



Western Australia

# *Economic Regulation Authority*

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## SUMMARY

### AMENDED DRAFT DECISION – GOLDFIELDS GAS PIPELINE

The Economic Regulation Authority today issued its Amended Draft Decision on the proposed Access Arrangement for the Goldfields Gas Pipeline (Pipeline Licence No WA: PL24) (**GGP**) lodged by Goldfields Gas Transmission Pty Ltd (**GGT**) on behalf of the owners of the pipeline on 15 December 1999. The GGP became subject to the *National Third Party Access Code for Natural Gas Pipeline Systems* (**Code**) with effect from 1 January 2000.

The GGP transports gas from Yarraloola in the North-West of Western Australia to Kalgoorlie and services the East Pilbara and Goldfields regions.

Under the Code, the Authority is required to publish a draft decision which either proposes to approve the Access Arrangement or proposes not to approve the Access Arrangement and states the amendments which would have to be made to the Access Arrangement in order for the Authority to approve it.

In April 2001 the Authority issued a draft decision.

On 6 November 2002, a notice was issued advising that the Draft Decision on the proposed Access Arrangement for the Goldfields Gas Pipeline would be amended.

A matter that the Authority intended to address through amending the draft decision was the interaction of the Code and the State Agreement (the Goldfields Gas Pipeline Agreement) that provided for construction of the pipeline and established a regime for third party access to the pipeline. However, on 10 June 2003, WMC Resources Ltd sought a writ of prohibition that would have the effect of preventing the Authority from considering or determining whether, under clause 21(3) of the State Agreement, the Code shall not have effect in relation to the GGP. The Court issued its decision in this matter on 2 December 2003 and on 18 March 2004 the Court declared that on the proper construction of the State Agreement and the *Gas Pipelines Access (Western Australia) Act 1998* the Authority is required to perform his functions under the Code without regard to clause 21(3) of the State Agreement.

On 6 April 2004, the Authority issued a notice further amending the process it intended to follow in assessing the proposed Access Arrangement taking into account the Court's declaratory orders.

In the Amended Draft Decision, the Authority proposes not to approve the Access Arrangement for the reason that it does not comply with the requirements of the Code. The Authority has indicated the amendments that GGT would be required to make to the proposed Access Arrangement for it to be approved.

One of the matters to be included in an access arrangement is a Reference Tariff for a service that is likely to be sought by a significant part of the market. One of the

significant elements in the determination of this Reference Tariff is the Initial Capital Base.

In its Access Arrangement submitted in December 1999, GGT proposed an Initial Capital Base of \$452.6 million as at 31 December 1999. The Authority has considered this proposal and in doing so has also had regard to a submission made by GGT in December 2002 in which it proposed an increased Initial Capital Base of \$553.4 million as at 30 June 2002, utilising a capital recovery calculation methodology.

In undertaking its assessment of the Initial Capital Base under the Code, the Authority made the following estimated valuations of the pipeline:

- a depreciated actual cost (**DAC**) of \$434 million as at 31 December 1999, using an historical capital recovery calculation similar to that set out in GGT's December 2002 submission but varying certain assumptions to reflect what the Authority considered to be the most plausible assessment of historical capital recovery;
- a depreciated optimised replacement cost (**DORC**) of \$407 million as at 31 December 1999; and
- a value of \$495 million as at 31 December 1999, derived using the capital recovery methodology proposed in GGT's December 2002 submission but varying certain assumptions to more accurately reflect the circumstances that existed prior to the introduction of the Code in respect of determination of tariffs for third-party use of the pipeline.

In deciding that the Initial Capital Base should be set outside the range of the pipeline's DAC and DORC, the Authority had regard to the previous tariff regime administered by the Western Australian Government under the State Agreement and the public interest in avoiding the potential for sovereign risk. In this regard, the Authority took into account the fact that an Initial Capital Base determined within the range of DAC and DORC would effectively "claw back" benefits gained lawfully by GGT through tariffs that were allowed to become entrenched by previous administration of tariff determination under the State Agreement.

Against these considerations, the Authority also weighed the interests of Users and Prospective Users and the broader public interest in having prices for gas transmission services reflect the efficient cost of pipeline assets in a workably competitive market. In this regard, the Authority determined that the tariffs established under the State Agreement implied a rate of return to GGT that is likely to have been substantially in excess of GGT's actual cost of capital and GGT has, consequently, obtained very substantial capital recovery.

The Authority did not consider that a reasonable avoidance of sovereign risk requires that the benefits of a prior regime should be entrenched indefinitely, particularly in circumstances where the State Agreement Act did not provide for the exclusion of the GGP from regulation of third party access under the Code.

In balancing the competing considerations under the Code, the Authority proposes to determine that the value of the Initial Capital Base should be \$480 million (including a value of working capital of \$1.3 million) as at 31 December 1999.

The Authority also proposes to find that the Reference Tariff for the Firm Service should be revised to reflect the following parameters:

- a nominal pre-tax Rate of Return of 10.81 percent, which the Authority considers appropriately reflects the prevailing conditions in the market for funds; and
- a present value of Total Revenue (with a discount rate equal to nominal pre-tax Rate of Return of 10.81 percent) of \$320.67 million in dollar values at 31 December 1999.

Reflecting these parameters, the Reference Tariff for the year 2000 would be as shown in the table below. The Reference Tariff for subsequent years would be determined by escalation of the year 2000 values at the rate of inflation.

Contract Duration	Toll (\$/GJ of Contracted MDQ)	Capacity Reservation (\$/GJ of Contracted MDQ/km)	Throughput (\$/GJ km of Throughput/km)	Indicative Tariff at Kalgoorlie (\$/GJ, 85% load factor)
1 – 5 years	0.238058	0.001372	0.000402	3.06
6 – 10 years	0.218220	0.001257	0.000368	2.80
11 – 15 years	0.208301	0.001200	0.000352	2.68
16 – 20 years	0.198382	0.001143	0.000335	2.55

For a typical User at Kalgoorlie, this would represent a reduction of approximately 18 percent on the level of the Reference Tariff originally proposed by GGT. The Authority proposes to determine that the Initial Capital Base should be greater than originally proposed by GGT. The Authority has also proposed a rate of return which it believes is commensurate with the prevailing conditions in the market for funds and the risk involved in delivering the Reference Service.

In its December 2002 submission, GGT proposed that the Reference Tariff should apply for a period of 5 years from the date of approval of the Access Arrangement. This would result in the Access Arrangement period extending to the year 2009. However, forecast information provided with the original proposal is only relevant to 31 December 2004. Forecasts for the period ending 31 December 2009 have now been provided and are presented in the Amended Draft Decision. However, in being mindful of the need for procedural fairness in assessment of the proposed Access Arrangement, the Authority has required that the proposed Access Arrangement make provision for a Revisions Commencement Date of 1 January 2006. Subject to consideration of any further submissions, this may be extended in the Authority's Final Decision.

The provisional views set out in the Authority's Amended Draft Decision reflect the Authority's assessment of all the information available to it at this time. In making its Final Decision, the Authority will take into account submissions on its Amended Draft Decision made by interested parties.

The Authority has set a period of time for submissions on the Amended Draft Decision from GGT and other interested parties. Submissions should be received by the Authority by the close of business on Friday 10 September 2004.

LYNDON ROWE  
**CHAIRMAN**

29 July 2004