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

Dear Mr Feil

Re: Response to Draft Decision Regarding Coverage of Dawson Valley Pipeline

Following review of the draft decision relating to coverage of the Dawson Valley Pipeline ('DVP'), we are concerned that some fundamental aspects of the Queensland gas market have not been taken into account in the decision making process. It is only after review of the draft decision that the materiality of these matters has become apparent and we feel it is beholden upon us to bring them to your attention.

The crux of our concern relates to the impact that gas from the Mungi, or other gas fields served by the DVP, will have upon the promotion of competition in downstream (rather than upstream) gas markets.

We have prepared the enclosed Response to the Draft Decision in order to demonstrate that the availability of gas from the Mungi, or other gas fields served by the DVP, will lead to a material improvement in competition in the Queensland gas market, particularly in Gladstone. The Response includes a conservative quantification of the benefits that will flow to gas users and shows that those benefits far outweigh the costs that may be associated with coverage of the DVP.

The prospective gas resource of the Mungi field is sufficient, even if deliverability is constrained by the available capacity of the DVP, to bring real benefits to gas users in the economically important Gladstone region. However, it is only through coverage of the DVP that there will be certainty that these benefits can be made available to gas users.

We urge you to take full and proper account of the enclosed Response.

Yours sincerely

David Casey

**Dawson Valley Pipeline:
Coverage Application Under the National Gas Code**

**Response to
Draft Decision**

1 Introduction

1.1 On 8 July 2005 the National Competition Council ('Council') issued a draft recommendation on the application under the National Third Party Access Code for Natural Gas Pipeline Systems ('National Gas Code') for coverage of the Dawson Valley Pipeline ('DVP').

1.2 The Council:

- a) concluded that coverage of the DVP will promote competition in the upstream gas production and sales markets, but failed to recognise that coverage of the pipeline will also lead to a material improvement in competition in at least one discrete portion of the downstream, Queensland gas markets [*draft decision paragraph 7.48*];
- b) concluded that it would not be economic to develop another pipeline to provide the services of the DVP [*draft decision paragraph 6.50*];
- c) concluded that access can be safely provided to the services of the DVP [*draft decision paragraph 8.5*]; and
- d) found that there was a likelihood that coverage of the DVP would not be in the public interest [*draft decision paragraph 9.10*]. This finding is erroneous since, as set out above, the benefits flowing from a material improvement in competition in at least one discrete portion of the downstream gas markets were not recognised.

1.3 This document has been prepared to demonstrate quantitatively that coverage of the DVP will lead to material improvement in competition in at least one discrete portion of the downstream gas markets and that coverage of the DVP will therefore be in the public interest.

2 Queensland Gas Market

2.1 The Queensland gas market comprises four¹ principal but geographically discrete sectors. They are as follows:

- a) the gas market of the Townsville area, which is supplied through the North Queensland Gas Pipeline and which is isolated from (ie, not interconnected with) other sectors of the Queensland gas market;

¹ There is also a market, comprising a single customer, in Barcaldine. The Barcaldine market is not significant in the present context.

- b) the gas market of the Mt Isa area, which is supplied through the Carpentaria Gas Pipeline and which, although interconnected through pipeline infrastructure, is remote from other market sectors;
 - c) the gas markets of Gladstone and Rockhampton, which are supplied through the Queensland Gas Pipeline. Although interconnected with other market sectors (ie, Mt Isa and Brisbane) by means of gas pipeline infrastructure, there is a considerable distance (by pipeline) between the respective sectors; and
 - d) the gas markets of Brisbane and surrounds, including Swanbank, all of which are supplied by the Roma to Brisbane Pipeline. The Brisbane markets are interconnected with other market sectors but, as for Gladstone and Mt Isa, are isolated in terms of pipeline distance.
- 2.2 Although three of the principal sectors of the Queensland gas market are interconnected, they function independently. In view of the location and cost of accessing pipeline infrastructure, gas producers will transport and sell gas into the market sector that affords the greatest netback value.
- 2.3 The netback value of gas is the value realised from a sale of gas after deduction of the costs of delivering gas to market. The netback value is, therefore, dependent upon both the achievable selling price of gas within a market sector and the cost of transporting gas through pipeline infrastructure to that market sector. The achievable selling price is, in turn, influenced by the price at which other producers offer gas for sale.
- 2.4 In simple terms, the physical relationship between established sources of gas supply and the principal market sectors is depicted in Figure 1.

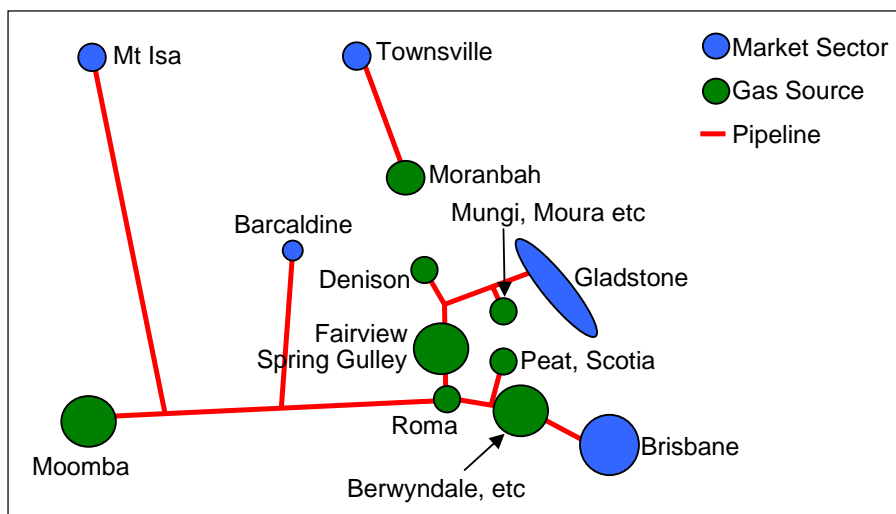


Figure 1: Relativity Between Sectors of Queensland Gas Market

- 2.5 If a source of gas supply is close (by pipeline) to a particular market sector the cost of transporting the gas to that market sector will generally² be lower than the cost of transporting it to more remote (by pipeline) market sectors.
- 2.6 Intuitively, the best netback price achievable for a particular gas source will be in markets that are close (by pipeline) to that gas source. Similarly, gas sources that are close (by pipeline) to a particular gas market sector are likely not only to influence but, through competitive processes, to set the price at which gas will be available in that market sector. This observation is reinforced in paragraph 5.6.

3 The Gladstone Market

- 3.1 There are eight³ gas users within the Gladstone market sector. It is understood the gas requirements of those users and their sources of gas supply are as set out in Table 1.

User	Estimated Load	Supplier
Queensland Nitrates		
Boyne Smelters		
Comalco		
Orica		
Queensland Alumina		
Queensland Magnesium		
Gladstone (retail)		
Rockhampton (retail)		
Total Market		

Table 1: Gladstone Gas Users

Note: Commercial in Confidence material has been removed from Table 1.

- 3.2 It can be seen that Origin supplies in excess of 60% of the Gladstone market. Energex supplies around 1/3 of the market and the remaining 4% is supplied by Santos.
- 3.3 Energex purchases gas from Anglo Coal (Moura) and from Santos, ex Tipperary (Fairview).
- 3.4 Origin sources gas:
- a) from the Spring Gulley - Fairview province coal seam gas fields;
 - b) from the Denison trough conventional gas fields (which are in decline);
 - c) via Wallumbilla; and

² The exception is when gas transportation charges are applied on a 'postage stamp' basis, such that the transportation cost is the same regardless of the distance over which gas is transported.

³ This is on the basis that the incumbent gas distributor (Origin energy) is treated as a single customer even though it distributes gas to a number of small commercial and industrial gas users.

- d) in small quantities, from Moura.
- 3.5 All of the gas that is used in the Gladstone gas market is transported to that market through the Queensland Gas Pipeline. Details of the cost of transporting gas to Gladstone are provided in section 4.
- 3.6 The principal sources of gas for use in the Gladstone market are located at or toward the beginning of the Gladstone Gas Pipeline and, as a result, gas transport costs and, in turn, the delivered cost of gas in Gladstone are high.
- 3.7 Gas users in Gladstone are actively seeking lower cost sources of gas. Clear evidence of this are the announcements⁴ by Energex, Comalco and Queensland Alumina that they have committed to purchase gas to be delivered by means of the proposed, but as yet uncommitted, PNG Pipeline.
- 3.8 Despite the long transportation requirement from PNG to Gladstone, it is evident that gas delivered from PNG represents an attractive alternative to gas that is purportedly available from incumbent suppliers to the Gladstone market. Otherwise Energex, Comalco and Queensland Alumina would not see fit to commit to purchase of gas from the PNG pipeline development.
- 3.9 There can be no doubt that the availability of gas from the Mungi or other gas fields served by the DVP will lead to improved competition in the Gladstone sector of the Queensland gas market. This conclusion is reinforced in the following sections.

4 Gas Transportation Costs

- 4.1 The cost of transporting gas to Gladstone from production sources along the Queensland and Roma to Brisbane Gas Pipelines is depicted in Figure 2. The cost depicted for transportation of gas from the Peat, Scotia and Berwyndale locations includes provision for backhaul through the Roma Brisbane Pipeline.

⁴ The Courier Mail, 6 July 2005.

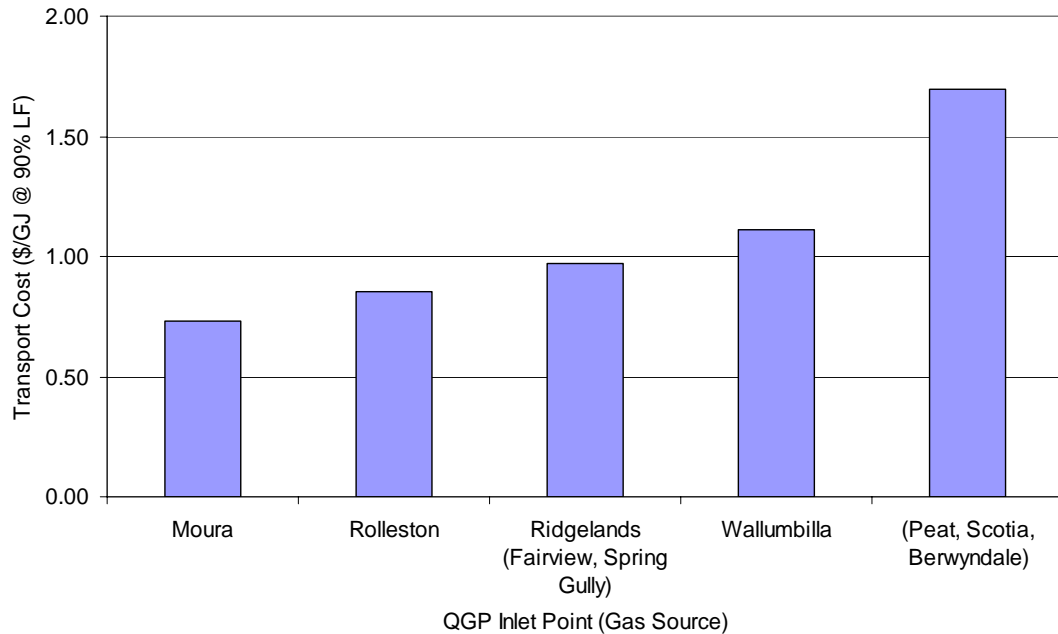


Figure 2: Cost of Transporting Gas to Gladstone⁵

- 4.2 For comparative purposes, the cost of transporting gas to the Brisbane market through the Roma Brisbane Pipeline is around \$0.88/GJ (at a load factor of 90%).
- 4.3 The cost of transporting gas to Brisbane from Wallumbilla is 20% (or \$0.23/GJ) lower than the cost of transporting gas to Gladstone from Wallumbilla. The cost of transporting gas to Brisbane from locations along the Roma Brisbane Pipeline (downstream of Wallumbilla) is to 50% (or \$0.82/GJ) lower than the cost of transporting gas from those same locations to Gladstone.
- 4.4 Gas from Wallumbilla or from locations along the Roma Brisbane Pipeline can therefore be more competitively priced in, and/or will receive a higher netback if sold into, the Brisbane gas market rather than the Gladstone market.
- 4.5 The cost of transporting gas to Gladstone from the prospectively large Fairview and Spring Gully resources is 33% (or \$0.24/GJ) higher than the cost of transporting gas to Gladstone from the Moura location.
- 4.6 Given the cost benefit associated with transportation of gas to Gladstone from the Mungi resource (or from other resources served by the DVP) it is self-evident that the availability of such gas to the Gladstone market sector will lead to competitive outcomes of significant benefit to gas users in that sector.

⁵ The abbreviation 'LF' as used in the y-axis description refers to load factor. It is the ratio of a user's average gas demand to its peak gas demand.

5 Quantification of Benefits Arising From Increased Competition

- 5.1 The DVP has a capacity of at least⁶ 7.3 PJ/a [*draft decision paragraph 6.42*]. Of this, only 3.0 PJ/a is presently expected to be utilised [*draft decision paragraph 6.43*]. Therefore, the DVP has capacity to transport, at least, an additional 4.3 PJ/a (approximately 12 TJ/d) of gas.
- 5.2 Subject to gas reserves certification, the potential exists for 4.3 PJ/a to be sourced from the Mungi gas field alone. The Mungi joint venture has predicted that the quantity of sales gas that is potentially recoverable from the Mungi prospect totals 162 PJ. Of this, 52 PJ may be allocated for supply to Ergon under recently announced arrangements [*draft decision paragraph 6.37*], leaving in excess of 7.3 PJ/a available over a 15 year period. This is equivalent to 30% of the Gladstone market.
- 5.3 Molopo and its joint venture partners have work programmes in place to prove the deliverability of gas from the Mungi and surrounding gas fields, and independent reserves certification activities⁷ are also in train.
- 5.4 On the basis that the spare capacity of the DVP is 4.3 PJ/a, Figure 3 shows the net annual benefit that would be derived by gas user(s) within Gladstone as a function of the gas price reduction that is achievable through having the opportunity to purchase gas from the Mungi gas field (or other fields serviced by the DVP). Figure 3 shows, for example, that if one-half of the transportation cost benefit identified at section 4.4 above flows through to the Gladstone gas market, the market benefit will exceed \$500,000 pa.
- 5.5 If, as is considered likely, the capacity to transport gas through the DVP from Mungi is in excess of 4.3 PJ/a, the annual gas market benefits will be proportionately increased. For example, if the DVP is capable of transporting the full 7.3 PJ/a (as referred to in paragraph 5.2) the annual market benefit associated with flow-through of one half of the transportation cost benefit will exceed \$850,000 per annum.

⁶ This is a figure determined by Origin Energy. Independent analyses suggest the figure may be constrained by the availability of compression capacity at the inlet to the DVP. It is probable that the ultimate capacity of the DVP is considerably greater than 7.3 PJ/a.

⁷ Independent reserves certification is carried out for Molopo by Netherland, Sewell & Associates Inc.

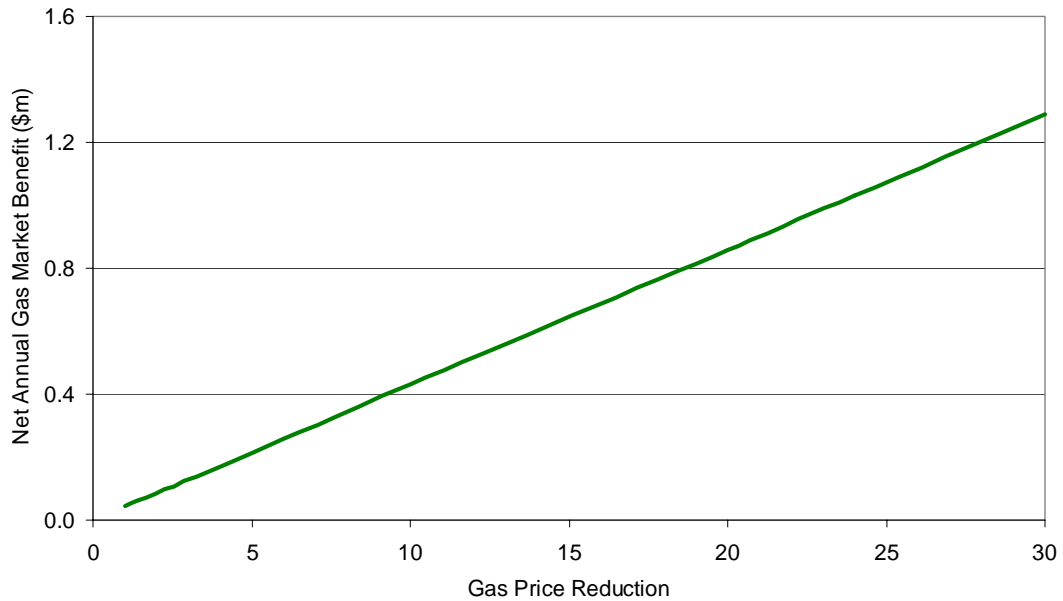


Figure 3: Gas Market Benefit Realisable Through Competition

5.6 Figure 3 has been prepared on the basis that the benefits of increased competition are limited to the quantity of gas that is delivered to the Gladstone market from the Mungji or surrounding gas fields. In reality, the competitive benefits may be significantly greater. This is because gas from the Mungji (or other) resource will compete for but will not always succeed in securing gas sales opportunities. Through this process, the effectiveness of which has been readily apparent in Western Australia during the 1990's, the benefits of a competitive gas market extend well beyond the quantity of gas that may be available from Mungji.

5.7 In addition, gas that is displaced from the Gladstone market will be available to other sectors of the Queensland gas market, most likely the Brisbane market sector. Therefore, a potential further, indirect benefit of improved competition in the Gladstone market sector will be an improvement in competition in other market sectors. It is not necessary for the present purpose to attempt to quantify this impact.

5.8 Access to the DVP will promote competition in the Gladstone gas market and the improvement in competition is not trivial.

6 Cost of Coverage

6.1 Origin's original estimate of the cost associated with coverage of the DVP was \$100,000 to \$150,000 [*draft decision paragraph 9.4*]. This estimate has been increased to \$500,000 [*draft decision 9.5*], a figure which is excessive if a fair, reasonable and prudent approach is adopted in preparation of Access Arrangement documentation.

6.2 Nonetheless, if a figure of \$500,000 is accepted it is equivalent to only \$100,000 per annum over a five year Access Arrangement Period.

- 6.3 An amount of \$100,000 is trivial when compared with the benefits that will accrue to the Gladstone gas market through improved competition involving gas supply from source(s) close to Gladstone. A gas price improvement of less than \$0.03/GJ, the benefit of which is limited to the quantity of gas that can be delivered through spare capacity in the DVP, will exceed the costs associated with coverage.
- 6.4 The benefits that will flow from (but are not limited to) improved competition in the Gladstone sector of the Queensland gas market therefore exceed the costs associated with coverage of the DVP.

7 National Code Coverage Criteria

- 7.1 The Council should conclude that coverage of the DVP will promote competition in the downstream Queensland gas market, primarily in (but not limited to) the Gladstone sector of that market.
- 7.2 Coverage criterion (a) is satisfied not only in respect of the upstream DVP gas market but also in respect of the downstream gas market.
- 7.3 Having recognised the magnitude of benefits that will accrue through promotion of competition in the Gladstone sector of the Queensland gas market, the Council must properly conclude that coverage of the DVP will be in the public interest. The benefits that may be expected to flow from coverage of the DVP far outweigh the costs of coverage.
- 7.4 Coverage criterion (d) is satisfied. It is in the public interest that the DVP be subject to coverage by the National Gas Code.