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3 March 2000

Dr Ken Michael AM
Office of Gas Access Regulation
GPO Box 8469
PERTH BUSINESS CENTRE WA 6849

Dear Dr Michael

GOLDFIELDS GAS PIPELINE

The Chamber of Minerals and Energy is pleased to respond to the request of Office of Gas Access Regulation (OffGAR) for public submissions on the proposed Goldfields Gas Transmission pipeline (GGT) access undertaking and makes the following comments.

Importance of Competitive Energy

It is useful to reiterate the great importance to any modern economy and to WA in particular of competitively priced energy. The price of energy is a key input into virtually all production processes. In WA, with its reliance on minerals extraction and further processing, energy is particularly important. This link can be clearly seen in the boost to further processing provided when gas prices were reduced following renegotiation of supply contracts in the North West. Preliminary modelling work done by the University of WA's Economic Research Centre suggests that a 25% reduction in energy prices boosts employment by over 1%, exports by around 0.5% and gross state product by a similar amount. Conversely, energy price increases will decrease economic growth to an equivalent degree. It is important to note that these results represent the impact of final delivered energy prices. Thus an increase (or decrease) in the cost of transportation has the same result as an identical increase in the cost of supply.

As the GGT submission notes, virtually all of the customer base along the pipeline is minerals producers. Thus the cost of transporting gas along the pipeline has a direct impact on the competitiveness of mines operating in that region.

Role of Regulation

The Chamber's view on regulation is that by far the best way of delivering service at the best possible combination of price and quality is via the operation of competitive markets. In these circumstances economic regulation is not required and would actually be counter productive. Where there is market failure, however, regulation may be required to prevent inefficient outcomes. These instances include where natural monopolies operate such as the GGT.

Reference Tariffs

The reference tariff proposed in the access arrangement is identical to the 1 January 2000 tariff. To that extent it is in accordance with users' current understanding and expectations. However, it is understood that there may be demand from some users for other services such as an interruptible service, and it needs to be considered whether the proposed reference service provides an adequate basis for negotiation in these circumstances.

The Chamber notes that these tariffs will be indexed in line with cpi and that there is no provision for escalation below this rate on a cpi-x basis.

Asset Base

The asset base proposed by GGT is \$452.6 million, which is based upon its calculations of the Depreciated Optimised Replacement Cost (DORC). This figure appears to fall between the National Access Code (NAC) norm of Depreciated Actual Cost and DORC.

Cost of Capital

The GGT's cost of capital is 12.2%, which is derived from a β of 1.4. This figure is high by the standards of previous regulatory decisions in Australia and those put forward in other access arrangements. The Chamber understands that the rationale for this seemingly high figure is GGT's assessment of the risk it faces. It is argued that the nature of the end user market served by the GGT is substantially different from those served by pipeline systems in the eastern states which have had regulatory decisions handed down.

GGT argues that the pipeline does not have any long term contracts and that gas use is contingent upon continued success of mining companies in the region. It argues that the prospects for these are uncertain and that the industry's future is likely to be constrained. This drives the high β as it is argued that the appropriate comparison is not with other pipeline companies but rather the mining companies upon which it depends. It is also argued that the GGT is subject to the risk of competition from a future link eastwards from the Dampier to Bunbury Natural Gas Pipeline.

The Chamber accepts that the risk profile of the GGT need not necessarily be seen as the same as other gas pipelines and, indeed, regulatory decisions are already recognising differences between pipelines as allowed for by the NAC.

However, the Chamber makes the following observations concerning the above arguments:

- The lack of long term contracts may but does not necessarily translate into a high degree of risk. What is relevant is the extent to which customers will be willing and able to demand services into the future.
- In addition to those companies currently operating, there are a number of prospective developments in the region which, if successful would augment demand. However, these developments have varying possibilities of proceeding.

The prospect of future competition is not a valid argument for earning above normal returns in the interim. The significance of competition is rather that it obviates the need for future regulation, allowing returns to be decided in the market.

The Chamber notes GGT's comments about the problems which can arise if rates of return are set too low. However, it considers that GGT's statement (Access Arrangement Information 7.4.1.3):

"On balance, the wider consequences of a low WACC are worse than the wider consequences of a high WACC. Therefore, if regulators are to err, it should be towards the decision which does not compromise the long term viability of the natural gas transport industry."

should not be seen to constitute justification for the realisation of above normal profits. Both the mining industry in the Pilbara and Goldfields and the energy suppliers to that industry must operate efficiently in order to be competitive in global markets. The Chamber argues that, ideally, the regulator should not err, but it should be in the direction of user benefit if it does.

It is hoped that these comments are of assistance. Please contact Charles Crouch, Executive Officer, Economic Affairs at the Chamber if any further assistance is required. As requested, a copy of this letter has been e-mailed separately to OffGAR.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian Satchwell', with a stylized flourish at the end.

Ian Satchwell
Chief Executive Officer