

GOLDFIELDS GAS PIPELINE

PUBLIC FORUM

DRAFT DECISION ON PROPOSED ACCESS ARRANGEMENT

TRANSCRIPT OF PROCEEDINGS

AT 4TH FLOOR AUDITORIUM SGIO BUILDING

170 ST GEORGES TCE PERTH

TUESDAY, 15 MAY 2001, AT 2.00 PM

Presenters:

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| Dr K. Michael, | Gas Access Regulator and Chairman |
| Mr P. Kolf | Office of Gas Access Regulation |
| Mr D. King | Goldfields Gas Transmission |

Forum Speakers:

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|-----------------|---------------------------------|
| Mr S. Lill | Anaconda Nickel |
| Mr M. Meaton | Economics Consulting Services |
| Mr J. Balchin | Allen Consulting |
| Mr W. Trumble | TransAlta Energy |
| Mr J. Harvey | WMC Resources |
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DR MICHAEL: Ladies and gentlemen, welcome to this forum on the Goldfields Gas Pipeline Draft Decision. I would like to welcome David King. Welcome, David. Later on, of course, we will hear from GGT.

The public forum is part of our process that we use following the Draft Decision so that we can have further feedback, either on information that we have not got, information used in a particular way or clarification of any of the points we have made in order to help us and the pipeline owners to understand the issues a lot more clearly so that when we are drafting up the Final Decision, we can take all those points into account.

We are currently in a public consultation period. There are comments still being provided up until the end of this month and there is a chance that this period may well be extended as well.

May I give you a brief outline on what we will be doing this morning? I am Ken Michael. I am the Regulator. I will be acting as the MC for the afternoon. It is most important that information is provided by yourselves. We are keen to hear comments from anybody who is here and we will encourage you to provide comments. We are here to consider the Draft Decision and provide clarification as required.

We will be recording this particular meeting. The microphones are there for recording, as you can see. We will be providing, as we have done in the other public forums in more recent times, a transcript of the proceedings on the OffGAR web site. If anybody has any problem with that, they must let us know and if they wish to review any of the material before it goes on the web site, that is fine, but we need to know. It hasn't caused us a problem to date and I don't think it should, but I think it is important that we do make the information available. So the speakers are there for recording, but also for use when you pose questions so that we make sure we pick up all the material we need to have.

There should have been a program slide come up first. Yes... I think the objectives we have been quoting - and these obviously pose interesting comments, but our objectives are clearly through the use of the arrangements that we have and through the National Gas Access Code that we are required to work within in promoting competition and encouraging economic development.

We are obviously about value to users, and that came through very much in a lot of the points that have been raised to date, and reasonable return to the owners. Of course that often causes interesting discussion as well, particularly in the current climate. However, we believe we have addressed all of those in arriving at the Decision we are presenting to you. We will obviously talk further about that as we go into the debate.

The program briefly for this afternoon is that I'm actually conducting the overview at the moment. Key issues will be addressed by Peter Kolf. We will have a break then. I think, David (King), you are happy with this arrangement that following the break you wish to make a statement, as I understand it. That is fine, and then we will move into an open forum discussion and we will take questions from the floor at that time.

Basically, the Access Arrangement for the GGP has raised a number of particular issues that we have been trying to address and hopefully have addressed in the Draft Decision.

Obviously, the valuation of the initial capital base and the rate of return, are always key issues and we will explain the parameters used in calculating the weighted average cost of capital, the reference tariff, the services and the tariffs that are associated with them and how we arrived at those. One of the issues that is fundamental as well to this whole debate - and I think it is focused on in the Draft Decision - is the throughput forecast. We will be making a comment on that and no doubt GGT will wish to comment on it a little later as well.

There are also other matters to be raised and discussed such as general terms and conditions. Mechanisms to trigger reviews of the Access Arrangement - we need to bring those to your attention and seek your feedback. We are asking for key performance indicators to be included as part of the Access Arrangement to assist getting a better grasp and understanding of the industry as it performs. Benchmarking will provide useful information for the future assessment of such regulatory processes, which no doubt will themselves go through a review period. Having that understanding, I think, is fundamental to having regulation. However, at the moment we are working within the National Gas Access Code and that is pretty clear on what the requirements are we need to follow.

There are a number of other non-tariff matters and, of course, there is a section on fees and charges. Basically that is as far as I was going to go. I was intending to give a summary of the key outcome of the Draft Decision but then Peter was going to give you more detail so I thought it was better to allow Peter to develop the arguments and I think that way we can save a bit of time and allow time for more discussion for comments in general. So I would like to invite Peter Kolf who is our Executive Director at the Office of Gas Access Regulation to take you through the Draft Decision and to give you a better understanding of the basis of that Decision and hopefully this will give rise to some comments or questions or points of clarification that you may seek or make. Thank you. Peter.

MR KOLF: Thanks, Ken. Thank you for the opportunity to give this presentation. What I would like to do is give a fairly brief overview of the Draft Decision, mainly to stimulate discussion and help us deal with issues to be raised a little later in the session.

The first of the issues that I would like to address is the services policy. The services policy that has been put forward for the Goldfields Gas Pipeline is for a firm service, a single firm service. It has also agreed or offered to negotiate non-reference services in good faith. The Regulator has required that an interruptible service should be available as a non-reference service.

Moving on to the Reference Tariff, the Code provides for the Service Provider to be able to recover the efficient costs of delivering the reference service. Those costs in summary are capital costs, non-capital costs, depreciation and a return on capital. We will be talking in a bit more detail about those as I go through the presentation.

The actual procedure for tariff determination as it is in the Code is a fairly well and clearly set out process. It first of all involves consideration of the initial capital base and then moves down to consider capital expenditure, non-capital costs, rate of return and so on as they are indicated on that particular slide. You will find that the Draft Decision deals with these matters pretty well in that order.

On the issue of the initial capital base, GGT proposed a DORC value, a depreciated optimised replacement cost value, of \$450 million. That was estimated on the basis of

depreciated adjusted historical costs. We had quite a bit to say about that in the Regulator's Draft Decision.

The initial capital base was calculated assuming historical depreciation on the basis of a units of production methodology, and that is a fairly important issue, which will be raised again a little later on. It was raised in relation to a period of time over a regulatory pipeline life of 42 years. Again we will be dealing with that in a little more detail later. That provided an initial capital base of \$452.6 million; which included \$2.6 million of working capital.

Turning to the Regulator's approach to the initial capital base, the Regulator determined the initial capital base on the basis of a DAC value, a depreciated actual cost value, which was \$435.4 million, which after you add the \$2.6 million working capital, gives an initial capital base of \$438 million. The Regulator's approach to calculating historical depreciation in this case was the use of the straight-line depreciation methodology, and we will talk more about that a little later. In addition to that, the Regulator used and assumed a pipeline life of 65 years and that was assumed on the basis of a weighted average methodology, the weighted average of the different assets that make up the pipeline itself.

The reason why the Regulator opted for a depreciated actual cost valuation was that firstly there were certain design constraints which were imposed on the initial construction of the pipeline under a State Agreement, which really had the effect of constraining GGT into building a particular type of pipeline and under those circumstances it was considered that it would be more appropriate to take into consideration the depreciated actual cost value of the pipeline rather than allow for the flexibility of changing the actual design of the pipeline as would occur if you were to use a depreciated optimised replacement cost value. So that was one of the important reasons for using the DAC value.

The other issue that needs to be taken into consideration here is that the DAC value in the case of the Goldfields Gas Pipeline was considered to be an appropriate methodology in view of the very low level of inflation that had taken place and our observation that construction costs had not increased significantly. So on the basis of those three considerations, it was felt appropriate that the depreciated actual cost methodology would be an appropriate methodology for the Goldfields Gas Pipeline.

Capital expenditure: GGT proposed capital expenditure of \$5.9 million over the 5 year Access Arrangement Period. That \$5.9 million is a simple aggregate of the total amount of capital expenditure for that period in real terms and, as indicated on the slide, the Regulator did accept that amount and therefore that amount of money was included in the calculation of the Reference Tariff.

Non-capital costs: GGT proposed an amount of \$54 million over the Access Arrangement Period and the \$54 million was calculated as before in real terms. The Regulator did seek a variation to that amount and adopted an amount of \$48.9 million, which represented a reduction of 9.1 per cent.

Moving on to depreciation, GGT proposed a units of production depreciation, and I have made mention of that before. In addition to that, it also sought to adopt an asset life of 42 years being related to the regulatory life of the pipeline. That had the effect of accelerating depreciation taking into consideration the general approach adopted by regulators in determining depreciation for pipelines. The Regulator, as I have indicated before, in relation

to historic depreciation, also adopted a straight-line depreciation methodology in respect of projected depreciation and adopted a pipeline life of 65 years.

One of the important considerations in looking to determining depreciation, particularly future depreciation, was in fact the throughput forecast. The Regulator, on the basis of various matters concluded that the throughput forecast put forward by GGT appeared to be conservative and therefore on that basis moved to the use of a straight-line depreciation method and not the units of production method of depreciation. I might just mention that additional advice on the throughput forecast has been requested and the Regulator would be quite happy to reconsider that based on any additional information that may become available on that issue.

The rate of return: the Code really has two important requirements in relation to rates of return; one being that the return should be commensurate with prevailing conditions in the market for funds and the other is that the financing structure that is used should reflect standard industry structures. The approach adopted by the Regulator is very much in accordance with those methods and if you go over and look at the methodology that was used in the Draft Decision, you will find that those two elements are clearly evident.

GGT proposed a rate of return of 12.2 per cent real pre-tax calculated on the basis of the capital asset pricing model and the weighted average cost of capital. The Regulator, on the other hand, adopted a weighted average cost of capital of 7.95 per cent, also real pre-tax, and that is equivalent to or translates into a return on equity of 13.3 per cent where that is calculated on a nominal post-tax basis, which is a fairly common way in which that particular rate of return is expressed around the country.

The rate of return calculation: the differences in the rate of return that was proposed by GGT and that which was determined by the Regulator actually had variations in all of the major parameters, risk-free rate, inflation rate, gearing ratio and so on. One of the important factors that made a significant difference in the Regulator's rate over the period was the risk-free rate itself which is based on a 10-year bond rate and that had moved from 6.7 to 5.35 per cent in the time that we were preparing the determination.

I should mention that that particular rate is likely to vary further before the Final Decision, because the weighted average cost of capital will be adjusted one more time just prior to the Final Decision to bring it in line with the parameters that then exist. There are other areas that I could talk at great length on, but I guess I prefer not to take up the time at this stage, but we can certainly raise any issues, should you wish to discuss any of those matters during the forum later on.

Total revenue: the Regulator's total revenue was estimated at \$259.9 million or \$260 million for all intents and purposes over the Access Arrangement Period. I haven't provided a direct comparison here with what was an equivalent amount that was put forward by GGT. Indeed, the proposed Reference Tariff that GGT put forward on this matter didn't have a direct revenue calculation associated with it so I was not really able to provide that, but the Draft Decision does indicate that the Regulator intends verifying the total revenue before the Final Decision is finalised.

Moving on to the Reference Tariff itself, I think it is important to take into consideration that the Code actually provides for the tariff structure itself, that is, the form of the tariff, whether it is distance related and what the components are of the actual tariff itself, to be at the

discretion of the Service Provider. The approach that the Regulator has taken here has been to adopt the tariff structure proposed by GGT and that includes the escalation approaches and so on.

It is important to bear in mind, however, that the tariff structure under the Code is subject to broad criteria of efficiency and equity and the Regulator certainly has taken those sorts of things into consideration. In effect, the Regulator has, at this point in time, accepted the tariff structure. However, there are aspects of the tariff structure on which the Regulator has called for additional information. There are some aspects, particularly the increases between the different levels of the structure, that parties might wish to provide additional information on. The Regulator would certainly be very keen to give consideration to such matters.

The Reference Tariff, as determined by the Regulator, is estimated to be approximately 30 per cent less than the Reference Tariff that was proposed in the Access Arrangement by GGT. To give you an indication of how the different elements of the reference tariff are impacted on by the different variations that were adopted, the following slide gives an analysis of how that 30 per cent was actually derived.

As you will see there, if you were to make an adjustment only for the asset life and nothing else, and that is to move from the 42 years to the 65 years, then the impact that that has on its own, all other things being equal, would be approximately 2 per cent. If after that you adjust the tariff - and in this case I might just mention that because of interrelationships between these different components the order in which you do this actually impacts on the magnitude of the change, but if the very next change you make after the asset life adjustment you adjust for straight-line depreciation, that would reduce the amount of the tariff by a further 3.3 per cent and so on.

The ICB in that situation would have a 6.2 per cent impact, the rate of return would have a 17.4 per cent impact and operating costs would have a 1 per cent impact. As you can see there, the rate of return is by far the most significant of the elements that impact on the tariff in this case. The Regulator's ICB adjustment is the second-most important.

Having said all these things, that really brings my presentation to a conclusion and I will hand the meeting back to Dr Michael. Thank you.

DR MICHAEL: Thanks, Peter. It was supposed to be 2.50pm by now so we are a little bit ahead of time, which I think is terrific, and that was the purpose of my comment at the beginning so that we could have as much time as possible for questions. David, it is probably a bit early for you. At this point I wouldn't like to take questions before you have had your say so we can take a break now just for, say a quarter of an hour and grab a cup of coffee. It will be out there hopefully.

When you are early, you don't always get the rest of the logistics right. So if you can do that, we will come back and we will then have David's presentation and then we will have general questions. We should be able to allow for a couple of hours of questions if you want to use that. Hopefully you do, so that we can get excellent feedback from you. So thank you for that. If you would like to ask either Peter or myself any particular details during that break, please do. I would be happy to respond on a personal basis as well. Many thanks.

DR MICHAEL: Thank you, ladies and gentlemen. We are certainly into that period where we can have a statement from GGT. I would just like to recognise - he has come over especially for the meeting - Manouch Daneshvar who is the Executive Director of CMS Energy. Welcome, Manouch. I overlooked mentioning you at the beginning.

MR DANESHVAR: Thank you.

DR MICHAEL: Thank you. David, would you like to make your statement, thank you?

MR KING: Thank you very much for hearing our statement. We are looking at just making a simple statement today. Obviously there are a lot of detailed things to go into, but we feel that the public comment, the written response phase, is the phase under which we should answer those queries. The statement is:

GGT, as Operator on behalf of the Joint Venture Owners, is of the opinion that in regard to the majority of the specified non-tariff amendments workable outcomes can be achieved by moving forward cooperatively.

GGT contends, however, that in other respects and in particular the area of tariff determination, the Draft Decision contains serious flaws in regard to both technical and legal matters. GGT intends to work with *OffGAR* in a manner that is consistent with prudent pipeline operator-ship and its ability to meet legal and pre-existing contractual obligations yet does not compromise the Joint Venturers' rights under the Goldfields Gas Pipeline State Agreement.

What is the greatest concern to GGT is the treatment in the Draft Decision of the prevailing State Agreement. GGT's Access Arrangement is intended to be consistent with the applicable provisions of the National Code having regard to the pre-existing provisions of the State Agreement.

The Joint Venturers are all significant investors in energy infrastructure. We are disappointed that the Draft Decision, despite our earlier submissions, proposes an outcome which is not consistent with the Joint Venturer's legitimate business interests.

The Regulator's apparent disregard of the effect of the State Agreement in this manner gives rise to serious concerns regarding existing and future economic development undertaken via the security of a State Ratified Agreement.

GGT finally wishes to emphasise that while these issues are being resolved it is very much business as usual. As a pipeline operator whose sole business is the transportation of natural gas, we are always keen to talk to existing and prospective customers.

So that is the statement and we open it up to questions.

DR MICHAEL: Thanks, David. All I can say is that again we are happy to sit down and receive all that information that you may have so that we can debate it. I think we can have a meaningful debate during this forthcoming period. I don't believe it was appropriate to have that debate in great detail in the sense of negotiated agreements prior to a Draft Decision. I think it is for us to take into account all the information that is provided to us and should certain information not be provided, then obviously we can only make the best judgment we can.

I must say we have had good cooperation from GGT. There are some differences obviously that you have heard, but the working relationship is very positive. We obviously each have a fair way to go in arriving at a conclusion that I believe GGT would see acceptable, but it will

be our task to work with GGT to demonstrate the various points that we have made and have been making.

I would just like to make one point on the State Agreement. I'm pleased that David used the words "apparent disregard" because that in his view is the way it seems. I can tell you it was not disregarded and that we have been through that agreement in much detail, both legally and technically, and we have compared the information in relation to the National Access Code in respect of legitimate business interests and the trade practices arrangements and the definitions therein.

We have had many discussions in relation to that and that particular information is the information that we have included in our Draft Decision, but whatever the case, I would be happy to discuss with GGT the outcome of those discussions and why we made the decisions we have. If they have any other information that would help us in respect of clarifying that position, we would be delighted to receive it. So I would like to put on the table that we will be continuing to negotiate in a positive way with GGT in that respect and all other aspects of the Draft Decision.

Now it is open for, if you like, questions. Can I remind you that the session is being recorded and that if you have any problem with this issue, let us know after the meeting because we can certainly discuss any aspects with you, but it is our intention to put it on the web site so that others can view the particular points that have been made? The "ums" will be deleted. When you come to the microphone, would you please give your name and your affiliation?

Peter is reminding me that I should have done something else, which is to please invite the panel to come over there if you wouldn't mind. We have Peter Kolf who has already been introduced. Just getting up to the dais is Michael Soltyk who is a senior analyst with us on contract. We have Nick Parkhurst in a similar capacity. On the end, may I introduce Jeff Balchin who advises me on a personal basis. He is from Allen Consulting and provides me with independent advice in respect of regulatory matters? Thank you, Peter, for reminding me. Questions? I have allowed 2 hours. I would also say that comments are also very welcome. Thank you.

MR LILL: Dr Michael, Simon Lill from Anaconda Nickel.

DR MICHAEL: Yes, Simon.

MR LILL: Just a quick question on the timetable, the process that you see before us from here.

DR MICHAEL: That is an interesting question, I think. What I would like it to be and what it will be are perhaps two different things. Submissions were to close at the end of May. I have had discussions with David on this and I have indicated that there will be maybe an extension on that. We are due to come out with the Dampier to Bunbury Pipeline Draft Decision. I think it may be that we allow for discussion to take place simultaneously, if you like, or concurrently, I should say on both pipelines. That is certainly a request I have had and I'm happy to comply with that so extending the period won't be a problem. That doesn't mean we can't start virtually as soon as - probably the end of May we will start putting all the comments together. We would come up with a Final Decision within about 3 months or 4 months.

MR KOLF: I would say, yes, that is an adequate period of time, but it really is going to depend on the nature of the issues that are raised and the amount of additional work that we need to do such as obtain legal advice and so on. If there is considerable work generated in considering issues such as the State Agreement, then that could take 4 months to resolve. I would see that very much as an outside period, but it is possible.

DR MICHAEL: Yes, I think it will depend on some of the comments in the statement. Obviously there is a lot of talking to be done and a lot of agreeing to be done before we get things on the table. That is the position of the Regulator you have heard today. That is based on all the information certainly before me and if there is anything in that, as I said right up front, that people wish to challenge or wish to speak to us about, then I'm very happy to take that information and review that position. After all, that is what a Draft Decision is about. Whether there is enough movement in there to satisfy GGT is for us to talk about and obviously the matter could be prolonged if those matters aren't resolved within the time frame I have specified, but that would have to be our target. Simon, does that answer your question.

MR LILL: Clearly our concerns are that it is within the GGT's interest to try and delay the Final Decision as long as they possibly can. As well, it is whether there is a managed proposal to meet certain timetables or whether there is some arbitration process that is being considered to ensure that the consumers are able to look forward to the (tariff) reduction in a due time rather than an extended timetable.

DR MICHAEL: Thank you, Simon. There are mechanisms in the Code, which allow that to take place and the Final Decision can still come out. If we can't reach agreement on the arrangement, then the Regulator can take certain actions and that would almost certainly place the matter perhaps into a different process, but you are quite right. Others who have raised this matter with me before on a number of occasions, about timing I'm talking about now, and I would have to say we didn't deliver as we thought we would. So it is in my interests and in our Office's interest to make sure we get that matter through as quickly as we can and we are not discounting the users in this respect. Comments or questions? Yes, please.

MR MEATON: Thank you, Ken. Murray Meaton, Economics Consulting Services. I raise a question really for the panel about the life of the asset. If my fading memory serves me correctly, there was one goldmine in Western Australia only 22 years ago. I think at that point there may have only been one nickel mine, but I'm sure my friend from Western Mining can correct me. I have just completed a study on the North-Eastern Goldfields and, with due respect to Simon at the back there, I would be struggling at the moment to find a project which is going to be around in that Region in 30 years' time. You have got a life of asset of 65. Can I ask what consideration was given to the likely customers for this pipeline in justifying a 65-year depreciation life?

DR MICHAEL: Peter?

MR KOLF: I think I would be inclined to change that question round the other way. At this point in time the situation is that we have indications from a number of parties - and that was documented in the Draft Decision - that the prospects for gas deliveries in the Goldfields Region are of a long-term and continuing nature and of an increasing nature. So the question that we were struggling with is that we couldn't really see a justification for reductions in demand for natural gas. I think that the general perception that we have in front of us is that it would be increasing. I acknowledge the fact that it is not possible to identify projects that

might be 20 or 30 years down the track from here. However, whilst that may be the case, it would be unduly and unreasonably pessimistic to assume that there are none.

DR MICHAEL: I think also, Murray, as I said before - I was saying during the break - if we haven't interpreted that position from the information we have in a realistic way, then we need to hear and we need to receive more information so that we can make our own judgments on that. I can only repeat each time that it is a Draft Decision and if we haven't quite got that right, then we need to look at it, but certainly we didn't just sit back and not look at these situations but we did receive advice and we did research the information. Obviously we have a different point of view there, but we need to explore that position a lot further.

MR MEATON: Ken, I would be happy to provide advice based on the study we did on the North-Eastern Goldfields. I haven't followed this issue through in detail, with due respect to Peter. It is just amusing that in the benefit cost study, the guidelines which were used for evaluating infrastructure investments forward under the Treasury guidelines - the normal time frame for those benefit cost studies is 30 years. In a benefit cost study with any investments beyond 30 years, the discounting means that the benefits are pretty small and the lack of accuracy of predicting the outcome beyond 30 years generally means that most benefit cost studies are limited to a 30-year time frame. I just find it intriguing that we have almost doubled that in this case.

DR MICHAEL: Thanks, Murray. Did anybody wish to comment from the panel?

MR KOLF: I guess I would comment that the issue here is in relation to depreciation. The depreciation itself is part of a cash flow analysis and that is also subject to discounting. So the differences in the approaches that have been adopted which is an accelerated-depreciation approach on the one hand versus a straight-line depreciation. I would think that the actual differences at the end of the day probably wouldn't amount to all that much.

If we were to make any adjustments to an accelerated depreciation approach quite to the extent that is within the Goldfields Gas Pipeline Access Arrangement at the moment is an issue that would still need to be addressed in any case. So, yes, there is the prospect for some change, but if that change were to be implemented, it probably wouldn't make all that much difference anyway.

DR MICHAEL: I wonder if any of the other panel members would like to comment. Jeff, did you want to make a comment on that?

MR BALCHIN: I suppose I could make a comment that's probably more in a general nature, not having actually done the analysis of this part of the decision, just on how demand uncertainty is conventionally treated when you're regulating assets. This is the approach I assume that OffGAR will adopt at least in future reviews. It is that other regulators generally - if there is uncertainty about demand, you would normally allow capital to be recovered earlier such that - at the time when demand might be dropping or other competitive pressures or anything that might affect your ability to charge people in the future, you actually don't have as much capital left so effectively your asset risk is reduced.

That's how you treat ongoing investments, so that if this was a new pipeline today, we would be saying - I assume GGT would be arguing that, "We're only going to be in business for 30 years, therefore we have to set prices to recover them in 30 years," and everyone would

probably agree with that and there would be some debate about how reasonable that is, but at the end of the day if they get their money back earlier, it just means in the future they have to charge lower prices. You don't get to get your capital twice.

One of the problems we have at the moment when you set the price for the first time is that what you think about depreciation will affect both the profile of recovery in the future as well as your initial value. Now, that is a problem you won't have in the future because you will have a value locked in, but right now effectively it is a bit more complex because you have got two things changing at the same time. Regulators, when they look at these things, often like to look at the incentives of the regulated parties.

In the future you would expect CMS or whoever is operating the pipeline to want to recover their capital as quick as they need to get their money back. At the moment though their incentives should be ahead. In fact, they should be arguing this pipeline is going to be around for 200 years because that then would mean they have recovered no capital at this point in time effectively and they have got a higher initial capital base than in 5 years time. They would then say, "Well, in fact the market has moved so I need to get some back earlier."

If I was asked to advise on this matter right now, I suppose my comment would be that in forming a view about the future market it has to be done and all you can do is rely on the best available evidence. At the end of the day a regulator is only human and they have to rely on the evidence and we live in an uncertain world.

DR MICHAEL: Thanks, Jeff. It is an issue that obviously is going to be at the very heart of the discussions that we will be undertaking, along with aspects of risk that we have talked about, but I thank you for those comments. Is there any other comment or discussion? Yes, Wayne?

MR TRUMBLE: Wayne Trumble, TransAlta Energy. Peter, I was interested in your comment that due to low inflation over the last few years - and I forget what the other factor was that you mentioned - you felt that the pipeline would cost no more to build today than it did then, if I'm quoting you properly. Did you take into account the effect of a 49-cent Australian dollar when you were making that statement or doing that calculation?

MR KOLF: Thanks, Wayne. Yes, we did look at the issue of the Australian dollar and the impact that it would have. As you know, we based the calculation on an actual depreciated cost value and the advice that we had in terms of costing of pipelines indicated to us that the effect had been very moderate, if indeed there was any impact at all, and on the basis of that advice we approached it from the point of view of a DAC value rather than a DORC value which, of course, would take into consideration other impacts such as inflation and exchange rate movements and the interrelationship between those two.

MR TRUMBLE: Who provided that advice?

MR KOLF: We had some of that advice from our technical consultants. Michael, you might wish to just provide some further advice on that.

MR SOLTYK: A valuation made at the time was in dollars as at December 99, therefore at that time the exchange rate was of 60 cents was taken into account, not 49 cents or 50 cents like it is just now. It was 60 cents at the time of making a valuation. Taking into account the

overseas components of sourcing of some material, this was reasonably small. It had a pretty small impact on total price.

MR TRUMBLE: Sorry, I still haven't heard an answer to my question. Who provided your advice?

MR SOLTYK: At that time I was working as an independent consultant and I was hired to make a valuation of this pipeline.

MR TRUMBLE: So you provided the advice prior to being hired?

MR SOLTYK: Prior to being hired by OffGAR, I was working as an independent consultant at that time and it was a bidding process and I won it and I was hired to prepare the valuation of DORC and DAC values. I did this job prior to having a permanent job with OffGAR.

DR MICHAEL: Can I just point out that in the Draft Decision you will find that his company is mentioned? I'm pretty sure of that.

MR SOLTYK: Yes, it is.

DR MICHAEL: What happened is there was an opportunity for short-term assignments on a contract basis and Michael applied to work for us. He is not a permanent employee of the Office of Gas Access Regulation. He remains a contractor at the moment to see this particular task through. Do you see a difficulty with that?

MR TRUMBLE: No.

DR MICHAEL: Thank you. I'm just making sure. I might also add that we worked out the value on a number of bases. We had so many different figures at one time, which included working out a DORC value in today's dollars using today's technology. One of the things that was of concern certainly to me - and Peter is well aware of this - is that the specified pipeline through the State Agreement. It certainly was a uniform diameter, if I recall, as we came up with a particular design and we priced that as well. In fact, if I recall, that might have even been lower than the DAC that we came up with.

MR KOLF: It was.

DR MICHAEL: I would have to say that I couldn't accept a lower figure than that particular DAC which took into account the pipeline that was in place because of the State Agreement.

MR PARKHURST: Yes, the optimised replacement cost, as costed by Michael here, which would be a new pipeline, not based on the existing one, came out at \$432 million in December 99 dollars, as opposed to the replacement cost of \$450 million.

DR MICHAEL: Is that information in the Draft Decision?

MR PARKHURST: It is page 99.

DR MICHAEL: Page 99, yes.

MR PARKHURST: There is a discussion about the different costings.

DR MICHAEL: Thank you. Wayne, does that at least address the issue? It may not answer your question, but it addresses the issue you are asking.

MR TRUMBLE: I heard what was said, thank you.

DR MICHAEL: Thank you. Obviously there are more things to be discussed in that area as well. You can see that. I'm happy to do so. Comments or questions?

MR HARVEY: John Harvey from WMC Resources. I'm just interested in the Regulator's perspective if there is a contradiction between the Access Code and the State Agreement, how do you see that being treated?

DR MICHAEL: It is an interesting question, mainly because I'm sure that matter is being addressed right now. We have done that. We have had advice from a number of sources or at least two that I'm aware of in trying to explain the relationship between the Agreement and the Code itself. Our advice is applying the Code is tantamount, as I understand it, Peter, to applying the Agreement. Those matters where we think there is a requirement to take account of, we have done so. Peter, would you elaborate further on those?

MR KOLF: I think that you have pretty well covered it. The principal area where there was understood to be a difference and where we were in need of having to take into consideration the provisions of the State Agreement was in relation to the asset valuation and it was for that reason that we adopted a higher initial capital base value than what would strictly be required under the Code. In respect of other issues, we were not made aware and we are not aware of other issues that are stated within the State Agreement that the Regulator is obliged to specifically take into consideration in the Decision.

DR MICHAEL: There may be other information we are not aware of, I should have to say. I'm not aware of any, but there may be and obviously if that fact comes to light, then we need to consider that. We have been pretty well through that process and that debate is not over and I think it is one that will continue and we will be happy to be part of those discussions. Are there any other comments or questions?

I was very ambitious in asking for a couple of hours. I thought with this one we would hear a lot more, but perhaps it is a bit difficult. Was there not enough information provided in the initial discussion? We are learning from each one and the previous one or previous couple I had feedback to say, "Allow the others to have a chance to speak as well", and so consequently we cut this back a fair bit hoping, of course, that with the Decision out for some time you would have a pretty good idea of what is in it. Certainly the first part, part A, which doesn't take too long to read, gives you a pretty good understanding of the key elements. If there aren't any further questions, I was going to ask if the panel members had any general comments. I'm sorry, Murray?

MR MEATON: Ken, I'm not trying to delay proceedings.

DR MICHAEL: I'm not suggesting that you are.

MR MEATON: Thank you. Do you have an opportunity to road test the weighted average cost of capital methodology? What I really mean is that, as a practising economist, I fully understand you are dealing with a very sophisticated methodology. However, sophisticated methodologies can still produce unusual answers. When it produces a rate of return at

investment level that I wouldn't invest at, I wonder if it is reflective of the industry and I particularly wonder at the moment if it is reflective of the resource sector.

We are seeing so little investment in Western Australia at the moment in the resource sector that the only conclusion can be that the rates of return on offer are not acceptable to most investors and yet the methodology is producing what appears to me to be an unacceptably low rate, understanding that the methodology is a very sophisticated technique.

DR MICHAEL: Thank you. It is obviously a key issue. Peter?

MR KOLF: I think that probably Jeff can do a better job of responding to this particular issue as to the methodology that is adopted. I would say that I would take the view that as far as the methodology itself and indeed the final outcome, by comparison with other decisions around the country, the Goldfields Gas Pipeline Decision has been a very favourable one.

It certainly makes provision for risk which is at the higher end of the spectrum and that was quite explicitly done in recognition of the risks that are associated with the Goldfields Gas Pipeline and also that Western Australia is not the same as the Eastern States and so on, and that it does have development requirements that perhaps exceed those in some of the other States.

However, I think you should take note of decisions, particularly the Amadeus Basin decision that has recently come out, which is a pipeline not dissimilar to the Goldfields Gas Pipeline, and certainly my understanding is that the decision on that one was that the rate of return was considerably tighter than what it was for the Goldfields.

DR MICHAEL: Peter, that is a draft decision as well.

MR KOLF: Draft decision, yes. While I concede that there are reasons for that, there are differences in risk profiles between the pipelines, I would still take the view that this particular decision is one that we regard to be at the higher end, but a reasonable return taking into consideration both users and the requirements of the Service Provider. As to the actual methodology itself and how you might justify the rates that are produced by the methodology nationally, I might ask if Jeff wants to make any comment on that.

MR BALCHIN: Thanks a lot, Peter. Just a bit on my background, I advise a number of regulators around the country on a whole range of economic regulatory matters, but for my sins this issue seems to be the one where I get asked to provide advice on more than any others. I do a lot of work for the ORG as well and I was heavily involved in the 1998 gas decision that seemed to have ignited debates around the place and I was heavily involved in the Regulator General's recent price review of the electricity distributors where for my sins again I was grilled by a QC in the appeal, but the matter was upheld there.

Now, on WACC I would be very keen actually to read whatever evidence people can muster on road testing the WACC. The problem is - and I normally start everything I write with the WACC sort of spelling out what we would love to have if we lived in the best of all possible worlds, which is where we're trying to estimate the cost of capital that investors require to invest in a particular asset and it is something we can only infer from evidence. It is something you can't ever observe.

Regulators commonly use models drawn from finance theory as a framework for estimating these returns, because basically in the absence of a model, where the hell do you start? Once you are using a model it is necessary to apply those models consistently and hence regulators go into some level of detail to ensure that the capital asset pricing model, which is the most widely used model in the world for estimating investor returns, is applied consistently throughout.

The concern that the model can generate returns would have a high degree of certainty so if you chose things right up one end of what you could call a reasonable range, it is quite clear that you would get answers significantly different, very different, to if you systematically adopted parameters at the other end of the range. It is also quite clear that anyone who has been involved in any of these regulatory things, if you look at the parameters, the things that a regulator might do and the impact they have on prices, WACC is always up there as number one.

If the WACC was 8 per cent and - normally the return on assets lies around this figure - a cost of service type building block revenue requirement is worth about 50 per cent. So if you change the WACC by one percentage point, that's a twelve and a half per cent change in the WACC, that equates to about 6 per cent change in tariffs. It has a very big direct effect on tariffs, so it's not surprising that there is a lot of attention to it and that, in response to that attention, regulators go into a degree of detail.

Finance theory can give you a steer, and there are debates about the size of these things all around the world and all you can do as a regulator is try to take the best that you can having regard to objective capital market information. In my view, a lot of the parameters that OffGAR applies are either right on the reasonable range or even some of them are slightly at the higher end of the range, like the betas are higher than what other regulators around the country have used and they are quite a lot higher than the sort of beta estimates you get for utility firms around the country.

One of the problems we have in Australia is that there isn't a large deep sector of traded utility stocks, but there are a few now. There are at least three that you can get betas for. In a few years we will have a few more companies with Australian Pipeline Trust and AlintaGas now being traded on the stock exchange, but those betas generally are quite a lot lower than what - the current empirical estimates are and quite a lot lower than what regulators have been using and are lower again than what OffGAR has used.

In terms of the sort of middle of the road application, finance theory - if you take a steer from that, you would have to say that the decision for Goldfields is at the high end of what you would normally come out with. I think you have come out with a sort of balanced application of the theory.

We have talked about road testing the WACC and trying to draw inferences from other sources of information about - there was a comment made of, "What can we look at?" and there was a comment made that there is not a lot of resource development happening in Western Australia. I'm not sure you can blame utility regulators who regulate transportation of gas and electricity on the lack of resource development, which is by and large unregulated.

I think if you look around the countryside at the moment and you say, "Is there evidence of a capital strike in pipeline development" - now, this is probably going to get me shot, but with The Fin Review reporting this morning that the Pipeline Trust is also looking at a project to

bring gas from Darwin down to Moomba and Duke - well, it has just built the Eastern Gas Pipeline. It's talking seriously building a pipeline over to Tasmania as well as a pipeline transporting gas from Victoria into South Australia. There is not a lot of evidence of an all round capital strike in the utility industry in Australia.

What other bits of information can you look at? As I said, I was heavily involved in the Victoria gas distribution price setting review of reference tariffs. It was probably the big one in Australia before they were privatised. If you were saying - if you got the cost of capital dead on and your benchmarks for op ex were dead on, capital expenditure was dead on and your demand forecasts were right, you could ask the question then, "What would these assets sell for in a competitive trade sale?" And if all of those parameters were right, they would sell right on the regulatory asset value. As it happens, they didn't. They all sold for multiples of the regulatory asset value, more than one and a half. The only parameter in the whole thing that can cause those sorts of wedges between asset values and regulatory values is an expectation that you will earn returns higher than your cost of capital.

In response to some of these concerns, that Australian regulators are delivering rates of returns towards the low side for international investors, the ACCC recently commissioned NERA, National Economics Research Associates, a very credible firm - the biggest economic consultancy firm in the world, I think, unless Charles River has got bigger recently - and they benchmarked utility returns, the returns that regulators have used in setting price caps all around the world. Their report I think is available on the ACCC web site, but if you ever seen the ACCC web site - you might have a hell of a time trying to find it, but I understand it's there somewhere.

Their conclusion was that the returns that Australian regulators provide are at the high end are either at or higher than what regulators in other countries generally provide. If OffGAR's returns are marginally higher than returns in other countries, then you would have to say the returns being provided here are at least as good as anywhere else in the world for regulated assets.

Now, again, that is a broad general benchmarking study they did. It doesn't take into account the specific risks of particular assets and all it can do is really try to answer the question about whether on average or looking at all the decisions you're sort of on the right track, but it is a piece of evidence that you can have regard to and take some comfort in that Australian regulators aren't systematically getting it wrong.

I suppose my final statement would be I'm always happy to see, and I think any regulator would love to see good, hard, objective evidence that can help them resolve some of the uncertainty that is inevitable when you're trying to estimate something that is completely and utterly unobservable and which everyone has an opinion on and which, for obvious reasons, the different parties in the transaction are going to have completely opposing opinions. Life is not easy, but if you could reduce it into a model, we probably wouldn't have jobs up here, at least in this field.

DR MICHAEL: Thanks, Jeff. I think the issue is that it is not as straightforward as we all might think. I'm sure Murray is aware of that, but it is true. If there is anything that can help us get through the maze, then we are always happy to work with it. We have WACC and we have been working to it. I should say that in relation to that that the return on equity nominal post-tax, as Peter quoted, in relation to the GGT is 13.3 per cent which is not dissimilar from other decisions that have been made certainly here in WA. Of course, you have to take that

carefully because it depends on the financial parameters that you adopt in making that assessment and they obviously are changing all the time. Any other questions or comments? Murray?

MR MEATON: A very thorough answer, thank you.

DR MICHAEL: I'm happy to take any further comments and questions. I'm sure you would all walk out on me in any case so I will close the meeting if there is nothing else that anybody wishes to say, unless the panel has any other comment. Any other comment from any of you? No. Could I just wrap up by perhaps quoting the key elements that were coming out just so that everybody can recall them? I'm happy to receive David's comments in relation to terms and conditions on which he felt they were ones which we could sit down together and finalise in some way. Thank you for that, David.

There are obviously matters that still stand on the table that require further discussion. Just to sort of clarify them, the ICB, the initial capital base, of GGT was \$452.6 million. We were talking \$438 million. The weighted average cost of capital, GGT, was 12.2 per cent. Our figure was 7.95 per cent and that translates, as I said to a 13.3 per cent return on equity post-tax and the Reference Tariffs are reduced by around 30 per cent. We obviously need to hear from you. Please take the time out to make a submission. We will certainly get a submission, I'm sure, in time from GGT. We look forward to that so that we can sit down and start negotiating some points, but we would also like to hear from all of you and from the Users as well, in particular, I guess, so that we can get a good feeling on what this should be and if anybody has information that they believe we haven't used, then I would be delighted to receive that as well. Any questions you do have during the course of any of this, please direct them to OffGAR and we would be happy to respond.

I would like to thank our panel, Peter in particular and Michael and Nick and Jeff and to you, David, and your team and to Manouch. Thank you for coming across from Michigan and being with us. At least you have heard it direct and we can debate the matter obviously further. We look forward to bringing this to a conclusion much sooner than later, Simon, I can assure you, but time will tell how we progress from here. Thank you for your time. Thank you for joining us and I look forward to hearing from you all insofar as your particular views may be on this Draft Decision.

There is one final thing. The next step is to produce a Final Decision after discussions and after assessments and then we have to come to an agreed arrangement for the Access Arrangement and that will depend on how those discussions have taken place and from then on obviously the Code is quite clear on what actions can be taken. Hopefully we will be able to come to some resolution. That is certainly our objective. As I said at the beginning, we have a good working relationship with GGT and that will continue as far as I'm concerned and everything will be talked about in whatever way people wish to and we will also address any issues you may wish to raise generally. So thank you for being with us and I bid you good afternoon. Thank you.