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8 July 2013

Rate of Return Guidelines Review
Economic Regulation Authority
PO Box 8469
Perth BC WA 6849

Lodged electronically by e-mail to publicsubmissions@erawa.com.au

Attention: Mr Richard Begley

Submission responding to ERA cost of debt working paper

The APA Group (APA) is a major energy infrastructure investor which operates some 13,000 kilometres of gas transmission pipelines and associated gas storage facilities in Australia.

In Western Australia, APA operates both regulated and unregulated pipelines. Through wholly owned subsidiaries, Southern Cross Pipelines Australia Pty Limited and Southern Cross Pipelines (NPL) Australia Pty Ltd, APA has the majority interest in the Goldfield Gas Transmission Joint Venture (GGT JV) which owns and operates the Goldfields Gas Pipeline.

On the technical economic issues associated with return on debt estimation raised in the Economic Regulation Authority's paper, *On the benchmark cost of debt* (Working Paper), APA has views very similar to those of the GGT JV.

Indeed, APA fully endorses the separate submission on the Working Paper made by the GGT JV.

APA itself has a keen interest in ensuring that the national gas regulatory regime delivers new infrastructure investment in the long term interests of consumers of natural gas while, at the same time, ensuring that it safeguards the interests of investors in that infrastructure.

The investors who finance APA's gas pipelines and storage infrastructure have been concerned that the rates of return allowed in regulatory determinations under the National Gas Law (NGL) and the National Gas Rules (NGR) have been lower than the rates expected on investments in that infrastructure.

Those investors see the amendments to the rules governing rate of return determination in the NGR, amendments made by the Australian Energy Markets Commission (AEMC) in November 2012, as having the potential to change this perception by aligning expected and allowed rates of return.

The critical change has been the inclusion of the allowed rate of return objective in the rules. Rate of return determination is, as a result, now outcome-focused. It is focused on delivering the right outcome: an allowed rate of return which is commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as that which applies to the service provider in respect of the provision of regulated services.

An allowed rate of return which achieves this objective is, in APA's view, likely to be seen by investors as a signal that the regulatory regime is providing returns consistent with market expectations.

To ensure that the right outcome is achieved – to ensure that the allowed rate of return achieves the allowed rate of return objective – the AEMC's amendments to the NGR also introduced flexibility into the process of rate of return determination by requiring that regard be had to relevant estimation methods, financial models, market data and other evidence.

APA is strongly of the view that this focus on the right outcome, and on the flexibility needed to ensure that the right outcome can be achieved, must be reflected in the rate of return guidelines which the ERA is to make and publish.

In particular, rates of return on debt, estimated in accordance with the principles set out in the guidelines, must be seen by investors as being commensurate with current costs of debt in Australian and international financial markets. If they are not, APA and others will be unable to attract the capital they require for the extension and expansion pipeline infrastructure. There is no guarantee that a single financial model, and a single method of estimation, will produce a rate of return on debt commensurate with the current rate in financial markets. If, as a result of inflexibility in models and methods, estimates of the rate of return on debt made by the ERA are not commensurate with current market rates, while estimates made by the AER are commensurate with those rates, investors will prefer to invest in eastern States rather than in Western Australia. Infrastructure investment in Western Australia will be depressed, with adverse impacts on other sectors of the State's economy.

APA has appreciated the opportunity for discussion, in a workshop setting, of the issues raised in the ERA's Working Paper, and to make further comments by way of submission.

APA would be pleased to discuss with the ERA any issue arising from our response to the Working Paper. Please contact Dr John Williams on (08) 6189 4594 or john.williams@apa.com.au.

Yours faithfully

P. Bolding

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Regulatory and Strategy