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Our Ref: DBNGP:AA

30 January 2004

Dr Ken Michael AM
Alternate Chairman
Economic Regulation Authority
Gas Division
Level 6
197 St Georges Terrace
PERTH WA 6000

Dear Ken

REPORT– REVIEW OF RATE OF RETURN METHODOLOGIES AND PRACTICES

I refer to the report prepared by the Institute for Research into International Competitiveness of the Curtin University of Technology on “Review of Rate of Return Methodologies and Practices” (the “Report”) that was issued by you, in your capacity as Independent Gas Pipelines Access Regulator, on 31 December 2003.

I note from the public notice accompanying the release of the Report that both the Report and the consultative process you have commenced are aimed at considering evolving best practice in the determination of allowed rates of return in utility regulation and that it and the public consultation in relation to it will assist future regulatory decisions.

You have requested public comment on the Report to be provided to you by today.

Epic Energy has not been able to properly consider it given the short consultation period that has been allowed and the inopportune time it has been released (particularly given the time of year and the fact that it has occurred when the Service Providers of the 3 largest covered pipelines are in the midst of or about to commence important regulatory approval processes).

Moreover though, Epic Energy considers that it is inappropriate for you to have prepared this Report and to be undertaking this process. This is so for the following reasons:

- Firstly and most importantly, the fact that you have indicated that the Report and the public consultation will assist future regulatory decisions gives the impression that you are

predetermining an important aspect of the access arrangement approval process – i.e. the regulatory Rate of Return.

- Furthermore, the process you have established amounts to a removal of part of this key aspect of the regulatory approval process.
- Both of the above reasons give rise to important procedural fairness concerns. The Code sets out an extensive and prescriptive consultative process to be followed in an access arrangement approval process and to vary from this would be problematic.
- In addition to the above, if this Report and any aspect of the consultative process you are about to undertake were to be used to justify the future assessment of the Rate of Return that is to be established for a revised access arrangement on the DBNGP, it would mean that the Regulator would have failed to take into account the specific circumstances and risks that apply to the DBNGP. Such risks and circumstances must be taken into account when assessing an access arrangement for the DBNGP as is required by sections 8.30, 8.31 and 2.24 of the Code.
- Even if the Regulator were to consider the Rate of Return afresh and in accordance with the requirements of the Code for assessing a revised access arrangement on the DBNGP, one must consider why costs are being incurred at this point in time, particularly when you have already sought to pass them on to industry through the mechanism under the funding regulations.
- Even if you dismiss the above concerns, serious doubt has been cast by the Australian Competition Tribunal on the credibility of some of the methodologies and values adopted by the ACCC in its capacity as transmission pipeline regulator for all pipelines other than those located in Western Australia. These include methodologies and values relating to the Rate of Return. The Regulator in Western Australia appears to have adopted similar methodologies and, in some instances values, which the Report seeks to endorse. Epic Energy would therefore be concerned were these to be adopted for the purposes of future regulatory approval processes.
- Further, as you may be aware, Epic Energy has made an application to the Gas Review Board under section 39 of Schedule 1 to the Gas Pipelines Access (WA) Act 1998 for review of the Regulator's further final decision of 30 December 2003. Some of the grounds of review relate to the methodology and values for establishing the Rate of Return contained in the Regulator's further final decision and the approved access arrangement. To proceed with the consultation process in these circumstances would be inconsistent with the approach you took in relation to other decisions of the Regulator that were the subject of a review process.
- Also, the Productivity Commission's recent draft report on the review of the Gas Access Regime identified important issues concerning the current cost of service approach to the setting of reference tariffs under the Code, including issues relating to the appropriateness of the Rate of Return methodology adopted by regulators and the values used in regulatory processes. Given this and the ongoing nature of this overarching review and the intention of the Ministerial Council on Energy to consider the PC's final report and implement any agreed outcomes by the year end 2004, any conclusions that you may reach in relation to the Rate of Return outside of a particular regulatory approval process must take into account the outcomes of that review process.

If you are still inclined to continue with your consultative process, Epic Energy considers that, as the Economic Regulatory Authority now assumes the powers and functions of multiple regulatory agencies, it is only proper that you release any other rate of return report that has been prepared for or by these other regulatory agencies to ensure that the matters can be fully debated before the current Regulator.

I trust you will consider the points raised in this letter in making a determination as to the appropriate way forward for the proposed consultation process.

As a final matter, given the above circumstances, Epic Energy must reserve its rights to refuse to pay any amounts you included or will include in any Standing or Service Charge that has been

issued by the Regulator or any other charge that may be issued pursuant to funding regulations. In this respect, it would be of assistance if you could itemise the amounts you have included in Standing or Service Charges already levied by the Regulator in connection with the Rate of Return Report.

I look forward to hearing from you at your earliest convenience. Should you wish to discuss any matters further please do not hesitate to contact me.

Yours sincerely

Anthony Cribb
Manager, Regulation & Risk