pipeline can be provided without undue risk to human health or safety.

Council's Final Recommendation

11. In its Final Recommendation, the Council indicated that there was no "available evidence to suggest that safety is a particular concern in relation to the provision of access or increased access to the services of the pipeline."
12. The Council acknowledged that "Queensland has passed regulations dealing with the safe operation of gas pipelines", and stated it "is confident that these regulations deal appropriately with any safety issues arising from access to the pipeline."
13. The Council concluded "that access (or increased access) can be safely provided to the services of the DVP" and found that "the DVP satisfies Criterion (c)."

Ministerial Findings

14. I found the following material facts, based on the evidence relied on by the Council in its findings in the Final Recommendation in relation to criterion (c).
 - Queensland has regulations that deal with the safe operation of gas pipelines and that these regulations can appropriately deal with any safety issues arising from the provision of access to the pipeline.
 - No submissions were received which raised safety concerns in relation to access or increased access to the services of the pipeline.
15. On the basis of these findings, I reasoned as follows.
 - Gas pipeline operators in Queensland must comply with that States' regulations for the safe operation of gas pipelines when providing access to the pipeline and no submissions were received that provided a contrary safety argument.
16. I am satisfied that the DVP satisfies Criterion (c).

CRITERION (d)

I considered criterion (d), that is:

that access (or increased access) to the Services provided by means of the Pipeline would not be contrary to the public interest.

Council's Supplementary Advice

17. In its Supplementary Advice, the Council considered that:

- (a) *"the sale of the DVP to the Moura joint venture, owner of the Anglo-Mitsui Pipeline, would remove the cap on transmission service market power that currently constrains the owner of the DVP." As a result the "new owner of the DVP would have the ability and incentive to raise prices up to the point at which a transmission service user would decide to bypass the DVP altogether."*
- (b) *"the cost of a complete bypass pipeline (to the Queensland Gas Pipeline) is likely to range from \$1.4 to \$2.5 million for 20 kilometres of pipeline." In addition, the Council considered that "the direct costs to parties participating in an access arrangement are likely to be towards an upper bound estimate of \$600,000."*
- (c) *"Despite the small size of the dependent upstream market, with the removal of the constraint that the independently owned Anglo-Mitsui Pipeline provided on the owner of the DVP, there is a significant likelihood that the costs of regulation would not exceed the benefits."*

18. The Council therefore concluded that, *"with a change in DVP ownership, the DVP would satisfy criterion (d)".*

Ministerial Findings

19. I found the following material facts, based on the evidence relied on by the Council in its findings in the Supplementary Advice in relation to criterion (d).

- The close proximity of the Anglo-Mitsui Pipeline to the DVP would normally act as a significant constraint on the ability of the DVP to exercise market power.
- The sale of the DVP to the Moura joint venture places the Anglo-Mitsui pipeline and the DVP under the same ownership which removes the previous restraint on the exercise of transmission service market power by one pipeline on the other.
- The direct costs to parties participating in developing an access arrangement are likely to be towards an upper bound estimate of \$600,000 while the cost of constructing a bypass pipeline would be in the range of \$1.4 to \$2.5 million.
- The removal of the constraint that the independently owned Anglo-Mitsui Pipeline provided on the owner of the DVP, means that there is a significant likelihood that the costs of regulation would not exceed the benefits of access.

20. On the basis of these findings, I reasoned as follows.

- I adopt a broad view of the types of matters which may raise public interest considerations. Matters that I have taken into account in making this decision included the overall costs of regulation, increased competition and restraint on market power.
- The costs of regulation would be significant and this is one public interest consideration against coverage.
- I note that the Council's Final Recommendation had recommended against coverage of the DVP principally because it considered that the Anglo-Mitsui Pipeline provided competition and constrained the potential market power of the DVP.
- However, the sale of the DVP to the Moura joint venture will concentrate ownership of both the DVP and the Anglo-Mitsui pipelines in a single company. This will significantly reduce that competition, and reduce the restraint on the exercise of market power by the DVP. This may allow transmission services on the DVP to be priced up to the level where a user would decide to bypass the DVP through constructing a new pipeline to connect to the Queensland Gas Pipeline.
- With the sale of the DVP to the Moura joint venture, coverage will promote the public interests of competition and restraint on market power.
- I therefore agree with the Council's finding that overall, the costs of regulating the DVP under the Code would not outweigh the benefits of that regulation in these circumstances.
- I agree with the Council's conclusion that with a change in DVP ownership, access to the services provided by means of the DVP would not be contrary to the public interest.
- I am satisfied that criterion (d) is met for the DVP.

CODE COVERAGE CRITERIA

1.9 Subject to sections 1.4(a) and 1.10, the NCC must recommend that the Pipeline be Covered (either to the extent described, or to a greater or lesser extent than that described, in the application) if the NCC is satisfied of all of the following matters, and cannot recommend that the Pipeline be Covered, to any extent, if the NCC is not satisfied of one or more of the following matters:

- (a) that access (or increased access) to Services provided by means of the Pipeline would promote competition in at least one market (whether or not in Australia), other than the market for Services provided by means of the Pipeline;
- (b) that it would be uneconomic for anyone to develop another Pipeline to provide the Services provided by means of the Pipeline;
- (c) that access (or increased access) to the Services provided by means of the Pipeline can be provided without undue risk to human health or safety; and
- (d) that access (or increased access) to the Services provided by means of the Pipeline would not be contrary to the public interest.

MINISTER'S ROLE IN THE COVERAGE DECISION MAKING PROCESS

The Provisions of the Code (sections 1.13 to 1.19) require the Minister to:

- consider whether the application meets the coverage criteria in section 1.9 of the Code (See Appendix 1)
 - the Minister's decision must be made against the same four criteria used by the Council;
 - if the Minister is satisfied that all four criteria are met, the Minister must decide that the pipeline is covered;
 - if the Minister decides that any one of the criteria is not met, the Minister must decide that the pipeline is not covered.
- make a decision that the pipeline is covered or is not covered within 21 days of receipt of the Council's final recommendation
 - the date for the decision can be extended further by periods of 21 days by advertising to this effect in the national press before each 21 day period expires;
 - the Minister's decision on coverage may take effect no earlier than 14 days after the decision was made.
- provide a copy of the decision and reasons for the decision to the relevant parties, including the Service Provider, the applicant, the Council, the relevant regulator, each person who made a submission, and any other person who requests a copy.