OFFICE OF GAS ACCESS REGULATION

OffGAR WESTERN AUSTRALIA

DAMPIER TO BUNBURY NATURAL GAS PIPELINE

PUBLIC FORUM

DRAFT DECISION ON PROPOSED ACCESS ARRANGEMENT

TRANSCRIPT OF PROCEEDINGS

AT RIVERSIDE BALLROOM SOUTH NOVOTEL LANGLEY

221 ADELAIDE TERRACE PERTH

THURSDAY, 2 AUGUST 2001, AT 2.05 PM

Presenters:

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Dr R. Challen	Environmental Resources Management Australia Pty Ltd

Other Panel Members:

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CHAIRMAN: First of all, let me announce my name which is Ken Michael. I am the gas access regulator in Western Australia, and my role today is to bring you a brief understanding of the draft decision related to the Dampier to Bunbury natural gas pipeline. My role will be to chair the proceedings and I will have a panel to assist me to make the presentations and also to make any responses that will arise during the open forum.

But in opening today's proceedings, I would like to welcome you to this forum, and I would also like to welcome Sue Ortenstone from Epic Energy and David Williams who I believe will make a short presentation just before tea. After the tea session - I will put up the program a little later - you will have the opportunity to ask questions. From about 3.20 till 5 o'clock is the allocated time for the forum, but you may have as long as you need. Hopefully during that time you will take the opportunity to raise matters that you would like clarified or comments you would like to make.

I will also have Peter Kolf, who is just immediately on the edge of the table there and who is the executive director of the Office of Gas Access Regulation, give a brief overview of the draft decision. He will be followed by Dr Ray Challen sitting next to him who is a consultant and who played a major role in the drafting of the draft decision. The assessment of the access arrangement was managed by Robert Pullella who is our senior analyst and who will join us as a member of the panel later, as will Jeff Balchin who is a consultant with Allen Consulting.

I thought I would start the proceedings today by giving a bit of a general statement on regulation and a general statement on the approach used here, and I think it's important to place the presentations that are to follow in context, and certainly there has been a lot of media and we are all well aware of it, and I need to be able to make sure that from the draft decision point of view, the facts that relate to this draft decision are clearly presented to you today so that you have a good overall understanding of the intent of the draft decision.

It is also useful, in looking at this draft decision, to reflect on why the current regulatory regime was introduced. The regulatory arrangements in Western Australia implement a uniform national framework for access to gas pipelines initially agreed to by all Australian governments on 25 February 1994. This framework was developed through extensive consultation with both the owners and operators of pipeline infrastructure, users and other stakeholders. The National Third Party Access Code For Natural Gas Pipeline Systems forms part of a uniform national framework. The introduction to the code states that: the aim of the code is to provide sufficient prescription so as to reduce substantially the number of likely arbitrations while at the same time incorporating enough flexibility for the parties to negotiate contracts within an appropriate framework.

The code has also been designed to provide a clear national access regime with consistency between different jurisdictions. Among other things, the code sets out the process to be followed by a service provider to put in place an access arrangement for covered pipelines - that is pipelines covered under the code. It includes the principles to be used in making the assessment. The principles define the overall boundaries within which both the service provider and regulator can work during the assessment process, but in

applying these principles, there is a limit to the level of discretion that can be used by the regulator when assessing the proposed access arrangement. In some matters, the limits are clearly defined, but for others it is a matter of judgment, and where such judgments are needed, the code provides guidance to the regulator on the matters he must or she must take into account.

The draft decision was an outcome of a considered assessment of the access arrangement proposal by Epic Energy and the issues raised in the submissions received during the course of the assessment period. It reflects an outcome based on the principles outlined in the code. Since the release of the draft decision, comments have generally been made in relation to the indicative reference tariffs that have been determined which in turn are related to the initial capital base and the rate of return being two key determinants of the reference tariff.

The most significant issue in respect of tariffs from Epic Energy's perspective has been the issue of a regulatory compact with the State Government. As noted in my notice with the draft decision, I have not been able to verify a regulatory compact. The draft decision took into account all the information provided by Epic Energy and other interested parties including the review of information made available to bidders at the time of the sale and the sale agreement, and the evidence which Epic Energy says supports the existence of its regulatory compact as to future tariffs.

However, it should be noted that such evidence was only one of the matters that were considered under section 2.24 of the code. It was after considering all these matters that a valuation based on the depreciated optimised replacement cost or the DORC was used. Indeed the valuation used in the draft decision was set at 100 per cent of the DORC valuation which is in contrast to many other similar regulatory decisions which have set this value at less than 100 per cent. The draft decision details the reasoning for selecting a DORC value as the initial capital base, and Dr Ray Challen will elaborate on this in his presentation later this afternoon.

I invite your feedback on this draft decision and will consider all of the information submitted in the final decision. Following the assessment of submissions and further discussions with Epic Energy and any other interested parties the next phase is to come to a final decision and seek a revised access arrangement to be lodged in accordance with the provisions of the code. It should be recalled that the process established under the code for the issuing of a draft decision, receiving submissions and discussing those and then issuing a final decision is designed to enable decisions to be made in an efficient and proper way.

Accordingly, a final decision may vary from its precedent draft decision if new information is presented. I therefore encourage all interested parties to make substantial submissions so that the most informed final decision possible may be made. I thought it appropriate if I just read out one paragraph from the notice that I issued with the draft decision, and it says:

The Regulator emphasises that the above Reference Tariff is indicative only and has

been calculated for the purposes of the Draft Decision. The Regulator has intentionally left Epic Energy with some discretion in determining how to go about meeting the Regulator's required amendments and Epic Energy may propose a revised Reference Tariff that differs in some respects from that indicated above.

You may be aware from the media that action is being taken by Epic Energy - and it is their right - to seek to stay the process.

I would just like to make it very clear that for today, this is a matter that will be addressed outside this forum and will not be the basis for responses, certainly on my part. Epic may wish to make some comments, and that will be their prerogative a little later. I should also add that the proceedings are being recorded, so later on I will be asking for people who will be making comments or asking questions to make very clear their name and affiliation so that we get that right. The intention is, as with other times, when we have undertaken this particular process, that it will be placed on the Web. However, as I have always said, should anybody have any difficulty with that, then please contact the office so that we can be aware of their concerns.

The program is there before you, and I think it is abundantly clear. Peter Kolf will speak in a moment, followed by Ray Challen and then Epic Energy's David Williams wishes to make a comment. Then at 3.20 we will have an open forum in which case the matters that we have raised will be presented for clarification. So with that introduction, thank you again for attending in such numbers. I think that encourages a good debate and I think better information, and hopefully a better decision. So I would like to introduce our executive director Peter Kolf to come forward and outline the overview of the draft decision. Thank you, Peter.

MR KOLF: Thank you Ken, I'm very pleased to have the opportunity to address you here today. My presentation is in the nature of an overview, and by way of an introduction to that presentation, I would like to just quickly give you an indication of the issues that I will be addressing which are first of all OffGAR's role in this process, particularly in relation to its advice to the regulator and others. I will then move on to the advisory team that were involved in the preparation of the draft decision for the Dampier to Bunbury Natural Gas Pipeline.

I would like to also go over very briefly some of the issues that relate to the issuing of a draft decision such as what it means and what's intended by it. I would like to give an indication of what the process is from here, and finally move on to an overview of the draft decision highlighting some of the key issues that are raised in that draft decision.

Turning to OffGAR's role, OffGAR acts as a secretariat and to some extent operates independent of the regulator. Indeed the regulator actually has two roles; one is the chief executive officer of OffGAR, the other is as regulator, and in his capacity as the chief executive officer he manages, has control of OffGAR, but it is a secretariat that provides advice to the Regulator. The secretariat also provides advice to the arbitrator, and in certain circumstances also to the Gas Review Board where there is no conflict of interest.

The regulator and the arbitrator are both independent, both of the government, industry, and to the extent that OffGAR provides advice to them. The parties are also independent in the sense that they can source independent advice and are encouraged to do so and have done so. To date OffGAR has handled decisions in relation to five covered pipelines. In fact, the number of decisions involved are two final decisions and approvals, and five draft decisions. For one covered pipeline, the access arrangement has been deferred until 1 December 2002.

There have been two ring fencing decisions that have been dealt with by the agency and considered and determined by the regulator, and these are both draft and final decisions, and there has been one associate contract decision issued. There have also been some appeals. There have been two appeals. They were the same parties, so in some sense it might be seen as one appeal, but in fact it was two appeals, and throughout all of these processes, there has been extensive public consultation, which is evidenced by the amount of information that is on the agency's Web page.

Moving on to the advisory team in relation to the Dampier to Bunbury Natural Gas Pipeline, the project manager for that particular assessment is Mr Robert Pullella and he will join us as part of a panel later on. The principal consultant in the drafting of the draft decision has been Dr Ray Challen. The legal advisers in this case were Corrs Chambers Westgarth and the technical consultant is Connell Wagner, and Mr John Elkins has joined us as a member of the panel today. Our economic adviser is Allen Consulting, and Mr Jeff Balchin will also be a member of the panel today.

My role in this process has really been the management of all the various decisions and the activities of the office and the editing of the material that's produced prior to it going to the regulator for decision. As you might well imagine, that has been a fairly substantial task. The office has had quite a lot to do over the last 2 years and things have been quite intensive at times.

Moving on to the draft decision itself, I think it's important to realise that the draft decision is an important part of the regulatory process, and Ken has made reference to that in his presentation. It reflects the regulator's understanding of the issues. It also reflects the quality of the arguments and the information that has been presented to the regulator for consideration. It has involved detailed consideration of all of the issues that have been presented, both in the application and the subsequent information requests that were made of Epic and which Epic very kindly responded to, and also the responses that we have had through submissions. The draft decision offers now an opportunity for all parties to clarify any particular issues that have been raised in that document and provide the regulator with an opportunity to move forward to a final decision.

The process from here is that at this stage we're looking to closing submissions on 10 August at which time the assessment team will move on to an assessment of the submissions, and that could include submissions from Epic of course, and it would involve a

movement toward the drafting of the final decision. Our objective at this point in time is to implement the final decision by the end of this year.

Moving on to the overview of the draft decision, clearly the proposed Access Arrangement was not approved by the regulator, and there are a number of amendments that are required before approval of the access arrangement would be possible. The draft decision itself deals with very many complex issues, and these have involved quite a major undertaking on the part of the office to be able to come to terms with and to provide an understanding of those and to communicate those as part of the draft decision. These issues have been dealt with in great detail, and indeed there are 350 pages of the document itself to verify that.

Probably the most important of the issues that have been raised are those that relate to the value of the initial capital base, and if I may just move on to the next slide and just briefly go over what the key issues are, and I will come back to the initial capital base as part of that discussion. First of all, the key issues include the services policy and the concept of the firm service that was put forward by Epic in its access arrangement, and the regulator has in principle accepted that concept of the firm service.

In respect of the rate of return, we have noted that that rate of return, as was documented in the draft decision, is not significantly different to that which was applied for by Epic Energy after you take into consideration changes in parameters such as interest rates, inflation rates and tax rates, and these are normally adjusted as decisions are taken by regulators over time.

In addition - moving on to capital expenditure and as is indicated in the draft decision - capital expenditure was accepted; the expenditure that Epic Energy put forward was accepted by the regulator. There were some items that were reallocated. Rather than us treating those items as capital expenditure, they may have actually been included in the ICB or they may have been included under operating costs, but all of the costs have been included within the draft decision that was issued by the regulator. Likewise non-capital costs or operating costs were also accepted by the regulator.

In respect of the initial capital base, this is the only real major area that there is a substantial difference between the draft decision and that which was put forward by Epic Energy, and that really relates to the issue of a regulatory compact, and as the regulator has indicated previously, he was unable to accept the initial capital base put forward by Epic Energy on the grounds that he was unable to verify the regulatory compact upon which it was based.

The reference tariff itself is therefore impacted on by the ICB and the position that the regulator has had to take in relation to the ICB. That essentially is all that I have prepared, and on that note I would like to thank you all and we can move on to the next speaker.

DR CHALLEN: Thank you, Peter. What I want to do in this part of this afternoon's proceedings is outline some key components of the draft decision, particularly those areas that have appeared to be of some public interest as evident by public submissions on the proposed access arrangement. This, in relation to the size of the document of the draft decision at least, is going to be a fairly brief overview. It is of course to provide a summary of the major points of the draft decision, and also I hope to jog people's memories of what would have been a long read and add to the question time that will follow the first part of this afternoon's session.

What I want to do first is have a look at the reference service proposed by Epic Energy and then later on I will move on to the reference tariff, effectively the price for that service. Epic Energy proposed a single reference service which they call the firm service. This comprised a basic forward haul and backhaul haulage service with receipt of gas in zone 1 of the pipeline, which is effectively the top end of the pipeline. Various ancillary services to that firm service were proposed to be provided as non-reference services, and these include services such as the availability of spot capacity on the pipeline, seasonal capacity, a park and loan service, a peaking service and others.

Submissions on the proposed access arrangement in relation to the reference service were many and varied. Firstly many submissions noted differences between the proposed firm service and the T1 service as established and defined under the Gas Transmission Regulations and subsequently the Dampier to Bunbury Pipeline Regulations.

The view was put forward in submissions that the firm service was substantially more restrictive than the T1 service in many respects. It included a reduced opportunity for users to reallocate capacity between delivery points and for the trading of capacity, more restrictive imbalance limits and higher penalties for imbalances, reduced opportunities for changing daily throughput nominations and provision of penalties on variances between nominations and deliveries, a different tariff structure to that of the T1 service, and the absence of provision for seasonal differences in contracted capacity, a park and loan service or an authorised overrun service.

Further, many submissions put forward a view that Epic Energy was under an obligation to provide a reference service that is the same as the T1 service: where this obligation may arise from a statutory obligation under the Dampier to Bunbury Pipeline Act, a contractual obligation under the pipeline sale agreement between AlintaGas and Epic Energy, and/or an obligation under the code by virtue of their purportedly being a substantial demand for a service of the type of the T1 service. Submissions also put forward views that other characteristics of the proposed firm service were unreasonable including limitations on locations for the receipt of gas into the pipeline, limitations on the backhaul of gas and a minimum contract term of 5 years.

In addressing these submissions and in considering the proposal by Epic Energy independently of submissions, the regulator gave considerable attention to the issue of whether Epic Energy is under a statutory or contractual obligation to provide a service that is strictly equivalent to the T1 service. The conclusion was that neither such obligation exists.

Notwithstanding this however, there was some evidence of market demand for many of the elements of the T1 service that may justify some commitment of Epic Energy through the access arrangement to their provision. However, it was borne in mind that the services policy of an access arrangement is required to contain only a general description of the characteristics of a proposed reference service as well as non-reference services, and not detailed terms and conditions. As a consequence, in addressing the services policy, the regulator gave attention to the general nature of the firm service proposed by Epic Energy rather than making a detailed comparison of terms and conditions of the firm service with the terms and condition of the T1 service under previous regulation.

The conclusions of the regulator in regard to the services policy and in particular to the reference service proposed by Epic Energy were that the firm service, in principle and in its general form, was acceptable. However, the firm service would require some revision to include some other elements as justified by some market demand for those elements. In particular, the firm service should include a seasonal service, that is the ability to have different contracting capacities for different times of the year; it should include the provision for receipt of gas into the pipeline at any location on the pipeline, and some proposed restrictions on the backhaul of gas should be removed.

The reference service should include the provision of metering information to users and in particular the provision of that metering information that users would need to avoid or at least assess their liability to penalty charges. Finally, the firm service should have a minimum contract term of 1 year rather than the 5 years proposed by Epic Energy.

The regulator is of the view that the firm service when amended in accordance with the requirements of the draft decision and when offered in combination with the non-reference services set out in Epic Energy's proposed services policy, is similar to the T1 service.

Moving on then to the reference tariff which is effectively the price for the firm service. An access arrangement must include a reference tariff associated with each reference service. In the case of the proposed access arrangement, we have a single reference service and therefore a single reference tariff or if you like, more precisely, a schedule of prices for that service, depending upon the characteristics of the user.

The reference tariff is established at a level that provides the service provider with an opportunity to earn a stream of revenue that covers the efficient costs of delivering the corresponding reference service, including operating costs, capital or depreciation costs and a return on capital. The definition of efficient costs and determination of appropriate depreciation schedules and rates of return on capital unavoidably involves a substantial exercise of judgment.

The code provides guidance in making the necessary assessments and judgments, in particular sections 2.24 and 8.1 of the code set out a range of factors that the regulator must take into account in considering reference tariffs. These factors relate for the most part to

the consideration of and balancing of the potentially conflicting interests of the service provider, users of the relevant pipeline and the wider public.

Let's look at the methodology used to establish firstly a reference tariff as proposed by Epic Energy and for the regulator to assess and revise that reference tariff. Epic Energy proposed a reference tariff and future tariff path independently of the costs of providing the service and in accordance with a purported regulatory compact arising from the sale process for the pipeline. The regulator was not able to establish any regulatory compact, as previously mentioned, insofar as tariffs may have been established at the time of the pipeline sale. In view of this, the reference tariff was assessed and revised in accordance with the guidelines established and set out in section 8 of the code.

We can most readily examine the principal components of the draft decision as it relates to the reference tariff by comparing the reference tariff and the various tariff parameters proposed by Epic Energy with the revised tariff and revised parameters required by the regulator in the draft decision. As most of you will have noted from the draft decision, the decision is requiring a reduction in the reference tariff from that proposed by Epic Energy. For zones 9 and 10 of the pipeline being the locations for delivery of gas of most interest to users, the tariffs are reduced from $1 and $1.08 respectively to indicative tariffs under the draft decision of 75 cents and 89 cents with all those numbers in dollars per gigajoule.

The difference between the proposed and revised reference tariff arises from changes to the various parameters and methodologies in the tariff calculation, and I will go through these briefly now and then look at some of those in more detail. Firstly, the regulator is requiring a reduction in the value of the initial capital base from a proposed value of $2,570.34 million to $1,233.66 million.

Capital expenditure is required to be reduced from $56.95 million to $35.89 million, although this reflects only a reallocation of these costs either to include some of that expenditure in the initial capital base or to shift some of that expenditure to non-capital costs for reason that they are more of an operating cost nature rather than a capital cost nature. So despite what appears a reduction, all of Epic Energy's proposed capital expenditure has in fact been accepted and taken into account for the purpose of the regulator's revision of the reference tariff.

Non-capital costs actually increase slightly from Epic's proposed access arrangement to those set out in the draft decision. This is not actually so much an increase in allowed costs as a result, as I have just mentioned, of a re-allocation of costs from capital expenditure to operating expenditure.

The rate of return decreases slightly from the proposed value of 8.5 per cent to a value of 7.85 per cent, although this reflects changes in parameters that are exogenous to the actual business operations of Epic Energy.

The depreciation methodology has changed from an annuity methodology to a straight line methodology, and the provision for deferred recovery of depreciation as proposed by Epic Energy is removed.

Finally the proposed multiple charge and zonal structure of the reference tariff as proposed by Epic Energy has for the most part been allowed, although some revisions are required that affect the level of tariffs at different locations along the pipeline.

Moving on to some of these parameters of the reference tariff calculation in more detail. In considering the value of the initial capital base, the regulator considered a range of different valuations methodologies, the values derived by these methodologies and the advantages and disadvantages of the alternative methodologies within the context of the Dampier to Bunbury Natural Gas Pipeline. The range of valuations considered included a depreciated actual cost of the pipeline, estimated to be $874 million to a maximum of the cost of purchase of the pipeline as set out by Epic Energy of $2,570 million.

Within this range there were other values considered, including that of a depreciated optimised replacement cost of the pipeline, which is considered to be in the order of $1,230 million, and an asset value that would correspond to Epic Energy's proposed tariffs without provision for deferred recovery of depreciation, that is actually at about $1,650 million.

In looking at this range of possible values for the initial capital base, the regulator had some key considerations. Firstly within the context of the Dampier to Bunbury pipeline, there are sound economic reasons to not value the pipeline at greater than the depreciated optimised replacement cost. Secondly, there were difficulties with a valuation based on a sale price. In particular, the absence of information available to the regulator that may indicate that the sale price had some justification in terms of a conventional and rigorous asset valuation methodology and the existence also of a range of factors that may affect the sale price of an asset such as the DBNGP including various strategic commercial considerations in the purchase of such an asset and also the fact that the regulated entity's cost of capital may actually differ from that considered by the regulator in the setting of tariffs.

Thirdly, the regulator did give attention to the process of the Dampier to Bunbury pipeline sale and a very strong indication to prospective purchasers of the pipeline that the asset valuation established under the code would not be in excess of a depreciated optimised replacement cost valuation. It is largely on this basis that the regulator determined an appropriate value to be based on a DORC valuation and to be $1,233.66 million, which is in fact based upon the DORC valuation presented to prospective purchasers of the pipeline.

Moving on to capital and non-capital costs, and I will just quickly repeat what I have said earlier, that these costs were accepted by the regulator, although with some shifting of costs between the capital base, capital expenditure and non-capital costs.

In looking at a rate of return, the regulator similarly to Epic Energy used the capital asset pricing model methodology. The regulator did have some methodological differences to the proposal of Epic Energy. However, despite these methodological differences, the overall result in determining a rate of return was that the rate of return set out in the draft decision is similar to that proposed by Epic Energy after taking into account changes to interest rates, inflation expectations and corporate taxation rates since the time of submission of the access arrangement.

In regard to depreciation allowances or depreciation of the capital assets of the pipeline, Epic Energy proposed an annuity depreciation schedule which is similar to, if you like, interest on a home loan account which pushes depreciation towards the future, but this was also coupled with deferred depreciation where a shortfall of revenue of Epic Energy in providing a return on their proposed capital base was actually capitalised and in effect added to the capital base.

The regulator has no in-principle objection to these depreciation methods. However, they need to be considered in the context of the particular pipeline. With the revision to the value of the initial capital base for the Dampier to Bunbury pipeline, deferred depreciation was considered no longer necessary. Further, the revised reference tariff was actually based on straight line depreciation by virtue of there being some advantage to Epic Energy in use of such a depreciation methodology, and in this instance what the regulator was in essence doing was considering Epic Energy's likely response to the draft decision and their revisions to the tariff methodology and considering that Epic Energy were likely to change their methodology for determining depreciation, and therefore for the purposes of providing information in the draft decision, the regulator used a straight line methodology rather than an annuity methodology as originally proposed.

Looking at the tariff structure proposed by Epic Energy, Epic Energy proposed a multiple charge tariff with some charges levied on the basis of pipeline zones and pass-through of gas through compressor stations. This, in effect, is a distance based tariff, not dissimilar in general terms to the tariff structure for the existing T1 service.

Several submissions were made in relation to the tariff structure. They were generally supportive of some form of distance-based tariff, although there was some dispute as to the details of that distance-based tariff and in particular to the location of zone boundaries, and not surprisingly, the issues raised in submissions more or less reflected the supposed interests of the parties making those submissions.

There was also some dispute as to the relative proportions of fixed charges and throughput charges in the reference tariff, in other words, those charges that are paid up-front for contracted capacity in the pipeline and those charges that actually relate to a quantity of gas throughput.

In looking at a tariff structure, the regulator stayed with precedent established in other decisions in Western Australia which was to take a view that the tariff structure is very much at the discretion of the service provider, subject to meeting broad criteria of economic

efficiency and equity. In relation to the particular tariff structure proposed by Epic Energy, the regulator had no in-principal problems with the structure proposed. However, there were some changes - and they are relatively minor changes - to cost allocation and for the definition of charges really on the basis of efficiency: in other words to make sure that what are true variable costs of gas throughput correspond approximately with the variable components of the tariff, and also some equity considerations for the tariff set for users with delivery points on different parts of the pipeline.

That then is the overview of the issues related to the reference service proposed by Epic Energy and the reference tariff for that service. I will now just very quickly in a few overheads try and summarise 350 pages of document in about six or seven bullet points. Epic Energy propose a reference tariff for their firm service of $1 and $1.08 to Perth and south of the Perth metropolitan area effectively, established independently of costs and based on a purported regulatory compact. They propose an initial capital base of $2,570 million based on the purchase price of the asset, and that actually increases in effect over time through the capitalisation of losses made.

It is therefore likely that tariffs could increase significantly in the future as a result of the initial capital base valuation or the capital base valuation proposed by Epic Energy.

In summary, the regulator's draft decision took into account that there is no evidence for purported agreements on tariffs as proposed by Epic Energy. Further, Epic Energy's purported regulatory compact would not in any case have justified the proposed asset value. Given this, the regulator revised the reference tariff in accordance with the guidelines established by the code with which Epic Energy was familiar at the time of purchase of the Dampier to Bunbury pipeline.

Lastly, two points: the asset value required by the regulator under the draft decision is at the top of the normal range contemplated by the code, and the decision does provide the incentive through a favourable rate of return, including a favourable rate of return on any future capital investment for efficient expansion of that pipeline over time. Thank you.

THE CHAIRMAN: Thank you, Ray and Peter, and now I would like to invite David Williams who would like to make a statement and also perhaps make some general comments. Please, David?

MR WILLIAMS: Thanks, Ken. For those of you that don't know me, I'm the general manager corporate services and strategy development of Epic Energy. Epic Energy is extremely disappointed with the draft decision handed down by the regulator on 21 June this year. Epic Energy believes there are a number of fundamental errors of law in the draft decision, in particular with reference to the proper application of the code. It is our view that the regulator has failed to take into account a number of very important factors prescribed by section 2.24 of the code, specifically the legitimate business interests of Epic Energy as a service provider, Epic Energy's investment in the pipeline, and the public interest, amongst other things.

Epic Energy is very concerned about the impact the draft decision would have if implemented on firstly Epic's financial position and our ability to operate a reliable and efficient pipeline; secondly, on the future growth and development activity in the state. Given Epic Energy's concerns with the draft decision, it yesterday served a notice on the regulator under the Limitations Act giving the regulator notice that Epic Energy intends to commence proceedings to have the draft decision quashed. Epic Energy has issued such notice out of an abundance of caution prior to issuing proceedings which are expected to be issued in about 14 days. Thanks very much.

THE CHAIRMAN: Thank you, David. What we will do now is we will break for afternoon tea - it almost seems a little while ago that you had afternoon tea, but we will have afternoon tea again and give you time to think it through and perhaps come back at about 20 past 3 we have got listed - say quarter past 3 if you come back, I will call you together and we will have a forum. Thank you.

THE CHAIRMAN: Thank you, ladies and gentlemen. We have the place booked until 5.00, so whatever time you wish to raise questions and any comments you may like to make, and we will do our best to address them, and those that of course - as always there may be some that we need to come back to you on, but overall I think with the team we have that was outlined by Peter earlier, we will be able to respond, and I'm sure - Epic Energy of course is welcome to address any of the comments that they may wish as well, and that will be their choice.

First of all I would like to remind you that the proceedings are being recorded and a transcript will be made available, when it's all corrected and checked, on the Web. I should also add that the overheads that you have seen by OffGAR will also be placed on the Web. So you will be able to get your copies from there if you wish. If anybody is having difficulty, please contact the office and we will be pleased to make a copy available to you.

In asking for questions or comments, I would require that you please announce your name and affiliation before answering the question or comment. So the forum is open. Yes?

MR TANNER: Thank you. Frank Tanner, Western Power. My question concerns the proposed penalty regime as proposed by OffGAR in the access arrangement draft. Go back to last year, Western Power put in several submissions concerning the nature of the penalty regime that Epic Energy was putting forth in its proposed access arrangement. I think we laid out our concerns pretty concretely in there. In going through the OffGAR draft ruling, I must say our concerns are pretty much the same as what we had with the Epic proposition.

The main concern that we are looking for and are considering on the OffGAR proposition is that we are looking for matters of principle in terms of where the code says that there is an ability for the regulator to apply principles in terms of applications of penalties. We can't see it. We would ask for OffGAR to perhaps clarify where they think that comes from, and in particular given the arbitrary nature of what has been put forth in terms of the 350 per cent of the underlying tariff as a quantum, there seems to be some arbitrary quality about that. Can you point out to us what specific guidelines there are in the code which you have used to guide your judgment in coming to that figure? Thank you.

DR CHALLEN: Penalties aren't considered explicitly under the code. The regulator has taken the view that penalties effectively form part of the terms and conditions for a service, although they are addressed separately in any decision documents of the regulator: apart from the terms and conditions more generally.

In relation to or forming part of the terms and conditions, penalties are considered under the criteria of reasonableness, just as other terms and conditions for a reference service are required to be reasonable. As a guide to what is reasonable, we have in penalties, as with many other terms and conditions, looked towards common industry practice and the 350 per cent is really in the middle of the range of penalty quanta that seem to be common practice for the pipeline industry.

THE CHAIRMAN: Frank, does that go some way towards addressing your issue?

MR TANNER: I hear what you say, but I don't think really answers the question because what I was asking for was the principles that should underlie a choice like that - and I'm turning you to a possibility, and that is that if there is a situation where a use of gas by a particular shipper points at use outside prescribed limits - and these might come in the form of access arrangement in terms of limits.

It seems to me if the operator's pipeline is not injured or the operator is not caused to be out of pocket or there is no overall damage done to the operation of his pipeline, given the state of imbalance, the state of peak flow of all the other shippers, then I would suggest to OffGAR that the principle that ought to be looked at is if there is a cost or an injured situation caused there, then that, I think, points towards some sort of principle, not a number which is perhaps arrived at through some averaging by practice elsewhere which is for a different sort of pipeline situation, particularly in that we have got a very long pipeline situation.

We have different types of shippers on our pipeline, but particularly with respect to industries here in the South West. I suggest to you we feel as though there is an arbitrary element to this thing, and that's where our concern lies.

THE CHAIRMAN: Ray, did you want to add to that?

DR CHALLEN: Yes, I can respond to that. I suppose in the ideal world, any penalty for a breach of contract condition, which is effectively what the penalty provisions under access arrangements provide for, would be related to the damages incurred by the service provider. However the damages incurred for any breach of a manner to which these penalty charges relate would be context specific, and as a general matter of principle when setting penalty charges, you are effectively looking at a trade-off between some ideal world of establishing penalties that relate to the damages incurred by the user for any particular infringement and the sort of, if you like, practicality of doing exactly that. The position taken so far is that to have constant rates of penalties, regardless of the damages that may be incurred in specific situations, is a reasonable trade-off in this particular context.

THE CHAIRMAN: Frank, I think your point has been noted. Again the terms and conditions are very much put forward by the provider, and certainly is their business in that sense, and I guess we have reflected on it as best we can, but we will note the situation and certainly examine that with Epic in relation to the comments you have made. Any other comments - John, yes?

MR DAY: Thank you. John Day, member of state parliament and opposition spokesperson on energy. What I'm actually seeking from the panel is in relation to some of the material that has been provided in Epic Energy's material that has been distributed where it says in effect that it's only those customers who are currently being serviced by the pipeline or at least those who can be serviced within the existing capacity of the pipeline that would

be covered by the proposed tariffs, and that any new customers for which greater capacity would need to be created would need to pay a substantially higher tariff.

If that is correct, obviously it would have a substantial impact on the ability of new players in the energy game, whether it be electricity generation or anything else, to compete I guess. So I am just seeking a comment from the panel as to whether they agree with that assertion, and secondly I state simply to place on the record that the opposition has expressed a view that we would be supportive of higher tariffs being arrived at, taking into account the overall public interest so as to ensure that a sustainable outcome is arrived at and to ensure that adequate expansion can be provided for in the interests of further developing industry in the state. So that is simply for the record, but what I would like a comment on if possible is that subject that I just raised.

THE CHAIRMAN: Thanks, John, and in relation to your second point, I appreciate you have made a submission on that basis and I thank you for it, and I thank you for the position you do have. I think on the first one, I guess, Ray, you might like to comment on that.

DR CHALLEN: Firstly on that point, there is, to the regulator's understanding, still some excess capacity on the pipeline. So there is some provision with the Dampier to Bunbury Pipeline for not only existing or existing users if it should apply, but certainly for new users to access capacity in that pipeline at whatever reference tariff is arrived at in the final access arrangement.

In regard to users that may wish to transport gas in excess of available capacity on the pipeline, the code certainly does provide for, if extensions or expansions to the pipeline are necessary, for new users to meet some of the capital costs of those extensions or expansions. So, yes, you are correct that new users may indeed pay a price greater than the reference tariff simply by meeting some of the capital cost for extensions or expansions.

However, if new users are paying more for capacity, that also lifts the value of capacity that is held under existing contracts and which new users may also purchase through trading of capacity between users. So in effect the existing users who now own capacity of greater value face exactly the same opportunity cost for use of that capacity as new users. So in effect the economic cost of capacity in that pipeline is actually the same for all users regardless of the nominal tariff that they may be paying.

THE CHAIRMAN: John, does that address - thank you. At the back and then - just one moment, Max. Peter, did you have something to say?

MR KOLF: Yes, I think I could probably add to what Ray indicated there. In the event that a new user is faced with a requirement to pay a higher tariff or is asked to pay a higher tariff, this is nonetheless subject to the provisions of the legislation, and there are circumstances there in which the arbitrator may be called upon to ensure that any tariff that is higher than what would be available under the pipeline generally would return the required rate of return that is provided for within the legislation. So that is just one additional item that I thought would be useful to mention.

THE CHAIRMAN: Thank you, Peter. Max?

MR TRENORDEN: Thank you, Mr Chairman. My name is Max Trenorden. I'm the member for Avon. For the record, I have got the John Cleese title of the leader of the second party in opposition straight out of Monty Python, but I am the leader of the National Party, and I am very concerned about the two answers that I have just heard frankly, and that is why I am here today. We need to develop it in rural WA urgently, and we don't need decisions that will stop that development. The concern that the National Party has - and it's a very serious and determined concern - we need new business and we need expansion of new business. For example Ravensthorpe Mines, which I was only down there a couple of weeks ago, are indicating they are likely to come on the capacity of the pipeline. Any new development will be quickly taken up, and the last thing we need is a higher cost in rural WA for development. I put that as forcefully as I can.

We need the competition of gas versus electricity and we need it now, we don't need it in the future. We don't need a decision that will delay that process. Mr Chairman, the National Party hasn't put a submission as yet, but we will be. As the cost of transmission is less than 20 per cent of the total tariffs, I just wonder what all the fuss is about. From where I stand and where I live, we listen to these sort of debates all the time. We want some equity in this process, we want the opportunity to develop rural WA, and there are industries out there waiting for that opportunity, and the last thing we need is someone with a foot on the hose.

We don't have the capacity in our organisation to work out what the price is, but we do want to know that the regulator is definitely going to take rural WA into account and we don't want a situation where the existing people who have been lucky enough to get onto a pipeline dominate the process. So it's mostly a statement, Mr Chairman, but I don't want any doubt that we in the country areas are looking for that competition that gas can supply, and we need it yesterday.

THE CHAIRMAN: Thank you, Mr Trenorden. I look forward to your submission, and I can tell you all comments and all submissions will be taken into account without question, but I don't know if any of the panel wishes to respond.

DR CHALLEN: The same comments apply to the previous question.

THE CHAIRMAN: Sorry?

DR CHALLEN: I think the same comments applied as answered to the previous question in relation to - - -

THE CHAIRMAN: We understand your position in respect of that, Max, and we will look forward to hearing some more details so that we can actually better understand the position you are taking, but there is no intent at all to ignore anybody in this exercise. I think I can only say that there are certain limits within which the regulator can operate, and those

limits I believe we have exhausted. However, if we haven't - and as I have said consistently, if there is information we haven't used or seen or there are arguments as to how it's being applied or there's other expressions of interest that people would like to give, then that's what this forum is about and that's what the submission is about and that's what the draft decision is about.

The draft decision is exactly that; a draft decision putting on the table what is the outcome of taking the information that we have been provided by others - by Epic, by others - an application of the regulatory process and we have that result. If that's not satisfactory to people, then we want to hear about it and we want to hear why and we want to hear on what basis we can modify, and I can also get on record, I'm prepared obviously to modify if we can substantiate those positions, but we need to be able to substantiate the positions that are being taken, and I look forward to that submission that will come forward from the National Party. Thank you. There was a question - just one over there first I think.

MR HENNESSY: Hi. Jim Hennessy from AlintaGas. Just following up on the first question where there is provision for surcharges in the event of certain capital investment being above the reference tariff. Are you aware of any provision within the code to provide for a rolling in of the tariff or for the capital investment to be put into the capital base and spread across all users if for example there are system-wide benefits?

DR CHALLEN: That provision certainly exists. For the current access arrangement period, Epic Energy did in fact not propose any capital expenditure relating to any significant extension or expansion of the pipeline. Had they done so, that could well have been taken into account as part of the capital base for the purposes of determining the reference tariff for the access arrangement period.

THE CHAIRMAN: Okay? I think just at the back, Stuart, yes?

MR HOHNEN: Stuart Hohnen, Ventnor Consulting Group. Ken, you have mentioned a couple of times in the course of the afternoon that the regulator is constrained considerably in what he can consider and what he can do and so forth. We are now facing the prospect of electricity, water, transport, gas all being brought within a regulatory umbrella in Western Australia. Are we to use the gas process as the model and the time frame of the gas process as the model for regulation of all these other areas or do you have some comments or words of wisdom as to how the process can be modified, how the framework can be changed to expedite and produce better base decisions?

THE CHAIRMAN: That's a nice awkward question. I have often said at forums such as this and others that what I would like to do at the end of the process of the decisions - and I might add that I was hopeful we would be getting there a little bit quicker than we have and I don't deny the length of period that this one has taken in particular, and the previous one at that, but that's how it has been. I would like to sit down with others and just explore the code regulatory process. I have said that to the industry and I have said that to other regulators, and I think that should happen.

I guess I feel that, without compromising my own position because I do look at the code and choose those areas of flexibility that I believe are there, and apply them. The different interpretation is that others believe that that flexibility is greater than perhaps I'm prepared to concede. I think the process I have said before is a long and can be intrusive process, and I believe there will be opportunities for - I would expect that single economic regulator when it's put in place to take opportunities and take advice from people such as myself in respect of the process, and also from industry.

If I have the opportunity, it would be my intention to call together the various parties and discuss it. So the answer is, I do see areas where I believe opportunities can be taken and also how it can be streamlined. The fact of the matter though is the code and the law, and the regulator has certain requirements under the law. The regulator must apply them, and we need to look at and reflect on what the business is, what the commercial interests are, and what the business of the pipeline is, and all of those need to be considered, and the code does give some guidance on the matters that should be considered. I believe we have considered those in this decision.

So I guess I wouldn't be prepared to be very specific for obvious reasons. I don't want to compromise the position of the office or myself, but I do believe that there will be an opportunity when we can resolve these other issues for the process to be examined and perhaps come up with opportunities for improvement. I will say one thing as the regulator in this position, that I think as a process - if we just set the code aside as the content, because I think that's really the issue at the end of the day, but if we look at the overall process and the independence of the regulator and the way in which the public consultation works, and that is through the access arrangements, the submissions, the comments, the draft decision, the investigations, the group of people that we use from such a wide variety of areas to explore these particular aspects and further discussion in this forum again, all I can say is that the process is a very open and transparent one, my office is always available for discussion and the opportunities are there.

I believe in that respect the actual process is a sound one, and I have always complimented the people who did come up with it if you are to have a regulatory process of this type. The question of the type is another issue, I wouldn't comment on at this stage, but I think there are opportunities for improvement, and I just hope that I get the opportunity, if I can successfully manage these two outstanding access arrangements, to explore that further with the providers and with industry in general and with the users. I don't know if anybody else - that's just as a general comment.

MR O'NEILL: Thank you, sir. Dennis O'Neill. I'm chief executive of the Australian Council for Infrastructure Development, and I guess I'm not here so much to ask questions as to perhaps offer a comment or a series of comments which do flow from perhaps that last point that was made. The council represents the interests of some 100 companies and organisations which invest and operate, construct, finance and otherwise provide support for public infrastructure in Australia and include amongst its members regulated businesses that cover airports, gas pipelines, electricity distribution, telcoms and so forth.

As has already been exchanged in some of the questions and discussion, I guess my comments are directed more to the likely outcomes of this regulatory process rather than to the nature of the process itself, and I understand that that may well require another day for wider forums and discussions, but I'm quite sure that the process itself has been conducted very professionally and as such I am not in a position to address detail of the process. I'm sure others will do that.

So while my comments are probably better addressed to a wider audience and not just to the OffGAR, I would still like to use this opportunity just to make a few observations across perhaps four points. One was on balance, second point relates to a question of double jeopardy, the third point is political risk and the last is consistency.

In relation to balance, the council would argue that there is a pressing need to recast the balance between short-term benefits to consumers in the form of lower prices and longer term community objectives from new investment in infrastructure such as adequacy and security of supply as well as better infrastructure, and of course that's a broad comment applying not just to gas, but to other forms of regulated infrastructure services.

We believe that there have already been considerable community benefits realised through the sale process for this pipeline, and arguably there is an element of further claw-back if you like of additional community benefit through the current regulatory process as required by the code. We would also point OffGAR to the recent Productivity Commission discussion paper in relation to Part IIIA review of the Trade Practices Act in which the PC offered the view - also I might add reinforced by subsequent comment by the ACCC - that Australia's infrastructure interests would be better served by erring slightly on the higher side in a pricing sense to ensure encouragement of new investment whereas if we look at the alternative, arguably Australia's economic interests would be more poorly served if we deliver short-term price benefits at the expense of longer term needs such as secure supplies, system redundancy and robustness, and the ability to offer new commercial users the confidence to expand their energy-using activities or to invest in new opportunities requiring secure competitively priced energy.

These are particularly important considerations in a state like Western Australia which has an economy so dependent on the resource sector and which aspires to a greater degree of downstream value-added processing.

My second point on double jeopardy - we believe that decisions of this type create the perception that there is no upside to any investment in regulated assets. Investors will lose money if investment is unsuccessful, if they get their risk factors wrong, their marketing factors wrong, but equally it looks like they cannot reap any benefits from a successful investment if access and pricing decisions such as of the type being considered here continue to flow through, and I would be quite frank, OffGAR is not unique in this respect. It's the entire process that is delivering decisions of this type. There was a recent one in Victoria in relation to electricity distribution with a similar outcome in terms of a claw-back of value.

So we're concerned that regulators can claw back gains from investors after governments have already benefited through an asset sale process, and there's an element of paying twice if you like, once up-front in the capital acquisition side and again through changes to the pricing regime. Western Australians have already benefited from an excellent sale price for the asset, and the further claw-back in value also to benefit to the community amounts in effect to a form of expropriation without due compensation.

On political risk, this is about perceptions, and there is now a perceived degree of regulatory risk not only in this state, but in Australia generally which has grown quite dramatically in recent years, and obviously added to by this draft decision which is contributing to a high country risk profile for Australia as a nation when viewed not just by international investors, but also by key domestic institutional investors who have gone public in recent months with their intention to increasingly move their investment opportunities offshore.

Private sector funding of new investment infrastructure is vital to the continued development of Western Australia, and we believe this draft sends contrary signals to existing and new investors in regulated infrastructure. It also sends warning signals to commercial users of regulated infrastructure services. Arguably this type of perception - and I emphasise the word "perception" because obviously at the end of the day, perceptions can equal reality - such perceptions have not been seen on the part of investors since the sort of activity that occurred in Latin America in the 1960s and in post-colonial Africa.

It's little different to the average observer - and I'm not talking about economists or financial advisers here, but it's little different to the average observer from my buying a house one day from one arm of government for $100 and the next day another arm of government telling me that it had been revalued at say $50. Now, I know this flies in the face of saying there's an independent regulator, but in perception terms, a regulatory system such as we have in this country is seem merely as another arm of government, and there are serious equity issues in such a process.

My last point inconsistency, I am suggesting here that there needs to be consistency in the messages sent to investors from both governments and regulators - the left and right hands of government therefore sending different messages to investors with expectations that may have been created through a sale process or through a project approvals process then being set aside by another part of what is ultimately a governmental process, albeit that it may be accountable to the parliament.

So in conclusion, AUSCID's comments as I said earlier point not necessarily to a flawed regulatory process, though that would be argued by others elsewhere, but to a questionable regulatory framework which risks delivering inappropriate outcomes which are contrary to Australia's and Western Australia's longer term interests. Without being melodramatic, I suspect it's our children and our grandchildren who will be the ultimate judges of that observation. Thank you.

THE CHAIRMAN: Thank you. Does anybody wish to make a - I take that as a statement and I think what you're seeking is an entirely different regulatory framework. I mean, it seemed to me that that was the point you were taking very strongly.

MR O'NEILL: It is a strong point and one that we will be submitting to you on separately with the hope that you can take that forward to - - -

THE CHAIRMAN: I look forward, as I said in my earlier comments, to any comments along general lines of regulation processes of interest to us. I can only emphasise the fact that as the regulator, an independent regulator reporting to parliament - and I would have to say that that independence has been respected by both sides of government and all politicians and I thank them for that - that the regulator has the process and the code which forms part of it to apply - and I would without doubt say that whatever opportunity there is to err on a side which will - and I have said this because we have the highest rates of return.

If you have a look at the WACCs - the weighted average cost of capital that we talk about where we do have that opportunity and we believe there is a higher risk associated with a place like Western Australia, in that respect we do consider the vastness of the state, but if you look at the areas in which we can take advantage of that point, then they're more limited, but we do explore them and we do use them, and I'm happy to say that there are the higher rates of return in the Western Australian regulatory decisions compared with others. I think, Peter, you might like to comment or others?

MR KOLF: I think it's fair to say that this state offers rates of return that are at the higher end of the range and that does take into consideration the circumstances applying to Western Australia, and I guess this question of what is an appropriate rate of return has received a considerable amount of attention by the ACCC and others. Again it is an issue that we in Western Australia may wish to take further and consider further, particularly in conjunction with any consideration of the regulatory regime that applies here at this point in time.

I think the important issue here is that why should investment be discouraged away from Western Australia in the light of the rates of return, their relativities as compared with those that are available in other states and overseas?

THE CHAIRMAN: Thank you, and I look forward to receiving that. There was a question - I thought I saw someone else over here. No? Sorry, yes - then I will come back to you.

MR REUDAVEY: Greg Reudavey from CMS Energy. Ken, I know you have said you don't want to comment on the legal issues that are surrounding this decision, but I was just wondering if you were prepared to comment on who might fund OffGAR's legal expenses. Is it Epic themselves or is it the taxpayer or who is it?

THE CHAIRMAN: It's not appropriate for me to comment. I said earlier - I announced right up-front, I said I will not comment about the legal action taken, and I won't be drawn

into any comment either. Anybody else? Thank you. Sorry, just here. Do that one and then we will come back.

MR PETRIG: Rudi Petrig, CMS Energy. Ken, I have got a question in relation to the extent that OffGAR has considered the broader gas industry and in particular Perth Basin producers, the new gas traders wanting to enter into the market and also end-user customers. There's some particular categories there such as very large customers, very large users, business customers and also mums and dads. If I can give a couple of examples of what has happened in recent times and whether that might be an indicator of what might happen in the future.

In terms of the DBNGP tariff, it used to be $1.25. It's now sitting at a dollar. At the same time the mums and dads out there are now paying 50 per cent more. So we have had a reduction of 25 cents, and yet mums and dads are paying 50 per cent more - 50 cents, sorry, more. Also if you look at - and I have had occasion to look at what happens to small businesses - not very small businesses, but typical businesses, and one in particular that comes to mind - I won't mention the name, but looking at the cost associated with getting gas to that customer which then affects the customer's price again whilst the DBNGP tariff has come down 25 cents, that customer now is facing or whoever supplies that customer is facing a cost increase of over a dollar to what it used to be. Can you comment on that?

THE CHAIRMAN: I will certainly pass that over. I am certainly not in a position to comment.

MR KOLF: I guess if I may respond to that, Ken.

THE CHAIRMAN: Yes, certainly, Peter.

MR KOLF: I think that the reality is that OffGAR or the regulator does not have an explicit responsibility in relation to retail pricing. These matters are matters for the minister at this point in time, and it really isn't terribly appropriate in that situation for us to comment on retail pricing. This agency and this regulator is concerned with the pricing of access to covered pipelines, and I think that's about where it's at.

THE CHAIRMAN: Well, of course with the single economic regulator coming, as of next year some time, of course that does provide that opportunity where they may get closer than they are at the moment. As I said before, the regulatory process we use is very clear as far as the process is concerned, and it relates - I think the reason for that is it relates specifically to access itself. So I really can't comment on retail.

MR ANDRUSIAK: Thank you. Jim Andrusiak for Western Power. I would like to come back to I guess what is the key issue, the ICB. I have noted that there is a generous application of Epic's request for 350 per cent on the penalties drafted into the decision, and we have heard the comments from the panel about the generosity of the WACC reaching close to the numbers that were looked for.

I find the question of the process of selecting a DAC or DORC to be still a bit confusing, but just moving on and accepting the focus on the DORC that's put into the draft decision, as I understand it - and perhaps you can help me improve on my understandings - the DORC was a figure that was adopted because it had been prepared by someone to put into the sales process, and when I read some of the footnotes, it looks to me like the out-workings of that DORC from the 1997 values has then been escalated to give a 1999 value, and the original number itself was plus or minus 15 per cent, escalating to be a plus or minus 20 per cent.

I guess the point of my question is that when this first regulatory process was done for the original tariffs that prevailed from the mid-1990s, the work was done with a degree of accuracy that the auditor-general reviewed and we wound up with a five-decimal place accuracy in the work. That five-decimal place accuracy then proceeded on to the mid-1990s when it was updated in 1998 even before the ORC which became the DORC was reviewed by OffGAR. So the point of my question is will the OffGAR decision, this draft decision, eventually be done with enough diligence to get beyond the plus or minus 20 per cent accuracy for the value of the capital base?

THE CHAIRMAN: I think you will find that it was done in two ways, would you [Dr Challen] like to explain the process of arriving at the ICB or one of you?

DR CHALLEN: Yes.

THE CHAIRMAN: Thank you.

DR CHALLEN: Firstly I will comment on a DORC value - a depreciated optimised replacement cost value - in general terms, not related to the DBNGP, and what you could really consider as issues of accuracy in a DORC value. The DORC value is effectively related to the replacement cost, an estimate of replacement cost of an asset optimised to replace the asset using our best available current technology.

There are effectively two issues of accuracy in this. The first is an accuracy in forecasting any cost that is driving a best estimate of a cost now for costs that would actually be incurred in the future if those works were actually undertaken. There's a forecasting accuracy issue there. The other one is an issue of optimisation, in other words the design or optimisation of the particular asset in question, and depending on who you get to do an estimate of an optimised replacement cost and the particular technology, if they adopt their own subjective design, judgments and indeed a level of optimisation, you will get different values.

So estimates of DORC values will vary across some range. So there are issues of accuracy there.

DR CHALLEN: I would say that plus or minus 20 per cent in deriving a DORC value is not unrealistic to what you might expect if you were to get values from several sources.

DR CHALLEN: Sorry? I will explain now the process we actually used with the DBNGP. With the DBNGP, Epic Energy actually submitted a DORC value to the regulator which we had reviewed; not for the regulator to arrive at his own DORC value independently, but rather to assess both the rigour and the methodological approach taken by Epic Energy in deriving their DORC value. On the basis of that assessment, we considered that the Epic Energy value was actually an over-estimate of a reasonable estimate of a DORC value and taking into account the regulator's approach to deriving a DORC value as at 31 December 1999 and inclusion of some of what Epic classed as capital expenditure in the access arrangement rather than including the capital base, we considered that the DORC value of Epic Energy was in the order of about - without looking it up in the document now - 1.23 billion dollars.

In determining the value for the initial capital base, the regulator considered a range of factors, one of which was the expectations for a prospective purchaser created during the process of the pipeline sale as to the value of that asset. In the information memorandum provided to prospective purchasers of the pipeline, there was an estimate of the optimised replacement cost.

Taking that optimised replacement cost estimate in that information which related to a time in 1997 and updating that to December 1999, taking into account capital expenditure since 1997 and depreciation since 1997, we arrived at a value very similar to our consideration of what a DORC value might be at December 1999, and given the sale process and the information presented as part of the sale process, we considered that that value, the updated value from the 1997 optimised replacement cost estimate, was in fact a reasonable value to use to value the initial capital base for the DBNGP for the purposes of the access arrangement.

THE CHAIRMAN: Peter?

MR KOLF: If I may add to that just a little bit, the derivation of a DORC value starting from scratch and doing it in a rigorous way is without doubt a very costly undertaking. The decision - the draft decision - did look at the possibility of independently doing that kind of an analysis, but for cost reasons considered that such an undertaking would best be done in the circumstance where Epic for instance may have desired such a valuation to be done on that kind of basis.

It is a draft decision and for that reason we do have the opportunity to proceed and redo that particular calculation, but as I said, that is a very, very considerable undertaking at considerable cost, and that cost was incurred at the time that the pipeline was sold and is the 1997 value referred to. It could be updated rigorously. However, taking the cost of doing that into consideration for the purposes of the draft decision, the approach that was adopted was felt to be a very reasonable approach.

THE CHAIRMAN: Thank you, Peter. I might add that what Peter is saying is that just like any aspect of the draft decision, there is opportunity to challenge those figures, to

challenge the approach and to assist us in getting the best value for that particular ICB. I think there is enough detail in the draft decision, and for those who haven't got a copy, it is on the Web site, or again you can contact our office and arrangements can be made for you to get a copy, but it would be worth I believe doing so, and if anybody has any comments in respect of that, we are happy to receive them. We are certainly reviewing our own material as we would do in working towards the next phase. Any other comments? Yes, Murray?

MR MEATON: Thanks, Ken, just a very quick comment first before a question - - -

THE CHAIRMAN: Name?

MR MEATON: Sorry, Murray Meaton, an interested observer. As a member of the practising profession of economists it constantly amuses me that we can use such sophisticated methodology to arrive at such rubbery answers, and the precision of the answer I think fails to reflect the lack of precision that really exists in the methodology, but my question I think which really gets to the heart of the matter, clearly there was in Epic's mind an implied tariff at the time which led them to estimate a basis for the valuation of the particular pipeline which they purchased.

There are a number of press releases at that time in which the previous minister referred to future reductions in transmissions tariffs down to a dollar a gigajoule, and Rudi has mentioned $1.25 at one stage. There is also a number of speeches by the minister, and I'm pretty sure if my memory serves me correctly that the minister also has written into Hansard the figure of a dollar a gigajoule.

The previous minister was too smart not to have any caveats on that particular figure, but my question really is given that that number was in such wide circulation at the time - I'm sure there is no written evidence to support that figure, but what sort of evidence might the regulator accept as sort of some implied understanding that a dollar a gigajoule was a reasonable tariff under the circumstances?

THE CHAIRMAN: Thank you, Murray. I think it's not for the regulator to demonstrate the existence of such agreement or regulatory compact as we have heard. It certainly is, as I see it, for the service provider or anybody else to provide us with sufficient information that we can examine to determine the robustness of it and to what impact it may have. It really depends on the quality of the information. You can't and I can't just take comments that have been quoted or said or expected and I don't think I would be fair to the process, I don't think I would be fair to the industry nor to the service provider in that respect in just reflecting on what might have been said or what expectation there might be.

You as an economist would well know that. In fact the rubbery nature of figures - you know economists better than I do, but I believe we have taken the approach in the ICB from more than one source, and that's the important thing. Of course there's assumptions in it, of course you need to explore other ways and other methodologies. That's the very nature of the process. It's no different than any other assessment in economic terms that I'm

aware of or in some engineering aspects that I'm more closely involved with where assumptions are made.

So the accuracy is as good as the assumptions made. The question is how robust are the assumptions. So we, instead of just saying QED, there was one answer, we explored different avenues for the DORC and arrived at a conclusion that was very close, and we have used that figure. Now, the question is in doing that, if there's anything within those figures that we have made assumptions on, that can be challenged and I think they are very clearly laid out, then we would be very happy to hear from them and we will review them.

If it's necessary to adjust the DORC as a result, the DORC will be adjusted. I can only keep repeating, and this is why I find some aspects of the last few days a little strange, this is a draft decision. It is the position taken by the regulator based on information placed before it by the service provider and by other people who made submissions, and using a process that is well laid out and well established. There may be areas where people can challenge an application or areas and assumptions used with the information.

The fact of the matter is, it is a draft decision, they are indicative tariffs, there are opportunities to make changes and modifications and certainly debate, and we haven't had that opportunity I might add, then as far as I can see - and that opportunity is offered to the service provider, then as far as I'm concerned, the position is that the draft decision is possibly and can be modified to reflect a better situation, a more informed situation if that is possible. The question gets back to hearing from you all today and hearing further from the service provider, hearing further from Epic.

So you know the business better than I do, Murray, and I don't think you can deny that.

MR MONKTON: Thank you, Mr Chairman. John Monkton from Western Power. I just want to ask a question with regard to the existing or grandfather contracts, and I wonder if the regulator would comment on how you would expect existing contracts, how they will operate in the new regime that's proposed, and will the regulator comment on the factors that would distinguish the difference between the proposed tariff and the tariff that has been determined in the past.

THE CHAIRMAN: Thank you. I'm going to pass over to Ray in a moment, but I think you will - as far as the contracts are concerned, that is a contractual relationship between Epic and the user, and I would believe that would be a matter of negotiation that would take place between them, and I think that's certainly the case. Ray?

DR CHALLEN: Yes. I don't really have anything to add to that, Ken, other than while there has been some discussion of whether a reference tariff determined under the access arrangement would apply to existing contracts, we would see that as effectively a contractual issue under those existing contracts.

THE CHAIRMAN: I think the other issue is in relation to the difference between the firm tariff and the T1 tariff.

MR MONKTON: Exactly.

DR CHALLEN: I think as we mentioned or as I mentioned in the presentation, with the firm service as required to be modified by the regulator under the draft decision would not be or is not considered to be, when offered in combination with non-reference services also indicated in the access or proposed access arrangement, are considered to be not materially different than the T1 service. So you therefore may well expect that a tariff, if it was determined for the T1 service, would not be greatly different than that determine for the firm service.

THE CHAIRMAN: Thanks, Ray. There was one over there. Thank you.

MR WILKINSON: Andy Wilkinson from CMS Energy. It alludes back to Murray's question I guess. Ray put up a slide saying that you could find no evidence of this regulatory compact, and then the next point was that even if you had, it wouldn't have made a difference anyway. I guess it raises the question of just what evidence would it take for that dollar figure that was bandied around so much to actually be given any credibility. If this was a poorly constructed offer by the part of the government, that's one thing.

Some of the work that I'm involved with is also on the goldfields gas pipeline as you will know, and there's a state agreement covering that pipeline. We have seen a tariff reduction on there which doesn't bear any great resemblance to the principles under the state agreement. Again it begs the question, just what sort of guarantee on the part of a government actually holds weight in the face of this regulatory process?

DR CHALLEN: I think I will answer the question related to the point you made on the slide that I presented, and that you say that if there was evidence for the regulatory compact as described by Epic Energy, it wouldn't have made a difference anyway. That wasn't quite what I indicated in the presentation. I said that if there was a regulatory compact as set out by Epic Energy, it wouldn't necessarily have given rise to the capital base proposed by Epic Energy in their access arrangement.

As to what evidence would it require for the regulatory compact to be taken into account, I don't think I can give a definitive answer on that here unless Ken or Peter want to comment on that.

THE CHAIRMAN: No. I mentioned earlier that again I would like to see more than what we have got before we can make any assessment, and I think to pre-empt such an outcome would just be - it wouldn't be a responsible way to go. So if there is any such and further more detailed information, we would be happy to receive it. On the issue of the goldfields gas pipeline, you did make a comment about tariffs. I just note that and indicate that that obviously is being addressed in another place. Any other comment? Another one?

MR WILKINSON: It's somewhat related to that and a previous question I guess in terms of - you were just saying before that you didn't see it appropriate to make a comment on the impact of retail tariffs to customers.

Again we have seen two decisions now, the two outstanding decisions at the moment where substantial reductions to the tariff have been indicated in the draft decisions. In both cases, the residential customers being serviced by those pipelines, both the DBNGP and the Goldfield Gas Pipeline don't stand to see any benefit from those tariffs. In fact, at the moment they are in an environment sort of pursuant to the regulation process that was ongoing here that has already affected AlintaGas.

Those customers have seen increases in the cost of gas delivered to their doorstep. The customers that stand to benefit from what we can for the DBNGP and the goldfields gas pipeline stand to be the existing large corporate customers. So in terms of where do you see the benefit of regulation going at the moment, there are a number of comments in your draft decisions that allude to a mandate if you like to reduce costs of delivered gas for the consumer. I'm just wondering if you can comment on just who those consumers are that you see.

THE CHAIRMAN: I don't know if anybody else wishes to discuss it. The fact of the matter is both of the documents you are talking about are in draft decision phase, and the impact they have on retail prices no doubt will be watched by others as well. So I don't think you can just say that - what you're suggesting is they won't be passed on to the consumer. I don't know if you can readily say that; (1) the tariffs haven't been determined and (2) any other process to watch over such a move hasn't had the opportunity to do so, but I don't know if you want to say anything, Peter?

MR KOLF: I suppose I could respond to that to some extent. The whole purpose of the regulation of pipelines as monopoly or natural monopoly assets is to ensure that there is a fair and reasonable tariff charged in relation to those natural monopoly-type assets and thereby encourage upstream and downstream competition with various parties having access to those pieces of infrastructure at reasonable tariffs. They are able to compete against each other in the hope that that will then lead to lower tariffs and better services.

Now, that's the fundamentals of it, and this government and many others across Australia have been moving toward that, and that's why the National Gas Pipelines Access legislation has been put in place, and I suppose that's really all that I should say at this stage.

THE CHAIRMAN: Yes, I think so. Thanks, Peter. Any other comments or questions? Yes, Mr Trenorden?

MR TRENORDEN: Ken, if I could just follow - Max Trenorden. If I could just follow the two previous questions. I have some confusion about where the public interest in all of this is because if the reduction of tariff doesn't end up being of benefit to the consumer, how do you define the public interest. I apologise, I wasn't here earlier and I will have a look at

some of the things that were put up earlier, but surely the public interest isn't only price to the transmission.

It's far more than that, and I'm just getting a little concerned about the direction of that. I think that's what I indicated earlier. The public interest is more than the price to the transmitter of the gas. It is also to the general public.

THE CHAIRMAN: I mean, the access arrangement is not a small document. It's not just price. There are numerous aspects related to it, but I don't know if Peter wishes to comment any further.

DR CHALLEN: It's just a comment that I suppose the retail price for gas to any gas customer is dependent on a large number of factors which would include the transmission price for that gas and other parameters related to the retail market for gas including regulation of retail gas prices for many customers of gas. I think if you were to look to why, if indeed it hasn't occurred, that reduced transmission costs have not flowed through to the customer, you would need to address these various other factors including regulation relating to the retail gas market, and in the absence of such a study I don't think that question can really be answered.

THE CHAIRMAN: Thank you.

MR BOARDMAN: John Boardman from Risk. To what extent are the experiences of the good intents of the California regulators and the consequential effects on end consumers and taxpayers in particular being taken heed of in making the decision?

THE CHAIRMAN: Jeff, would you like to comment on that one? I think it's a bit broader than I would like to address.

MR BALCHIN: All I can say is - my first comment would be thankfully in Western Australia we probably don't have the tightest environmental controls on the building of new power stations and transmission lines in the world coupled with a drought in the north affecting hydro supplies, booming demand in Silicon Valley that has meant demand has been growing at 8 per cent per annum over a number of years with very little addition to supply, and coupled with high natural gas prices that have forced up the costs of gas generation as well, coupled with some, in my view, trading rules in the Californian spot market that just exacerbated what market power existed there anyway.

What you should take from that is, I think, California is used to represent many, many bogeys and in fact when you try to divine what has happened in California, as I have done for other reasons, there are many messages you can take, but there aren't any simple messages. I think the message that Ken and Peter have tried to convey earlier - and I think it's the right one - is that the regulator does take seriously incentives for investment. Everyone wants growth, employment and the benefits that new investment brings, and that has gone a long way towards influencing all of the decisions that I have assisted them with in relation to pipelines in Western Australia.

That is about all I would like to say at a general level, if there are any more specific comments - I think - no, I think that probably does it.

THE CHAIRMAN: Thanks.

MR BOARDMAN: I'm sorry, I missed something in the dialogue there. Could you just quite simply explain - you did take the situation into account and believed it was not applicable or you didn't take it into account?

THE CHAIRMAN: What is it about California that you think should have been taken into account? I think if you can point that out, it might be an easier question to answer.

MR BOARDMAN: Over-regulation, interference in free-market.

THE CHAIRMAN: I think what you're trying to do - a couple of the questions today have been about the framework itself, and I accept them and I think we will just note them. The reality is - we really need to just keep the focus on this - is that we do have a national access regime, we do have a code, we do have a law, we do have service providers. Some of us don't like it, some of us do. The fact of the matter is how can we get the best that we can out of the process so that all the interests are covered?

We believe we have done that with the draft decision, we have attempted to do it with the information we have had. I can't repeat enough that if there is anything in there that we haven't considered or there's additional information and you have got 300 to 400 pages to look through, then please convey it to us because we're keen to know, but it is an access regime, and it is related to reference tariffs as well as of course conditions of service and other things, and there are incentives and initiatives within it in different forms, maybe not to the extent some would like, but they're there. Yes? Just behind you? Name and affiliation, please.

MR WILKINSON: Andy Wilkinson, CMS Energy. Just in regard to the incentives, and you were saying that the regulator takes very seriously the role of encouraging investment, do you seriously think that a spread of less than - in the vicinity of 1 per cent in rates of return allowable across the country - and it's just slightly more than 1 per cent, and that then captures the rate of return you can get if you invest in a distribution network servicing Melbourne with a growing community that - you know, you can't stop them breeding; they're going to grow - compared to - and applying a rate of return that's within 1 per cent of that figure to pipelines that service the most remote areas, and everything in between, is that seriously taking into account the incentives required for infrastructure investment?

THE CHAIRMAN: I think you're taking a very narrow view, and I would - - -

MR WILKINSON: Sorry.

THE CHAIRMAN: - - - one other - anybody else like to comment? Jeff or Ray?

MR WILKINSON: It's not a narrow view, it's a narrow spread.

MR BALCHIN: It's a difficult question to answer because I suppose it gets back to - one of the hardest issues for determining costs of capital for different types of projects stems from the fact that it's hard enough to, given the information that exists in the market to estimate the cost of capital for the average gas utility in Australia - put aside whether it's Victoria, Western Australia, Northern Territory or Tasmania which is soon to get gas, it's hard enough to estimate the average without trying to take into account the particular circumstances of every different type of asset, and it's for that reason that the regulators often try to get the average right, and there are fairly small variations from the average because it's hard enough to get the average right and you're really having a lend of yourself if you think you can estimate precisely the cost of capital associated with different assets.

The main reason for that is that when you look at the different assets that exist, most of the risks that exist are risks that are specific to that asset, and why does that matter? Because in finance theory - and if you think about it for 5 minutes, it makes a lot of commonsense. The only risks that are really important or the risk that investors should demand compensation for are only those that you can't get rid of for free if you hold a widely diversified portfolio of assets. The implication of that is that it's only the risks that are related to market-wide events that affect the cost of capital. It is very hard to get a handle on the market-wide events and the market-related risks associated with individual projects in the absence of a deep source of stock market data.

Even if a single project is listed, it's still very difficult to infer the relative risk given the statistical uncertainties associated with estimating betas and assorted things. You need to apply standard finance theory models, and it's often the case that people don't like hearing that their project-specific risks are irrelevant for the cost of capital estimation, but that is an implication of finance theory, and it's one of the foundations stones of modern finance theory, and therein lies the problem.

So it may well be the case that some of the projects in the remote areas are more risky. It seems intuitively sensible that it may be the case. It may be that they are less risky when you talk about market-wide risk rather than risks associated with those specific events specific to that asset. If it is more risky, we don't really know how much more risky it is. It's hard to get a good handle on that without a good source of data, and that's really not available.

So I think your question is sensible that there's a spread of less than 1 per cent? I don't really know the answer. Is it sensible? There's no objective evidence with which to test it. If you can look at the sort of evidence that does exist, one of the interesting, I suppose, sources of more recent information, is some of the brokers' reports that came out on the Australian Pipeline Trust, I think in most of the ones - I think all the ones I can recall reading, the same costs of capital were used to assess the discount rate and the cash flows of all of the pipelines in the Australian Pipeline Trust which included the Amadeus Basin and the Darwin pipeline, the Goldfields gas pipeline as well as the Moomba-Sydney pipeline.

So it's not only regulators that are using the same cost of capital for these assets, it's also the people who are investors. So I think - I hope that addresses to some extent the comment that was made.

THE CHAIRMAN: Thanks, Jeff. Comments? Questions? Exhausted you? Frank, you had the first one and this may well be the last, but never the least, Frank.

MR TANNER: Thanks for the second opportunity. Just to turn to a couple of points which other speakers have referred to - and this is the delivered cost of gas into regional areas. Western Power as you know has a gas-fired power station located in Carnarvon on the end of a very long lateral going in there; very low load, but essential for delivery of electricity in that area.

There has been a public and regulated contract in place now since 95 and broadly the cost of the lateral, as we say it, runs according to some mortgage style formula set in place some time ago. Just in my recollection, the initial cost of that line was of the order of $14,000,000. The outstanding balance under the mortgage scheme is probably just a little bit below $10,000,000. The proposed tariff for Carnarvon in that zone would more than double from where it is now given the nature of the load there.

In other words, we are saying, for a service which on average is costing us somewhere around $4.50 or so, we could be paying in the order of $9.50 or thereabouts, and underneath this it seems to me that with the approach that the regulatory approach that is taken to cost allocation may be a contributing factor here that we see possibly of the order of another $30,000,000 being allocated by way of process to that lateral.

We would like to work with OffGAR through how that has come about, because my concern is obvious as to the point to my question there. We can't sustain that sort of cost impact in our business. We definitely need to get to the bottom of it, and I guess the spin-off to the question is, if our level of valuation and thinking is more like half your number or $30,000,000 below your number, then where would that $30,000,000 elsewhere be allocated in the other assets along the pipeline? I throw it open for comment, but we would like to get together with OffGAR and work it through.

THE CHAIRMAN: Do you wish to make any comment? I'm sure we would be happy to sit down with anybody in the room or anyone else to explain or to hear from them in any aspect.

DR CHALLEN: What you have mentioned there is really an allocation of capital value and therefore capital costs to different parts of the Dampier to Bunbury Pipeline system. In assigning a value to the capital base, the allocation of value to different parts of the assets is always to some extent arbitrary and therefore the reference tariff, the capital cost component of the reference tariff for any delivery point on the pipeline, is of course also to some extent arbitrary.

In looking at the tariff, the cost allocation and the ultimate tariff structure that affects the price for different users at different locations on the pipeline, as I mentioned in my presentation, we look generally at the proposal put forward by the service provider, and assess it against broad criteria of efficiency and equity.

One of the considerations we took into account in looking at the tariffs proposed for the DBNGP and those revised tariffs from the regulator in the draft decision was that generally on the DBNGP there will be a substantial reduction in the tariff relative to the tariff that applies under the current regulatory framework.

Given that situation and according to broad equity considerations, we consider that if there is to be a large reduction for most users, then consideration should be given that the tariff for any user, that any user would pay under a contract being entered into under the reference tariff, should not be greater than the tariff that they would have paid entering into a contract under the existing regulatory framework, and I refer you to amendment 63 of the draft decision that relates to that matter.

At the moment we have left it at the discretion of Epic Energy as to how they go about addressing that amendment. It could well involve, but it does not necessarily involve, a reallocation of value of different assets within the overall asset valuation, and it includes the issue of the Carnarvon lateral, which you have raised.

THE CHAIRMAN: It was Frank Tanner, I should have mentioned, who asked the question. Frank, if you would like to follow that up, please contact our office. Thank you. Any other questions or comments? Yes, Fred Howie?

MR HOWIE: Fred Howie from CMS Energy. A general question I guess; we have heard today that some quite theoretical approaches have been taken particularly with respect to determination of acceptable rates of return, but also perhaps in the wider issue of asset valuation. It's a question in two parts; firstly given the uncertainties that you have identified associated with the theoretical approaches that you have taken, do you do any kind of independent reality check on what the theory comes up with, and if you do, could you comment on what those checks are?

THE CHAIRMAN: All I can say to you, Fred - and I will pass that on - the theoretical process you're talking about are well-established methodologies as I understand it.

DR CHALLEN: Perhaps I might just comment on your question, Fred, in relation to the asset valuation, and I might leave the issue of empirical evidence on the rate of return to Jeff Balchin. In regard to asset valuation, I think if you like our reality check, to use your term, on the asset valuation is really to consider several different valuation methodologies and the range of considerations set out in the code in section 8.10 of the code to look at the appropriateness of each individual value, and also as a means of assessing how it affects different parties with an interest in the pipeline. Such valuations as depreciated actual costs and DORC values, in other instances optimised deprival values, they all give you a feel if you

like and assist an inevitably subjective judgment as to what the valuation of that asset should be for regulatory purposes.

So it is in considering alternative valuation methodologies, actual capital investment, past depreciation and so on that allows you to make that subjective judgment.

THE CHAIRMAN: Thank you. Any other questions or comments? Yes, at the back? Jeff, sorry - sorry, if we just take one more comment here. If you pass the mike around, Cathy. Yes, please?

MR BALCHIN: You want me - - -

THE CHAIRMAN: Yes.

MR BALCHIN: Sorry, Ray I thought was flick-passing to me comments about the WACC. Actually I recall - I was here for the GGP public forum a while ago, and I think Murray Meaton asked me the same question. I think he phrased it, "Do you road-test your WACC?" and I will try to be a bit briefer this time. The answer is yes, whenever there is objective information that's available in any work I do - and I know the regulators themselves try to make use of that information to narrow down the range of their estimates of the cost of capital, given that it is a very significant parameter in the derivation of regulated charges.

I think when I answered the question last time, I listed a number of things that you could look on as objective evidence. One of them is - I think I might have made the point - I think I pointed out a study that NERA - a well-regarded economic consultancy - had done for the ACCC the benchmarked regulated rates of return around the world - around the world meaning Australia, UK and the US - and the rates of return in Australia were comfortably within that range, in fact well ahead of what you get in the UK and almost from recollection anyway bang on what you get in the US.

Other bits of information you can look at, as I noted previously in relation to the last question I answered, there is often a fair bit of information you can divine from brokers' reports and other reports that value things that investors rely on, and if you know how to interpret and adjust the different types of returns, you can use that to see where the regulated returns are coming from, how they sit. The returns assumed in many valuations the brokers perform for their clients are often less, and in some cases substantially lower than the returns that regulators provide regulated assets. So that's a second piece of objective information that I would say that is the sort of thing you could look at.

A third piece in this case is that as Ken and Peter and I think Ray pointed out, the rates of return asked for by Epic Energy that were estimated by their consultants the Brattle Group - and I would have to say that was quite a high quality piece of work that as presented to the regulator - were very similar to those actually provided for in the draft decision. There were some slight methodological changes and the impact of several

exogenous factors were passed through when reading through the Brattle Group report. You would expect they would have been comfortable with those.

That I would see is a third piece of objective evidence, that studies by someone for the proponent came out with a very similar answer to what OffGAR did itself. I suppose I would leave the question open. If there were any other pieces of objective evidence that people think can be used to narrow down the range and to get a handle on what people's expectations as to rates of return are, it's something that I personally and OffGAR and regulators around Australia would always love to see.

THE CHAIRMAN: Thanks, Jeff.

MR HENNESSY: Jim Hennessy from AlintaGas. This is in a sense a follow-up to an earlier question, and it really goes to the issue of sort of two classes of users; existing users potentially being on a lower price depending on the outcome of the regulator's final decision, and new users paying perhaps a higher price. Under the old arrangement, the gas transmission regulations which applied from 95, the essential model was that all capital expenditure was rolled into the tariff, and the tariff was redetermined every 3 years such that if there happened to be an investment that was a high marginal cost investment, prices to everybody would increase.

However, if an investment was a low marginal cost investment, prices to users would decrease, and that's in part the reason why tariffs on the DBNGP have fallen since 95. The question I have got is really doesn't the provisions of 8.16 of the code, in particular (b)(ii), in which there is likely to be system-wide benefits of both looping and compression upgrades, provide a circumstance where the incremental capital in its entirety can be added to the capital base, and the price for all users reviewed such that the service provider would get an efficient return or a reasonable return on the investment, and that all users would be essentially on a level playing field.

There would be no second-class citizens, and to the extent that there was high marginal capital cost investment such as in looping, the price would increase in the short term, but in the longer term if the marginal capital cost of the investment were low, then users would see falling returns. It seems to me that this model basically would provide a win-win all round. Basically Epic would be encouraged to invest and recover the investment, users would benefit, there would be no second-class citizens, certainly in the gas industry. I just want to clarify is that your view of how section 8.16 of the code works particularly in regard to the fact that a service provider has the ability in between access arrangement periods to request a review of the tariff in any event?

DR CHALLEN: Section 8.16 of the code and other sections or other parts of section 8 of the code relate to capital expenditure and how that is treated in the determination of reference tariffs. Whether capital expenditure is rolled into the capital base resulting in higher capital costs to all users and a higher reference tariff to all users, or whether capital expenditure is met by capital contribution by particular users is really dependent on the

specific context of the expenditure in question, how it may relate to the system as a whole or to specific users.

But there is certainly nothing in the code that is or in the considerations in the draft decision that is contrary to what you have just said. However, I will make the point though that Epic Energy didn't propose any capital expenditure associated with significant extensions or expansions of the pipeline for this access arrangement period, and therefore they weren't taken into account in determination of a reference tariff simply because they weren't proposed, but if they were, they would have been.

MR KOLF: I suppose I could add a little bit to that, Ken.

THE CHAIRMAN: Yes, Peter.

MR KOLF: In the existing arrangements, it is at the discretion of the service provider as to whether the service provider wants to roll these things in or whether the service provider wants to charge for new capital expenditure separately, the same rates of return would apply in either case which means that essentially there isn't really any difference as to whether it is rolled in or not rolled in other than that if it is rolled in and if it is accepted by the regulator, it does have implications for the existing users in terms of a higher cost than giving rise to increases in tariffs for new users.

Now, that may be appropriate or it may not be appropriate depending on the circumstances, and this is a matter for both the service provider and the regulator to consider.

THE CHAIRMAN: Thanks, Peter. There was a question at the back.

MR WILKINSON: Andy Wilkinson, CMS. I guess the question is the purchase price for the DBNGP was in the order of two and a half billion dollars. My understanding - and I'm happy to be corrected on this - is that about 30 per cent of that money came from Australian superannuation funds. I'm just wondering to what extent in considering the public good that that sort of factor is taken into account in coming to your decision and coming out of the valuation that sees basically half of that investment written off.

THE CHAIRMAN: Do you want to comment, Ray?

DR CHALLEN: The source of whatever funds - - -

THE CHAIRMAN: Not the issue.

DR CHALLEN: - - - that Epic may have financed their purchase of the DBNGP from, is information that was not provided to the regulator and was not - and nor necessarily should be - taken into account in the draft decision.

THE CHAIRMAN: Any other comments or questions? We're nearing that 5 o'clock time. We still have time for one or two. I can see we have worn you out. I will bring the proceedings to a - right on the - I have to prepare it all over again.

MR BARRETTO: Mark Barretto, North West Shelf Gas. Really a very simple question. The deadline for the submissions is next Friday. Is there any room for - at the risk of publicly embarrassing myself here, is there any room for an extension on that given everything we have heard here today?

THE CHAIRMAN: There are other matters taking place outside this forum that I mentioned earlier in relation to a legal matter. It's not legal yet; it's a notice, but if I can set that aside and that can be clarified, the answer is yes, I would consider an extension of that was desired.

MR BARRETTO: Thanks.

THE CHAIRMAN: Any other question or comment? I will bring it to a close, and in doing so, thank you all very much. We have had the biggest number. Somebody said maybe there is something in regulation, and there has been more people here today than I have seen almost collectively at some of them. That's because of the interest and the keen interest shown, and in that respect I do thank you very much. We thank you for your comments, and I trust that you will follow up those comments.

Could I just in closing thank Sue Ortenstone CEO of Epic Energy, David Williams and their team recognising the difficult nature of their position, and actually appreciating that position, and I trust that we will respond to the letter that has been given to us, and David knows that. Whether it's a satisfactory response will be for further time to tell, but I would like to just indicate the nature of the draft decision, that we are prepared and always willing to talk certainly to yourselves and Epic Energy. We would be delighted to do that and go through it in more detail so that we can look for those opportunities that you believe should be there, and explain other situations should they need justification, but that applies also to any of you if you wish to raise any matter with us or seek discussion, the office is available.

I would just like to thank our panel. I won't go through them individually. They have addressed the issues I think exceptionally well, and thank you, Kathy and Lucia, for helping us and making the arrangements, and also thank you for the taping. We will get as much as we can on the Web site, particularly the overheads, as soon as possible. The transcript will obviously take us a little while, but we will have that on as well. So if anybody has a problem with that, please contact our office. So thank you very much again, and I bid you good afternoon.

AT 4.55 PM THE MATTER WAS ADJOURNED ACCORDINGLY