



6 May 2005

Mr John Feil
Executive Director
National Competition Council
GPO Box 250B
Melbourne VIC 3001

Dear Mr Feil

Oil Company of Australia (Moura) Transmissions Pty Limited (OCA) is pleased to present the attached submission to the NCC in its consideration of the application for coverage of the Dawson Valley Pipeline (DVP).

OCA can see no reason why coverage of the DVP should be granted.

It is the view of OCA that there has been no substantial change in the DVP, the customers it serves, the Queensland market or Origin Energy Limited's (Origin) share of this market, which would warrant overturning the Commonwealth Minister's decision to revoke coverage of the pipeline.

The findings of the NCC when it recommended revocation are still relevant.

Furthermore, there is no evidence that OCA or Origin have the opportunity to behave anti-competitively.

It is our strong view that there are no benefits to be gained from imposing coverage but that there are potentially significant costs that would be incurred by OCA, the regulator and government.

We would be happy to discuss this matter with you or your staff in the near future.

Queries should be directed to Bruce White on (07) 3858-0687.

Yours faithfully

A handwritten signature in black ink that reads "K.R. Rouse".

K.R. Rouse
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Dawson Valley Pipeline

Response to application for coverage
under the national gas code

Oil Company of Australia (Moura)
Transmissions Pty Ltd submission

May 2005

OCA's views on coverage of the Dawson Valley Pipeline

Oil Company of Australia (Moura) Transmissions Pty Ltd (OCA) does not agree that coverage of the Dawson Valley Pipeline (DVP) needs to be reinstated. We can see no evidence that there has been any substantial change in the conditions that were current at the time of the revocation decision and the NCC recommendations that supported that decision.

OCA and Origin Energy Limited's (Origin) positions in the market have not changed to any substantial degree. Since that time Origins market share has remained stable and there have been several new entrants into the market.

Neither OCA nor Origin has either the ability or the opportunity to exercise any market power. The DVP is one very small part of the overall Queensland gas market and, while Origin is a moderately large player in the market, it is only one of several in a very competitive market.

Given this, we can see no benefits to be gained from coverage but we can see that there are substantial costs that would be incurred in establishing an access regime. Those costs will fall on OCA, the regulator and the government.

In short, criteria A and D of the Code were not met in 2000 and are still not met now.

The Dawson Valley Pipeline

The DVP is described under section A of the National Third Party Access Code for Natural Gas Pipeline Systems (the Code) as follows:

Pipeline Licence	Location/ Route	Operator	Length	Pipe Diameter (mm)	Regulator
Qld: PPL26	Dawson Valley to Alinta Qld Gas Pipeline	Oil Company of Australia (Moura) Transmission Pty Limited	47Km	168.3 mm	Not covered

The DVP licence is owned and operated by OCA (Moura) Transmissions Pty Ltd, a wholly owned subsidiary of OCA (Moura) Pty Ltd which in turn is wholly owned by Origin Energy CSG Limited (formerly Oil Company of Australia Limited), an Origin group company.

The DVP transports gas 47km from the Dawson Valley gas fields to the Alinta Queensland gas pipeline.

The DVP was constructed in 1996 by Conoco Australia as part of its development of the Dawson Valley coal seam gas fields. Gas from the Dawson Valley fields is the only gas transported through this pipeline.

This pipeline together with the associated gas fields (not including the Mungi field) was acquired on 1 April 1998 by Origin Energy CSG Limited when it acquired 100% of the issued share capital of Conoco Australia Pty Ltd and its controlled entity Conoco Australia Pipelines Pty Ltd.

The DVP is a single high-pressure gas pipeline constructed from high strength pipe of 168.3 mm outside diameter. The pipeline currently operates at 14,000kPa. The maximum capacity of the pipeline is 20TJ/day. It is currently contracted at 50% of maximum capacity. Currently, the major customers of the Dawson Valley gas fields are Origin and Energex Retail Pty Ltd (Energex).

There are currently 3 shippers on the DVP:

- Energex, which supplies gas to the Queensland Nitrates plant at Moura;
- the Mungi Joint Venture Parties, Lowell Petroleum NL (a subsidiary of Molopo Australia Limited) and Helm Energy Australia LLC (MJV Parties), which supply their share of gas from the Mungi field to Origin at the interconnect with the Alinta (previously Duke) Queensland Gas Pipeline; and
- Origin, which aggregates its own gas from the Dawson Valley fields (including its share of Mungi gas) with gas purchased from the MJV Parties for supply to Origin's customers in Gladstone and Rockhampton.

The Mungi Joint Venture is an unincorporated joint venture between OCA Moura (50%), Lowell Petroleum NL (25%) and Helm Energy Australia LLC (25%) in relation to that portion of the area of Petroleum Lease No, 94 which lies to the north of latitude 24° 37' 20" south. Lowell and Helm's share of Mungi Joint Venture gas is sold to Origin.

There have been successful arrangements in place between OCA and the shippers for the transportation of gas from the Dawson Valley gas fields to the respective shippers' delivery points since the revocation of coverage in 2000. These delivery points are the Alinta Queensland Gas Pipeline, and the Queensland Nitrates plant. There are no separate DVP transportation agreements with individual end use gas customers. It is not expected that there will be any additional users on the DVP in the near or distant future (refer Mungi field reserves section below).

Throughput for the DVP for the year ended December 2003 was 3.1 PJ which was up from 1.5 PJ for the year ending June 2000. Throughput grew to 3.3 PJ for the year ending December 2004. This level is expected to drop to 3.0 PJ per year and remain at around this level for approximately 20 years based on current reserve and deliverability estimates for the Dawson Valley gas fields.

Historical Regulation of the pipeline

As with all pipelines which were in service before the introduction of the Code, the DVP was originally covered under the Code and was proposed to be regulated by the ACCC. However, in 2000, the Minister for Industry, Science and Resources revoked coverage of the DVP based on the advice of the NCC.

The decision to revoke coverage of the DVP was based on the failure of the pipeline to meet two of the four criteria for coverage contained in the Code, namely:

- That despite the known fields and a number of exploration prospects within the proximity of the DVP there had been no indication that an additional party had sought to interconnect or to have access to the pipeline. As such the NCC was not satisfied that coverage would result in increased access and therefore would not increase competition in at least one other market; and,
- The costs of regulation were seen to outweigh any potential benefit from regulation. As such it was found by the NCC that coverage of the DVP did not support a net public benefit.

Having not met the criterion for (a) and (d) it was found that the DVP should not remain covered and coverage was revoked.

Preliminary issues

Before addressing the particular issues raised by the NCC, OCA would like to address a few fundamental issues that need to be covered.

Definition of the market and service

In his November 2000 decision to revoke coverage of the DVP and two other Queensland pipelines, the Minister for Industry, Science and Resources stated:

I agree with the NCC's finding that the relevant market, in which access to the pipeline may promote competition, is the Queensland gas sales market. I also agree that the services provided by means of the pipelines are those related to the transport of natural gas from the Oil Company of Australia gas fields in the Dawson Valley to the Duke Queensland Pipeline ... as well as to all the possible destinations between these start and finish points and proximate to the ... pipeline(s).¹

Having reviewed the original NCC analysis that supported these conclusions, OCA sees no reason to disagree with this view of the market. However, OCA does view this definition as a very narrow interpretation of the market. Clearly gas does have substitutes in the Queensland energy market and clearly they can compete with gas, particularly in the longer term when investment decisions are more flexible.

Mungi field reserves

One issue that is noted several times in the Molopo application and the NCC issues paper needs clarification. In its application Molopo states:

The independently certified proven and probable (ie P50) reserves of the Mungi Gas Field are 25 PJ although it is estimated that the field may contain some 162PJ of recoverable gas. In addition, other significant prospects exist for discovery of gas within the areas surrounding the Mungi Gas Field (para 6.).²

¹ Senator Nick Minchin, Decision on revocation of three Queensland gas pipelines, 23 November 2000.

² Molopo Australia Limited, Application to the NCC seeking coverage of the DVP, March 2005.

It needs to be made very clear that, apart from the 25PJ noted, the rest of the potential recoverable gas (137 PJ) is not classified as proven or probable reserves³.

The potential recoverable gas referred to in Molopo's submission is certainly not a bankable asset and is speculative in nature. Furthermore, this situation was known at the time of the revocation decision by the Minister.

Until these potential gas resources are shown to be proven or, at least, probable reserves, they should not be taken into account by the NCC in making its decisions regarding coverage of the DVP. At the very most, they should only be given the same consideration that they were the last time that the NCC considered this issue.

Response to the Code's requirements and the NCC's specific questions.

The following discussion concentrates on the criteria under the code but pays particular attention to the questions raised by the NCC.

Criterion (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 the services provided by means of the pipeline.

Has Molopo appropriately defined the relevant dependent markets? Is it separate from the market for the services provided by the DVP?

As stated above, OCA agrees with the previous conclusion of the NCC that the relevant market is the market for gas in Queensland. We can see no reason why this situation may have altered in the intervening four years.

In fact, we take this as the very narrowest view of the market. The fact that other energy sources clearly compete with and provide substitutes for gas is evidence that a broader interpretation of the market would be the Queensland energy market.

Are there any other dependent markets in which competition may be promoted as a result of access through coverage?

Any improvement in competition relies on two assumptions:

- the market is not currently competitive or, at least contestable. Particularly, that Origin is able to exercise some sort of market power in one or more dependent markets;

³ Recoverable reserves are classified into two main categories: discovered and undiscovered. The discovered reserves are subdivided into proven, probable and possible. Proven reserves are known reserves which, on the available evidence, are virtually certain to be technically and economically producible, i.e. having a better than 90 per cent chance of being produced. Probable reserves are known reserves which are not yet proven but which are estimated to have a better than 50 per cent chance of being technically and economically producible. Possible reserves are those reserves which, at present, cannot be regarded as 'probable', but are estimated to have a significant, but less than 50 per cent chance of being technically and economically producible.

- any changes that might arise out of coverage of this particular pipeline having an appreciable impact on the market.

With respect to the first assumption, the Queensland gas market is highly competitive. There are:

- A large number of gas fields owned and operated by a diverse group of companies;
- A number of different pipeline owners and operators controlling a considerable number of spur and main pipelines; and
- A large range of customers.

The overall structure of the market is set out in the attached map. Origin's market share has remained steady over the past five years but is poised to grow marginally as a result of the Spring Gully project. There are several factors of the market which are important to note. First, the structure of the market has not changed substantially since the revocation decision, except in so far as there has been the entry of a major new participant in the market, Alinta, in place of Duke Energy, and several smaller participants (e.g. Mosaic, Queensland Gas Company, Tipperary).

Second, there is no evidence that either OCA or Origin have ever exercised any market power since the revocation decision.

With respect to the second assumption, the statement in the application for coverage that "Competition within the Queensland gas market is presently constrained in view of the limited availability of gas from competing producers" is not supported by any evidence and is contradicted by the actual operation of the market. The 25PJ of proven and probable reserves at Molopo is an extremely small proportion of the overall gas resources in Queensland.

According to the Queensland Department of Natural Resources and Mines, "During 2002-03, production of natural gas totalled 5250Mm³ (197PJ) including 619Mm³ (23PJ) of coal seam gas⁴". The yearly production from Molopo is only roughly one tenth of one percent of Queensland's total yearly gas production.

Given this, there is no evidence to support the contention (paragraph 7d) that there are likely to be any competitive benefits flowing from access coverage. Certainly there is no evidence to support the example given in the application of a putative fall in gas prices that would flow from coverage of the pipeline.

To what extent do the vertical linkages within the Origin Energy Group create an ability and incentive for OCA to engage in monopoly pricing or otherwise exercise market power in dependent markets? To what extent (if any) do other gas pipelines constrain the exercise of market power?

Origin's position as a vertically integrated player in the Queensland market is unchanged since 2000. The point of vertical integration is not to extract monopoly

⁴ http://www.nrm.qld.gov.au/mines/petroleum_gas/production.html

rents, it is to facilitate stability, a holistic investment approach and risk management. In Origin's case, vertical integration has for instance facilitated the early development of gas reserves at the Peat CSG field for the supply of gas to a co-generation project at Bulwer Island, Brisbane.

OCA (and Origin) is only one of several players in the Queensland gas market. While Origin is, to some extent, vertically integrated, so are several of the other players in the broader Australian market, notably Alinta, AGL, and Santos. To the best of our knowledge, the prevalence of vertical integration has not resulted in a single complaint to the ACCC under the provisions of the Trade Practices Act 1974 regarding transfer pricing issues which would be the appropriate forum to raise such concerns.

Notwithstanding the comments previously made by the NCC regarding the economics of an alternative pipeline, the existence of the Anglo Mitsui pipeline also provides a natural limit to the use of any such pricing. Effectively, the presence of this pipeline within the general vicinity of the DVP, and the Mungi field, does limit the extent to which Origin can engage in such pricing or anti-competitive market behaviour.

Criterion (b) – that it would be uneconomic for anyone to develop another pipeline to provide the services provided by means of the pipeline

What is the capacity of, and the reasonably foreseeable demand for, the transportation services provided by the DVP?

The DVP has a 20 TJ/day capacity. Of this amount there is currently 10 TJ/day contracted. Origin expects this demand to remain steady in the medium term. Given continued spare capacity on both the DVP and the Anglo-Mitsui Pipeline, it would continue to be uneconomic to invest in another pipeline in this area. However, it is important to note that if Molopo's assessment of the potential size of the Mungi field is correct⁵ the current DVP would not have enough capacity to cater for the volume of gas to be transported, thus facilitating the need for future economic investment in a new pipeline.

All of the current gas from the fields that supply the DVP (apart from the the MJV Parties share of Mungi Gas) is under long term contract. This is unchanged from the time of the 2000 revocation decision.

Would it be uneconomic to build another pipeline or modify existing pipelines to compete with the DVP?

Given the existing recoverable gas reserves the situation has not changed since revocation of coverage of the pipeline in 2000. That is, given the tests outlined by the NCC it would be uneconomic to build another pipeline to compete with the DVP.

⁵ Origin's view of the Mungi Gas Field is vastly different to Molopo's view. Origin's assessment of 2P reserves is less than half Molopo's stated 25 PJ & less than a quarter of Molopo's total recoverable reserves of 162 P.

However, if Molopo’s assertions about potential future gas production are accepted, there will be no alternative but to build a new pipeline because the existing one is too small to cope with the the presumed throughput.

Table 1.1 sets out the assumptions used to determine the impact of additional gas finds on the DVP. **[Commercial-In-Confidence information in this table has been deleted in Origin’s submission for public release.]**

Gas Field	Available Reserves (PJ)	PJ/annum	Daily potential throughput TJ/Day
Mungi Field	25*	0.3	0.8
Dawson Valley Fields Potential recoverable gas in the Mungi Field (with assumed life of 20 years)	137*	6.9	18.9
Total			

* Molopo’s estimated recoverable gas from the Mungi field

As can be seen, using Molopo’s estimates regarding total recoverable reserves, the daily throughput on the DVP for gas from the Mungi field and the current gas from the Dawson Valley fields would outstrip maximum daily capacity of the DVP of 20 TJ/day by approximately 8 TJ/day.

However, as noted, OCA does not consider that the total recoverable reserves for the Mungi field of 162PJ suggested by Molopo are realistic given current knowledge.

What would be the cost of building new pipelines or modifying existing ones?

OCA considers that the pipeline costs submitted by Molopo are also conservative estimates at best. The costs of pipeline construction generally range between \$800/mm/km to \$1300/mm/km for small diameter short distance pipeline construction. Molopo’s estimate is at the upper end of this range, suggesting that the cost of the pipeline could potentially be overstated by as much as \$1.0 million.

Can gas be physically transported along the route of the DVP by other pipelines other than the DVP? What (if any) capacity constraints would prevent this from occurring?

OCA understands that there are no capacity constraints on the Anglo Mitsui Pipeline which runs parallel to the DVP for about 25 per cent of the length of the existing pipeline at the northern end of the DVP. Further, at the southern section of the DVP there is currently not an alternative route by which the services could be provided.

Criterion (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.

OCA does not have any issue to raise with regard to this criterion. We do not believe there would be any health or safety risks that would arise from access.

Criterion (d) – that access (or increased access) to the services provided by means of the pipeline would not be contrary to the public interest.

OCA would like to clear up one misconception raised in the application and repeated in the discussion paper – both papers state that OCA submitted in 2000 that the cost of an access regime would be \$100,000 to \$150,000.

This is only partially correct. What OCA actually said was that it's own costs in developing an access regime would be in the range of \$100,000 to \$150,000 and that the regulator and the Queensland Government would incur similar costs. We do not believe that anybody disputed these figures during the revocation process. Given inflation and the general increase in the cost of regulation, we now believe that total costs would be over half a million dollars, not including the costs to all parties of this NCC coverage review.

Total regulatory costs would thus be equivalent to approximately \$200,000 for each of the three pipeline users. It is unlikely that each user will receive the equivalent in savings as a result of coverage under the Code. This point was highlighted by the Productivity Commission's recent review of the Code which stated:

The (Productivity) Commission considers that the existing regime leads to the application of cost-based price regulation (through the application of reference tariffs) in situations where it is doubtful that it maximises net benefits to the economy, after taking into account the economic costs of regulation.⁶

In its application Molopo has stated that the costs of regulation would be more than outweighed by the associated benefits (paragraph 7d). A figure of \$0.10/GJ was quoted as the likely decrease in gas prices as a result of coverage.

This figure appears to be completely arbitrary and unsupported. OCA notes that this type of rationale would support the regulation of all goods and services as regulation would necessarily result in lower prices.

The true economic benefits which need to be considered are those related to improvement in allocative efficiency. The allocative efficiency detriments that could be expected to arise out of imposition of coverage can not be calculated but would presumably be significant.

It would appear that regulation would result in significant cost without the realisation of any net benefits.

⁶ Productivity Commission 2004, Review of the Gas Access Regime, Report no. 31, Canberra, page 35.

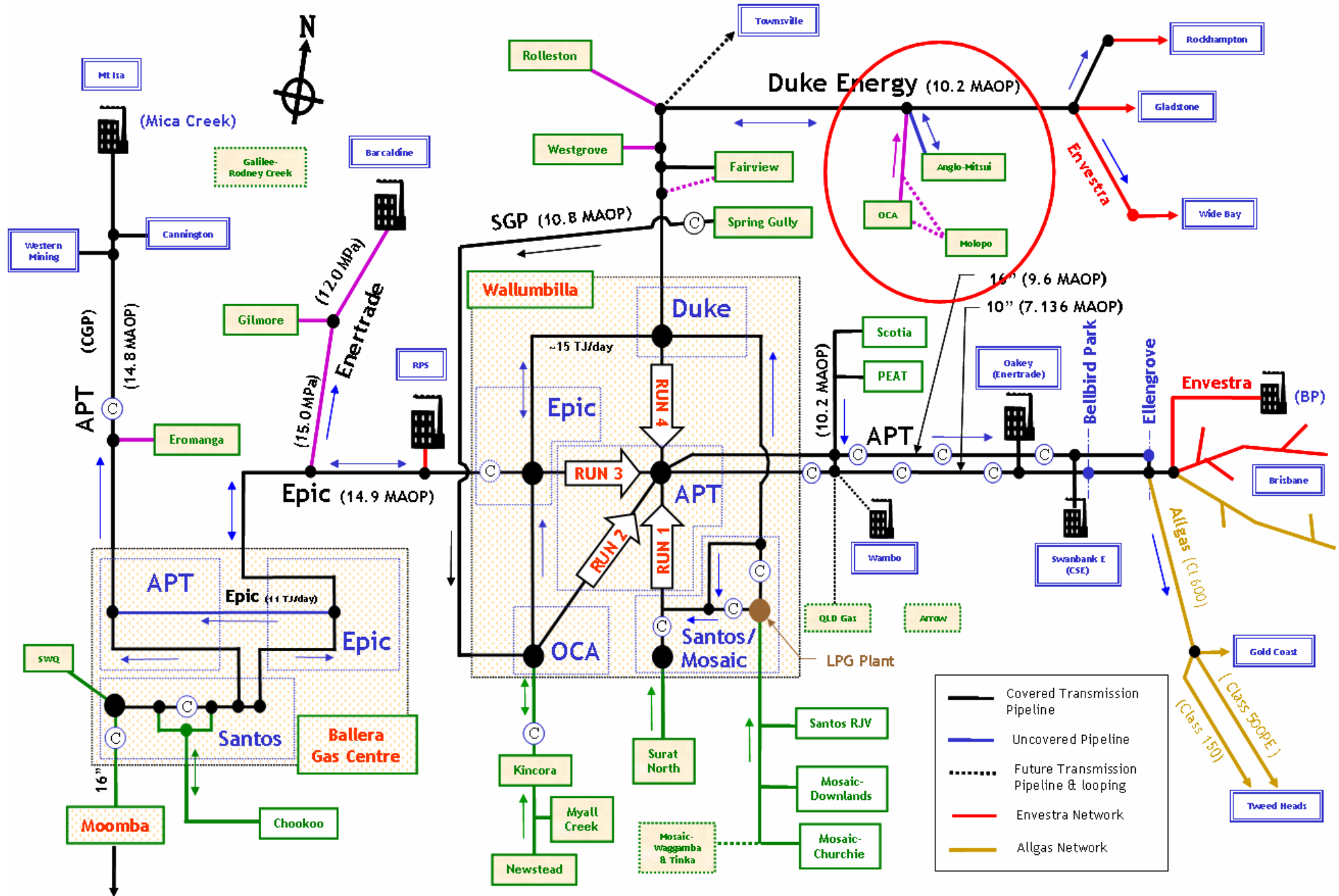
Conclusion

As noted above, OCA (and Origin) does not support the coverage of the DVP. We believe that the circumstances which facilitated revocation of coverage in 2000 are unchanged. Importantly, coverage of the pipeline continues to fail two of the tests set out in the Code:

- Increased access to services provided by means of the DVP would not increase competition in any other market; and
- The potential cost of regulation means there could not be a net benefit associated with coverage.

This situation continues to support the NCC original recommendations made to the Minister for Industry, Science and Resources in 2000 to revoke coverage.

Queensland Gas System, 2005



- Covered Transmission Pipeline
- Uncovered Pipeline
- - - Future Transmission Pipeline & looping
- Envestra Network
- Allgas Network