Goldfields Gas Transmission Pty Ltd
5 June 2003

Supplementary Submission on Stage 1

(as defined by the 6 November 2002 notice
of the Acting Gas Access Regulator)

Addressing Issues Raised by WMC
in its Submission of 17 December 2002

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1. Purpose of Submission

On the 17 December 2002, WMC Resources Ltd ("WMC") made a submission (the "WMC Submission") to the Acting Gas Access Regulator (the "Regulator") concerning Goldfields Gas Transmission ("GGT"). This was in response to a public invitation of the 6 November 2002 by the Regulator seeking comments from interested parties on matters identified in the Goldfields Gas Pipeline ("GGP") Draft Decision, released by the Regulator on the 10 April 2001 (the "GGP Draft Decision (2001)") under the Third Party Access Code for Natural Gas Pipeline Systems (the "Code") and having regard to reasons handed down by the Supreme Court of Western Australia in regard to the Dampier to Bunbury Natural Gas Pipeline (the "DBNGP Court Decision").[1]

On the 10 January 2003, GGT advised the Regulator of its intention to make a supplementary submission to him addressing various issues and concerns regarding the WMC Submission in order to bring these matters to his attention. This supplementary submission by GGT does not attempt to address all of the matters that have been alluded to by WMC, particularly those that GGT considers it has adequately addressed in its other submissions. Therefore any failure to specifically address any particular matter in this submission should not be taken to constitute acceptance or concurrence with anything alluded to in the WMC Submission.

GGT confirms that it intends that this submission should be made publicly available on the Regulator's website.

2. Executive Summary

The WMC Submission contains numerous statements which support a variety of representations that GGT has previously made to the Regulator. Given WMC's unique historic and current role in respect to the GGT, these areas of commonality with GGT's own submissions to the Regulator, require that appropriate recognition be given to the rights, obligations and circumstances which precede the Code, continue to prevail in the absence of a conclusion to the process under the Code, and will continue subsequent to the outworkings of Clause 21(3) of the State Agreement.

Notwithstanding the areas of agreement, the WMC Submission also contains a substantial number of assertions that are of concern to GGT in terms of consistency, accuracy and the potential they have - both explicitly and by implication - to mislead the reader to conclusions which are both inaccurate and damaging to GGT and its owners. Furthermore the outcome advocated by WMC in its submission would most likely result in circumstances which are contrary to the objectives of the Code in promoting third party access for potential new entrants in the downstream market in which WMC itself competes. In this context it is noteworthy that under the terms which WMC itself negotiated, WMC is not a "Third Party" for the purposes of either the GGP State Agreement (by virtue of Clause 9(1)(l)) or the Code (by virtue of Section 97(4) of the Gas Pipelines Access (Western Australia) Act 1998, and Clause 21(3) of the State Agreement). Furthermore it should be noted that WMC already has access to the GGP and, under the contractual terms which WMC devised prior to the sale and novation of

[1] [2002] WASCA 231, 23 August 2002.

its interest in the pipeline, WMC preserved for itself certain preferential rights to additional access to the GGP for gas transportation.

In considering the WMC Submission, it is GGT's view that the Regulator needs to also consider the full context of WMC's own historic role in the circumstances surrounding the GGP in order to properly balance the statements presented. GGT wishes to draw the Regulator's attention to specific issues, including the following matters.

(1) Matters in which the WMC Submission lends support to the case presented to the Regulator by GGT, including:
  - (i) The appropriate economic life for the GGP is 42 years.
  - (ii) The tariff calculation methodology so far adopted by the Regulator, and that which was used to determine the original tariffs for the GGP, are fundamentally different.
  - (iii) WMC itself devised and wrote the contract under which it is now entitled to gas transportation services on the GGP from Southern Cross Pipelines Australia ("SCPA", comprising the Australian Pipeline Trust ("APT"), CMS Energy ("CMS") and Transalta)[2].
  - (iv) The ongoing risks faced by GGT include;
    - (a) cost uncertainties,
    - (b) demand uncertainties,
    - (c) contractual exposures, and
    - (d) competition from other forms of energy.

(2) Assertions by WMC which misrepresent certain facts, involve omissions or inconsistencies, or which otherwise are not aligned to the objectives or intended outcomes of the Code, including;

  - (i) The WMC Submission is focused on the position of existing customers, of which WMC is the largest, making representations which are not in line with the objectives of the Code and which are possibly to the detriment of new third parties (ie. potential new downstream projects).
  - (ii) The WMC Submission makes a number of assertions that are inconsistent with claims and statements within the submission, upon which other assertions are based.
  - (iii) WMC confuses the concepts of Internal Rate of Return (IRR), "commercial rate of return" (which by definition under the GGP State Agreement, accommodates appropriate business risk), and the non-asset-specific Weighted Average Cost of Capital (WACC) calculation employed by the Regulator under the Code.
  - (iv) In its discussion of project risk, WMC confuses the position of a ringfenced pipeline owner with the position of a downstream nickel producer, as well as the nature of the competitive forces faced by each.
  - (v) No basis is given as to why the GGP has not and does not continue to satisfy (within the physical and economic practicalities of feasibility) the State's original development objectives.

[2] As of 1 May 2003, Transalta sold its shares in SCPA to APT, hence SCPA now comprises of APT and CMS.

(vi) WMC has not until recently contested the adequacy of the published GGP tariffs.

(vii) The WMC Submission obfuscates the distinction between the lower up-front GGP tariffs originally determined on a Net Present Value, whole-of-life basis (above which the tariffs have never increased), and the tariff discounts which have from time to time been offered by GGT.

(viii) Contrary to the implications contained in the submission, at the time of the sale of its interest in the pipeline, WMC monetised the value of its future risk-weighted cashflow expectations associated with its investment in the pipeline, based upon its perception of future uncertainties at that time.

(ix) The value of assets which formed part of the acquisition valuation but which do not form part of the regulated asset base, have already been removed from GGT's submitted regulatory values.

(x) The WMC Submission confuses the concept of owners' entitlements to Initial Committed Capacity with contracted capacity which actually earns revenue – a significant distinction now that the GGP is no longer owned by vertically integrated mining companies.

(xi) WMC misrepresents both the degree of demand responsiveness for converting power generation facilities to <u>and</u> from gas, as well as the potential gas demand which exists in the region.

3. Regulatory Process

As previously advised, GGT accepts the Regulator's process of reissuing the draft decision in two stages as outlined in the notice issued on 6 November 2002 and entitled 'Proposed Access Arrangement for the Goldfields Gas Pipeline'.

WMC has expressed the view that 'to embark on the second part of the decision will be a waste of effort on the part of the Regulator which has the potential to cause further delays'. GGT disagrees with this view, and maintains that the Regulator is bound, as a matter of law, to consider the impact of clause 21(3) of the State Agreement on the extent to which the provisions of the Code have, or are likely to have, a material adverse effect on GGT Joint Venturers' legitimate business interests. While GGT accepts that the Regulator can not make a binding determination as to the scope of his own jurisdiction, GGT agrees that the Regulator is nevertheless obliged to reach his own views as to his powers in relation to the application of the Code provisions, and it is understood that the two stage process is designed to assist in that regard.

GGT further confirms that this supplementary submission is made without prejudice to GGT's arguments that, under subclause 21(3) of the State Agreement:

(i) certain provisions of the Code have no effect to the extent that such provisions, in their terms, have or are likely to have a material adverse effect on the GGT Joint Venturers' legitimate business interests; and

(ii) further or alternatively, the application by the Regulator of the Code provisions will have no effect to the extent that such application causes, or is likely to cause, material adverse effect to the GGT Joint Venturers' legitimate business interests.

4. Alignment between WMC Submission and GGT's current position

The WMC Submission raises a number of issues with which GGT takes exception. It also contains numerous statements however, which provide additional support for previous submissions made by GGT to the Regulator, some of which have not been previously acknowledged in the regulatory process under the Code to date.

(i) The Original Owners (who now represent approximately 75% of pipeline usage) were instrumental in determining the terms of Third Party Access (refer WMC Submission, page 8) and in particular, WMC wrote its own contract governing its terms of access, later novating part of its interest in the contract to SCPA (refer WMC Submission, page 9).

(ii) The appropriate economic life of the GGP for evaluating tariffs is 42 years (refer WMC Submission, page 6).

(iii) The tariff calculation methodology employed by the Regulator is different to that undertaken to determine tariffs for GGP under the State Agreement (refer WMC Submission, pages 6 & 12).

(iv) GGT faces ongoing risks which include exposure to cost and demand uncertainties, the inflexibility of existing contracts which can lead to irrecoverable loss of revenue, and the competitive threat from more economic forms of energy which threaten the ability of GGT to earn a commercial rate of return (refer WMC Submission, page 25).

5. Propositions in WMC Submission which GGT disagrees with

It is significant that WMC is one of only ten customers serviced by the GGP, and accounts for approximately half of the committed capacity of the pipeline. WMC was also the dominant Joint Venturer and designated operator, responsible for the construction and initial operation of the pipeline up until the sale of its interests just prior to the introduction of the Code. Historically, WMC was therefore highly influential in developing the third party tariffs, as well as devising the Gas Transmission Agreement (under which terms it continues to enjoy access to the GGP) at a time when WMC was in the position of vertically integrated pipeline operator as well as upstream and downstream user. GGT submits that it is appropriate for the Regulator to consider the potential for any reduced tariffs which might eventuate under the Code to yield a financial "windfall" to WMC in addition to the economic profit it realised upon the sale of its interests in the GGT, as well as the distorting effect that such an outcome would have upon a commercial arms length arrangement previously entered into within a functionally competitive market.

GGT submits that the WMC Submission contains many statements and omissions which have the potential to lead the reader to certain erroneous conclusions. The WMC Submission contains numerous misrepresentations, omissions and inconsistent statements that GGT considers require critical examination in terms of the following aspects.

5.1. Background to Basis for WMC Assertions

As discussed above, WMC effectively devised the contractual terms upon which it would subsequently be entitled to use and pay for gas transmission services on the

GGP. As discussed in the WMC Submission on page 9, the Gas Transmission Agreement was determined entirely between WMC entities prior to the sale of the company's interests in the pipeline. When WMC sold its interests in the GGP to the current Owners – an entirely commercial transaction - WMC did three pertinent things:

(i) WMC established an asset valuation which was unquestionably determined by an arms length commercial transaction in the open (and free) market.

(ii) WMC received full compensation for the risks associated with the "non-core" investment which it had previously been facing as a pipeline owner (i.e. WMC's core business is in mining), whilst at the same time achieving its original objectives of supplying its mining operations with cheaper, more price stable energy.[3]

(iii) WMC transferred those risks associated with the ongoing ownership of the GGP onto the Current Owners, at a market value for the asset which monetised the future value of the risk-weighted expected returns of the project. (That is, the sales value can be equated to the Net Present Value of the future revenues which WMC had been expecting to receive from its investment in the pipeline).

The Original Owners of the GGP were the Initial Customers of the pipeline and they built the pipeline primarily designed to meet their own energy needs, establishing what was for them, an acceptable tariff path. They now constitute the majority of the GGP customer base, representing approximately 75% by contracted volume. WMC alone currently constitutes approximately 50% of the total throughput, and given that WMC is one out of a customer base of only ten, this represents a significant degree of countervailing market power. By virtue of Clause 21(3) of the State Agreement which they themselves negotiated, the Initial Customers are not covered under the Code, although they cannot be denied the right to make whatever representations they wish to the Regulator under the Code process. However, this may have potentially detrimental consequences for accommodating the gas delivery needs of future downstream new market entrants (representing competitors to the existing incumbents in the downstream market) and hence, for the promotion of future downstream competition. As the former president of the Australian Pipeline Industry Association, Mr Mike Lauer, recently put it (with emphasis added):

> *"Indeed, the only time the transmission pipeline industry seems to see a number of the more vociferous gas end-users is in the regulatory forums. The fact is, that those who use gas transmission pipelines are aggregators/wholesalers, many of whom make up the membership of AGA, and a few very large mining and industrial customers.*
>
> *The vast majority of gas end users served by gas aggregators have no direct dealings with gas transmission companies, and they may never even have a contract for gas transmission services.*[4] *<u>Yet the new regulatory processes provide</u>*

[3] e.g. "WMC's Involvement in the Development of the Goldfields Gas Pipeline", John Harvey, Manager – Energy Supply, WMC Resources Ltd, 12 March 2002.

[4] While generally true for other pipelines, the GGP is somewhat unique in the extent to which the majority of the gas it is contracted to deliver is for only a small number of

> *those gas end users with a powerful forum in which to exert an inordinate influence over the terms on which gas transmission will take place. Perhaps the level of this influence reflects the fact that the primary role of the regulator of transmission gas pipelines is that of advocate for consumers.*
>
> *The problem that all this causes for me today is that the gas users we hear from are already serviced with gas, they have access to gas supply infrastructure and they are protecting their own varied self interests.*
>
> *The development of major new gas pipeline infrastructure is a second order issue for existing gas users."*[5]

To the extent that any regulatory process is able to be influenced by existing corporate gas users, it is economically rational that they should wish to "protect their own vested interests". They might do this in a number of ways, including;

- by seeking windfall economic gains (merely transferring profits from the pipeline infrastructure investor to the downstream corporate investor, without having any positive impact on the degree of competition, or the prospects for enhanced competition in the market), and/or
- by raising the barriers to market entry for their own downstream competitors (by pursuing regulatory outcomes which make the provision of new gas delivery capacity for new entrants more expensive).

Clearly, such outcomes are not in line with the objectives of the Code in regard to promoting competition, particularly in regard to promoting competition "in another market" to the market for gas transmission. There are also negative implications for the Code's intention to provide protection for the legitimate business interests of service providers (per section 2.24(a)).

In particular, reference to the assertion that *"[i]n WMC's view there can be no doubt that prejudice to WMC is a relevant consideration to the (sic) taken into account by the Regulator in determining when and how to proceed with the completion of review of the Access Arrangement"*[6], GGT submits that consideration of any such "prejudice" can only be assessed from the relevant starting point. Consideration of such a claim will only be relevant if it also encompasses the role played by WMC in establishing the specific regulatory circumstances and historic tariff levels, as well as the magnitude and nature of the benefits enjoyed by WMC as a consequence of the sale and any subsequent tariff discounts prior to or following the introduction of the Code. This must include the various aspects of contractual advantage to WMC, as well as the enjoyment of fulfilled objectives from the construction of the GGP. Not only did the existence of the GGP permit WMC to proceed with the development (and subsequent profitable sale) of the East Spar gas field, it also ended WMC's

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customers, and who, typically being large corporations, manage their own gas supply contracts rather than use the services of an intermediary gas aggregator.

5 "Major Planned Pipeline Extensions", Presentation by Mike Lauer to the 2001 AGA Convention, 16 November 2001, "The participation of gas users in gas transmission".

6 WMC Submission, 17 December 2002, page 37.

exposure to crude oil price spikes[7] as reflected in the price of diesel for power generation. Furthermore, GGT understands that under the terms of the gas transmission agreement devised by WMC prior to the sale of its interests, by which WMC is now entitled to access to the GGP (refer WMC Submission, page 9), WMC retains certain rights of preferential access, including those of an "Associate" entity for the purposes of the State Agreement.

These factors are no less significant than the fulfillment of other objectives in terms of the supply of cleaner energy and the benefits to WMC of reduced cost energy associated with historic tariff levels and the potential to share in future improvements in economies of scale if and when the necessary underlying load growth should eventuate. It is also relevant to any consideration of the effect upon WMC to take into account the receipt of a sale price which, at the same time as fully compensating WMC for its investment risks in the GGP, also served to monetise those risks and hence enshrine a market determined basis, accepted by WMC,upon which future tariffs should be founded.

5.2. Consistency

The WMC Submission presents an inconsistent position in regard to a number of propositions that it raises. These are discussed below.

5.2.1 Regulator's consideration of the State Agreement

The WMC Submission presents an inconsistent position in regard to the extent or otherwise of the consideration WMC claims that the Regulator should give to the State Agreement. On the one hand the submission makes certain representations about the tariff determination methodology under the State Agreement to which WMC assert the Regulator should give regard. However the WMC Submission also goes on to assert that the Regulator should, on the other hand, give no regard to the effect of other aspects of the State Agreement on the basis that the Regulator is neither party to the State Agreement[8] nor the correct person to determine the effect of those aspects of the agreement. This appears to GGT to be an attempt to gloss over the obligations of the Regulator under s.2.24(a) and (b), s.8.1(d) and s.8.10(f) and (g) of the Code, which are a substantial part of the very subject of the Regulator's invitation for submissions from interested parties. In addition, it would seem to be an attempt to distort the factual basis upon which the Regulator's remaining considerations may be founded.

The WMC Submission asserts that on the basis of having revised the inputs to what it claims is an original GGT model,[9] the Regulator should now give consideration to newly modeled outcomes (in terms of project risks, tariffs and associated rates of return) which differ markedly from those which underscored

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7 "WMC's Involvement in the Development of the Goldfields Gas Pipeline", John Harvey, Manager – Energy Supply, WMC Resources Ltd, 12 March 2002.

8 The Regulator may also wish to give consideration to the fact that WMC is not itself a party to the State Agreement, which exists as a contract between the Current Owners of the GGP and the State Government. In addition, the Gas Transmission Agreement to which WMC is a party, is between itself and Southern Cross Pipelines (comprising APT, CMS and Transalta). WMC does not therefore have a direct relationship with GGT as a shipper.

9 WMC Submission, 17 December 2002, page 6.

the project at the time of WMC putting its assets up for sale, as now being representative of the current owners' expectations at the time of that sale proceeding.[10] This argument by WMC is patently flawed. Future hindsight (even if it were accurate) cannot possibly form the basis of past expectations.

There also arises a number of inconsistencies in the manner in which WMC has claimed to apply the model that it has in its possession.

For instance, WMC claims that consideration of the actual sale price - which it acknowledges is a derivative of future revenue expectations <u>at the time of sale</u> - should not form any basis for determining future (regulated) tariffs, as in WMC's view, this logic is circular.[11] This is despite the fact that this is exactly how the competitive market naturally functions, certainly in the sense of constituting a "workably competitive market" as discussed in the Epic Decision. It would also seem to be a direct contradiction of the Regulator's necessary consideration of the objectives in s.8.1(a), and more particularly s.8.1(b), (d), (e) and (f) of the Code, as well as s.2.24(a). Furthermore, WMC's assertions are inconsistent with the determination of the Court in regard to the consideration due to an arms length commercial transaction made prior to the application of the Code, as is discussed further at the end of this section of GGT's submission.

A more fundamental inconsistency concerns the methodological distinctions between the WMC approach and that of the Regulator, which the WMC Submission highlights. The WMC Submission describes the application of the model it has, in a manner consistent with the conventional commercial application of discounted cashflow technique to evaluate project profitability.[12] That is, for given capital and operating costs, load forecast and timeframe over which the investment outlay is to be recovered (to mention only the major model determinants), an expected rate of return is calculated based on a tariff (or range of tariffs) considered to be commercially realistic in the context of the specific market. In a normal project evaluation context, the expected rate of return (whether this be considered as a range or distilled into a single, probabilistically-weighted figure) would be subsequently considered in order to ascertain whether or not investment in the project is (i) economically viable and (ii) attractive enough to proceed with in the face of all other commercial considerations. The latter consideration would normally also take account of a myriad of other project specific issues (for example, strategic fit, capital rationing constraints, shareholder and board-level perceptions and other, possibly unquantifiable, risk factors), the resolution of which will determine whether or not the project becomes commercial.

The WMC Submission correctly identifies that this approach is fundamentally different from the traditional regulatory approach to determining a tariff from the starting point of a "target" rate of return. Paradoxically, the WMC approach is to then produce a number of tariff scenarios, each having associated with it a resulting rate of return, from which the WMC Submission then devolves to the

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10 WMC Submission, 17 December 2002, page 7.

11 WMC Submission, 17 December 2002, page 32.

12 i.e. The model is used to calculate "*a 42 year internal rate of return using these forecast cash flows*". WMC Submission, 17 December 2002, page 6.

selection of a single desired tariff scenario. This, not surprisingly, is determined by WMC to be merely the same tariff as that previously published by the Regulator in the GGP Draft Decision (2001). This selection appears to be based upon nothing more than the opportunity to pursue the vested interest outcomes described in section 5.1 above. The balance of the WMC Submission goes on to seek to justify a dismissal of all those aspects of investment risk which WMC has passed onto the Current Owners of the pipeline and for which it has itself been recompensed.

It is the view of GGT that such outcomes would be neither equitable nor consistent with the objectives of the Code. Moreover in this regard the DBNGP Court Decision provides the Regulator with specific guidance as to the consideration that is warranted where an investment in a pipeline, which is made before the Code applied, is undertaken in the course of an arm's length transaction and is based on a sound commercial assessment of the values of the pipeline in the circumstances "then prevailing and anticipated".[13] The Court's determination was that it is relevant to consider the investment, the interests of the service provider in recovering that investment together with a reasonable return, and the reasonable expectations under the preceding regulatory regime of the service provider.

5.2.2 Obligations of Owners under the State Agreement

The WMC Submission makes certain claims in respect to the extent to which the published tariffs for the GGP are inconsistent with the obligations of the Pipeline Owners under the State Agreement. In this regard GGT urges the Regulator to note:

(i) That WMC was itself instrumental in establishing the initial GGP tariff schedule (A1) which was determined by the Minister as complying with the obligations under the State Agreement at a time when WMC itself stood in the position of pipeline owner, prior to, during and for a significant period following the construction and initial operation of the pipeline.

(ii) That WMC subsequently sold its interest in the GGP for a price which, from its own commercial perspective, factored in the monetised value of future cashflows based upon WMC's view of revenue risk (and hence determined its required rate of return) to the pipeline <u>at a time subsequent to the issue of construction risk being resolved</u>.[14]

(iii) The view of GGT's risk exposure as discussed in the WMC Submission confuses the perspectives of a pipeline owner with that of a nickel producer (which the submission claims is not appropriate to apply to the pipeline's risk calculation in any event). WMC claims that the threat from potential low cost lateritic nickel production technology was factored into the original project risk and hence rate of return calculation

13 [2002] WASCA 231, 23 August 2002, paragraph 179.

14 WMC Submission, 17 December 2002, pages 23 & 24.

that resulted in the A1 tariff.[15] This cannot be an accurate representation of the pipeline project view, as it is clearly the perspective of a "hard rock" nickel producer.[16] The perspective of the (ringfenced) gas pipeline Joint Venture would of necessity have been a broader view of the gas use market, akin to what it is today. From this perspective, it is irrelevant which nickel production technology dominates the downstream industry because as long as the industry remains viable, gas for process and power generation would continue to be demanded. It could be noted that the amount of gas demanded per unit of nickel production is potentially lower for lateritic development processes, according to claims by the proponents. However, even if a more cost efficient technology were to displace a less efficient one (although this might appear to be a questionable proposition given WMC's claim to be "in the lowest quartile of operating costs"[17]), as long as the efficiency gains result in greater output levels, this is not a substantial risk to the pipeline business, and never was. The real risk for the GGP (and for gas suppliers) is rather that such projects do not proceed successfully (or are located too far away from the pipeline to be serviced by it). In the sense that new project developments which might underscore the future demand for services of the GGP are uncertain, obviously the risks to which these projects are exposed, are also shared by GGT (in contrast to WMC's previous assertion). In any event, the rate of return which originally contributed towards the establishment of the A1 tariffs, was predicated entirely upon risks pertinent to the gas pipeline and not those of a particular nickel production technologist. Support for this can be found in the definitions in Clause 1 of the GGP State Agreement which provides (with emphasis added) that:

> *"**legitimate business interests of the Joint Venturers**" means the legitimate business interests of the Joint Venturers' as owners and operators of the Pipeline on the basis that they constitute an independent pipeline owner offering transmission services without any bundling of those services with other services such as purchase, sale, storage or supply of gas (beyond short term balancing between receipts and deliveries)"*

Hence the nature of the risks which were identified at the time of committing to the construction of the GGP (ie. ultimate pipeline utilisation, downstream resource project longevity and economic variability, etc) were at the time of the pipeline's construction and remain today, largely unchanged. If anything, the competitive threat from potentially cheaper delivered energy sources (as alluded to by WMC[18]), along with the costs of regulatory compliance and associated treatment

15 WMC Submission, 17 December 2002, page 20.

16 Although even this understates the benefit of the pipeline to the incumbent nickel producer from having the advantage over a new entrant, of a source of cheaper energy and first call on access to any available capacity as a consequence of WMC's vertically integrated operation, as it was then.

17 WMC Submission, 17 December 2002, page 30.

18 WMC Submission, 17 December 2002, page 25.

of real investment, have subsequently increased the risks to the GGP which underscore the derivation of an acceptable commercial rate of return. This is particularly so relative to the asset valuation established by the Original Owners, including WMC, at the time they sold the GGP.

(iv) Prior to the sale of its interest in the GGP, WMC as operator of the GGT had published only one discount offer (the A2 tariff which represented a 15% discount to A1) and this discount was made available for only a short, specified duration prior to its expiry. Furthermore, this discount was offered after approximately two years of pipeline operation. Subsequent and greater discounts were made under ownership subsequent to WMC having monetised its expected investment in the pipeline. That is the later, more heavily discounted tariffs were offered after WMC had been fully recompensed and had itself crystalised the future value of its investment via the market mechanism. This was based upon receipt of a sale price which, according to typical practice, equated to the present value of the future cashflows the seller represented as being a reasonable expectation (prior to any further discounts being known). To achieve an acceptable sale price (as opposed to the purchase price determined by the buyer), these future cashflow expectations would then be discounted at the rate of return the seller, that is WMC, was expecting from its investment if it were to retain ownership. This expected rate of return obviously embodied a certain investment risk premium specific to the GGP.[19] Consideration of the extent to which the Owners have, over time, complied with the terms and objectives of the State Agreement needs to include an appreciation of all (and not just selected parts which now favour the dominant corporate beneficiary) of this history.

(v) WMC has not until recently contested the consistency of the published tariffs with the Owners' obligations under the State Agreement. Of course WMC cannot question the adequacy of the initial tariff, which WMC itself established prior to 1996. However WMC has not previously raised any formal objection to the subsequent discounted tariffs which have from time to time been offered, even though the last of these published rates (the A4 tariff) was known since mid-1999. WMC transferred its interest in the GGP from that of Owner to that of Shipper four years ago in late 1998, and has been aware of the existence of the A4 discounted tariff for the past three and a half years. If WMC's

[19] This example also serves to highlight a practical flaw in regard to certain arguments to the effect that regulatory rates of return based on CAPM should not include a risk consideration for asset-specific risks on the basis that these are hypothetically diversifiable. In this example we see an entity which is eminently placed to manage specific pipeline risk (which is not core to its vertically integrated business) through investment diversification, instead opt for divestment. It may then seem rational and consistent with competition theory that the new (and current) asset owners should be specialised pipeline companies. However such companies, by virtue of having a narrower commercial focus and industry exposure, are less able to diversify their risks. Notwithstanding this flaw in regulatory logic, it is apparent that in any case, it ought to be access to the particular asset that is the focus of appropriate regulation, and not the inferred financial structure or investment portfolio of the asset owners.

claim that the A4 tariff or indeed any earlier discount or even the original tariff which WMC itself had established, were now in some way inconsistent with the Owners' obligations under the State Agreement, one would surely have expected an earlier attempt to formally raise the matter. Consequently GGT urges the Regulator to give consideration to the credibility, relevance and the matter of the timing of WMC's current assertions.

5.2.3 Relationship between forecast demand and rate of return

The WMC Submission contains another logical inconsistency which begins with a presumption that the WACC published in the GGT Draft Decision (2001) somehow correlates with the market valuation of the GGP established by the Original Owners at the time of the sale of their interests in the pipeline.[20] It is readily apparent that no such correlation can be said to have any historical basis. In fact, this assumption is clearly at odds with WMC's later assertion that *"[i]t is an essential part of the State Agreement tariff and access model that the parties must consider the risk inherent in the cash flow forecasts and strike a "commercial rate of return" consistent with the risk encapsulated in the cash flow forecast."* [21] The WACC published in the Draft Decision was established, in accordance with Code precedence, without consideration of *the risk inherent in the* [GGP] *cashflow forecasts* (because this risk is considered by the Regulator to be diversifiable, as discussed in following paragraphs) and thus is distinguished from being a "commercial" rate of return. Furthermore, the market value of the GGP was established (at the time of acquisition by the Current Owners) without the benefit of hindsight as to the methodology or application of how the then non-existent Regulator under the Code would one day determine returns under that embryonic regulatory regime. Rather, the market derived a value based upon a subjectively weighted view of a range of future load predictions and reliance upon the efficacy of the State Agreement and the certainty this provided in terms of tariff and hence return on investment.

Further to this, it should be noted that the WMC Submission cites the "administrators of the Code" in regard to the purported removal, as far as possible, of risk from cashflow forecasts *"so as to render the cash flow forecasts compatible with the rate of return constructed by regulators as a weighted average cost of capital."* [22] This assertion should be contrasted with the table on page 15 of the submission, which describes the rate of return developed by the Regulator in the GGP Draft Decision (2001) as being the *"Regulator's best estimate of the* <u>*risk weighted*</u> *rate of return"*. These representations by WMC of the Regulators methodology are inconsistent. In the latter statement, WMC is quite incorrect in its representation of the Regulator's approach. While GGT has previously stated its contention with the approach adopted by the Regulator, according to the Regulator:

> *"...the CAPM methodology does not make allowance for adjustments to the cost of capital to account for risk that is specific to the Goldfields Gas*

[20] WMC Submission, 17 December 2002, page 7.
[21] WMC Submission, 17 December 2002, page 12.
[22] WMC Submission, 17 December 2002, page 12.

> *Pipeline. As discussed above, firm-specific risk is not relevant as these risks can be eliminated by investors holding a well-diversified portfolio of assets."* [23]

Clearly, the rate of return developed by the Regulator in the GGP Draft Decision (2001) cannot be described as including a weighing of the risks which are pertinent to the GGP. Further, in relation to the preceding assertion by WMC, the Regulator also states:

> *"Nevertheless, the issue of non-diversifiable risk needs to be considered in relation to the particular regulated entity. To the extent that an adjustment (upward or downward) is required to ensure that the entity can, on average, expect to earn the WACC, this should be done through adjustments to the entity's cash flows."* [24]

Despite the inconsistencies identified above, the WMC Submission goes on to argue that its preferred approach is to develop a range of cash flow forecasts and to then calculate what it wrongly refers to as a "commercial rate of return". In reality, WMC merely identifies the Internal Rate of Return ("IRR") for each forecast scenario.[25] While this is exactly the approach that might be adopted for the commercial evaluation of a potential project or acquisition, and is how the impact of a proposed tariff discount might be quantified, the manner in which WMC has attempted to apply this approach to a regulatory evaluation is flawed and has resulted in a number of misleading conclusions.

In particular, the supposed use of a range of cash flow predictions (i.e. tariff and load forecast pairs) does not disguise the fact that the WMC Submission merely converges upon a pre-selected tariff outcome, without any convincing rationale for why the selected tariff outcome should be preferred. Of course, the selected tariff outcome is the one which yields to WMC the windfall gain first mooted in the GGP Draft Decision (2001) and which WMC is now seeking to capture. Having determined the tariff and calculated the IRR for a number of demand forecasts, the rest of the WMC Submission is largely focussed on attempting to justify a sub-commercial rate of return to GGT.

A further aspect of the WMC approach that appears to have resulted in a logically flawed conclusion is in the manner of correlating investment risk with forecast demand. This is illustrated on page 20 of the WMC Submission where WMC states:

> *"In simple terms, a tariff cannot be set by removing the major risks to revenue (and, in this case, to investment) and then arguing that the "rate of return" applied to those forecasts should continue to reflect the risk which*

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23 GGP Draft Decision (2001), page B:141. This statement highlights a problem with the current application of the Code in that there obviously exists some confusion in regulatory circles, not just in the objectives of the Code as identified by the Supreme Court (and the Productivity Commission), but also in respect to exactly what it is that is being regulated to ensure Third Party Access – i.e. the asset or the Owner of the asset.

24 GGP Draft Decision (2001), page B:142.

25 WMC Submission, 17 December 2002, page 12.

> *has been removed. If risk is removed by adjusting the revenue functions used in the tariff setting exercise, then the rate of return and the Reference Tariff need to be adjusted accordingly."*

This conclusion is quite clearly at odds with the earlier references to statements by the Regulator. It also leads to the logical inconsistency that if one's view of future demand is, on average, pessimistic (that is there is a perception of higher risk of the investor not being able to recoup the money which they have already sunk into their asset), it is appropriate to apply a low required rate of return in order to consider the investment commercially viable.[26] This appears to confuse the reality that, if a tariffs are set at a level which cannot be later exceeded (due perhaps to a regulatory mechanism which sets fixed or declining price caps, or due to competition from close substitutes, etc), then a lower than expected future demand profile will result in a lower rate of return being realised. The two situations are distinctly different.

The WMC Submission correctly points out that GGT faces ongoing risks which include exposure to cost and demand uncertainties, the inflexibility of existing contracts which can lead to irrecoverable loss of revenue, and the competitive threat from more economic forms of energy which threaten the ability of GGT to earn a commercial rate of return.[27] However the submission also asserts that the theoretical ability of the service provider to initiate an immediate tariff increase for subsequent new contracts in the event of a serious adverse movement in costs or revenue, mitigates the exposure of GGT to these risks. This implies a heavy financial obligation on potential new users of the pipeline, and in fact, GGT contends that such an imposition would generally be a commercial impracticality. It would be generally difficult to charge new users a substantially higher price and, in contrast to the statement at the bottom of page 24 of the WMC Submission, Tariff Setting Principle 12 of the State Agreement specifically prevents a higher tariff being passed on to users under existing contracts before they expire. (In fact this statement by WMC is oddly inconsistent with the statements which precede and follow it).

5.2.4 Demand Responsiveness - Fuel Switching and Competition

It should be recalled that the objective of the application of the Code is primarily to promote competitive economic development by providing third party access on equitable terms to essential infrastructure facilities which might otherwise be barred due to monopoly interests. A key regulatory assumption which has previously been superimposed upon this objective, is that reducing the price for the use of a facility (via economic regulation), regardless of the starting point, will automatically work to adjust the supply and demand balance. This is economic theory at its simplest - lowering the price for a service will result in increased demand for that service and that increase is automatically beneficial. The validity of this simple regulatory assumption and the justification for its continued adoption are increasingly being challenged by factual experience that demonstrates a lack of supporting evidence. There is also other evidence of the negative consequences for investor confidence and hence infrastructure

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26 WMC Submission, 17 December 2002, page 20.

27 WMC Submission, 17 December 2002, page 25.

expansion, as well as the ongoing expense of the process of refining rights, regulatory practices and theoretical understanding through the courts, as demonstrated in the recent DBNGP Court Decision. In the meantime, in regard to the GGP where no claim can be legitimately made that the Code is intended to redress a physical restriction of Third Party accessibility, the implicit merits of the Code process then entirely devolve to this simple economic premise regarding the price-responsiveness of demand. In this regard, GGT has sought to demonstrate to the Regulator in a variety of its submissions and representations, that it has first hand experience that the markets which GGT serves are unresponsive to this approach.

One aspect of this demand responsiveness that is addressed in the WMC Submission (on page 29) relates to the ability of existing customers to switch between competing fuel sources. In the first instance it should be noted that the WMC Submission has a focus on the contractual constraints of existing GGP customers – commitments which were freely established in commercial negotiation. The WMC perspective is inconsistent with the focus required of the Regulator, which is to ensure future equitable Third Party Access that seeks to mirror that which might be available in a workably competitive market.

A further matter of logic arises in respect to the preceding discussion about the scope for demand to respond to price reductions. The WMC Submission concludes that *"[f]uel switching is not, as GGT would have the Regulator believe, a simple and inexpensive matter"*.[28] The WMC Submission makes the argument in respect to the difficulties for existing GGP gas users to switch away from gas to an alternative fuel or gas source. However to the extent that these arguments are valid for switching <u>from</u> gas, they are at least equally valid for consideration of the difficulties of switching from an existing alternative <u>to</u> gas delivered via the GGP. GGT urges the Regulator to contrast the implicit assumption that lower transport price will facilitate switching to gas with the arguments presented by WMC to the contrary. Further, GGT requests the Regulator to consider that it is <u>easier</u> to switch from gas to diesel fuel (involving a significantly smaller fixed capital outlay) than it is to switch from diesel to gas fuel, which involves a much larger capital outlay (mainly for lateral pipeline connection) as well as economic restrictions such as having sufficient remaining project duration to recoup the investment. In addition (and at odds with WMC's assertion to the contrary), many facilities which are currently connected to the GGP also have an operational requirement for back-up facilities. It is GGT's understanding that a number of the operations along the GGP which have installed gas turbine equipment, also retained pre-existing diesel power generators for additional backup. To what extent plant operators have chosen to retain and maintain this equipment is not information that is readily available to GGT with any accuracy. Indicatively however, it is GGT's understanding that the following facilities located along the GGP have or have had some form of alternate power or alternatively fuelled power back-up:

(i) Hamersley Iron's operations at Tom Price and Paraburdoo.

[28] WMC Submission, 17 December 2002, page 29.

(ii) Duke's (formerly owned by BHP) power stations at Port Hedland and Newman are dual fuelled (i.e. gas and distillate) and can transfer from one to the other 'at the flick of a switch'.

(iii) Southern Cross Energy's (formerly owned by WMC) power station at Mt Keith is dual fuelled (noting that WMC is also a substantial consumer of diesel for its non-powered mining operations).

(iv) WMC's Leinster operation which in addition to retaining diesel generators for back-up, has more recently been connected to high voltage transmission lines for added security.

(v) WMC's operations at Kalgoorlie and Kambalda which, while obtaining electricity from Southern Cross Energy's power stations (formerly owned by WMC) which are fuelled by gas from the GGP, continue to have access to the Western Power 220 kV transmission line from the Muja Power Station at Collie for power back-up.

(vi) Normandy's (formerly owned by Great Central Mines Ltd) operations at Wiluna and Jundee.

(vii) Goldfields Power's power station at Parkeston is dual fuelled and also has interconnection to Western Power's 220 kV transmission line from Collie to provide potential back-up to customers.

Of course the preceding discussion relates to existing gas consumers, whereas the focus of the Regulator's task is with respect to future accessibility for new customers, that is Third Parties. In this regard it should be noted that new remote area operations are likely to continue to have a requirement for on site power back-up. This appears to be so, regardless of any contractual reliability provisions included in gas supply contracts, and whether or not, as the WMC Submission states, such dual fuel capacity is expensive and associated with loss of plant efficiency. In fact, GGT's experience and the advice it has received from suppliers, is that dual fuel capability is a minor incremental cost when installing gas turbine generators, involving some tens of thousands of incremental expenditure for diesel storage etc, representing a fraction of a percent of the total facility cost. As an example, it is GGT's understanding that the Telfer gold mine expansion being undertaken by Newcrest Mining Ltd, will see the installation of dual fuel turbines for power generation, despite the significant investment in a gas pipeline from Port Hedland. The implication for GGT is that fuel switching from gas is likely to be a readily available option to any large new customer. In addition, the economic hurdle of higher capital outlay being associated with the construction of a gas lateral, is compounded by the likely continued requirement to install new equipment which has a dual fuel capacity. This must be seen as a competitive disadvantage for the GGP and a significant factor in any consideration of the prospects for future gas demand growth.

In this regard, it is worth touching upon a number of the examples of potential load growth mentioned in the WMC Submission.[29] The following points are relevant to the Regulator's consideration of WMC's assertions:

[29] WMC Submission, 17 December 2002, page 21.

(i) BHP Billiton's Mining Area C, near Newman, has already been factored into GGT's most recent gas forecasts based upon customer advice.

(ii) Robe River Iron Associates' West Angelas mine is understood to be sourcing its power via high voltage transmission lines from Dampier.

(iii) The problem for GGT which arises from the concentration of potential resource projects in the Pilbara region, is that even were they to elect to connect to the GGP (an outcome which GGT continues to actively seek in the face of strong competitive and technical constraints), substantial pipeline inefficiencies would ensue and need to be addressed. This is because the effect of a higher load in the northern portions of the GGP, does nothing to utilise the pipeline further south, and in fact can severely constrain capacity. A substantial northerly load bias would necessitate additional compression expenditure (south of, but adjacent to the northern load) in order to maintain pipeline capacity to the south. This gives rise to an issue of equitability in that the expenditure would be necessitated by northern customers but not for their benefit. Conversely, the compression would be required for the benefit of southern customers, but not necessitated by them. It is not clear that the Code can accommodate such an issue, but it would seem clear that if the only effect of the Code's application to the GGP is to reduce tariffs to sub-commercial rates of return, there will be little latitude for commercial resolution to such issues.

5.3. Accuracy

The WMC Submission discusses a number of issues in a manner that is inaccurate and thereby misleading. These are discussed in the following sections.

5.3.1 Confusing Owners' Initial Committed Capacity and Contracts

On page 27, the WMC Submission identifies that the Initial Committed Capacity ("ICC") (as defined under the State Agreement) accounts for all of the original capacity of the GGP (although it should be noted that subsequent compression has somewhat increased current capacity above the figures cited in the submission). The claim is also made that this ICC represents GGP capacity which *"is contracted to 2036 and beyond".* This is an inaccurate statement which confuses the notion of Owners entitlements to capacity, with actual utilisation of capacity which earns revenue for GGT, and thus overstates the utilisation of the pipeline. What the State Agreement actually says is:

> *"The aggregate of the binding commitments procured under subclause (2) for terms of 10 years or more and the capacity reserved by each of the Joint Venturers under any agreements of the kind referred to in subclause (1) is referred to in this Agreement as the "Initial Committed Capacity".* [30]

[30] Goldfields Gas Pipeline Agreement Act 1994, Clause 8(3)(b).

Subclause (1) referred to above states:

> *"Prior to submitting any proposal in relation to the matters referred to in paragraph (a) of subclause (1) of Clause 9*[31]*, each of the Joint Venturers shall be entitled (and is hereby authorised by the State) to reserve to itself, for such period and on such terms as the Joint Venturers may agree, access to such of the transmission capacity of the Pipeline as it requires for the transmission of such gas as each Joint Venturer or its associates may require. The Joint Venturers shall not be obliged to charge each other or to pay tariffs for such access or for transmission services in respect of such gas and, subject to this Agreement, may make such contractual arrangements between themselves in relation thereto as they see fit. The Joint Venturers shall advise to the Minister details of any such agreement at the time of submission of proposals under paragraph (a) of subclause (1) of Clause 9."* [32]

These were pragmatic provisions of the State Agreement, allowing the original vertically integrated Joint Venturers to design and build a gas pipeline to suit their own operational expectations, and apportion access to capacity in accordance with the Owners' respective shares in the investment, while also providing for the prospect of future Third Party capacity. Thus the State Agreement also stipulated that the minimum size of the GGP had to be the greater of;

> *"a diameter of 400 mm from the commencement of the Pipeline through to Newman thence 350 mm through to Kalgoorlie; and*
>
> *such diameter or diameters as are required so that the initial operating capacity of the Pipeline is sufficient to provide for all Initial Committed Capacity"* [33]

and that;

> *"the capacity of the Pipeline shall be able to be expanded, by using additional compression, by a minimum of 50% of the Initial Committed Capacity."* [34]

It should be noted that these are the arrangements defined and entered into by the original GGP Owners, including WMC. All rights[35] and obligations pertaining to GGP ownership were assigned to the various Current Owners of the GGP at the various times of acquisition of their respective interests in the pipeline. It is also pertinent to consider that whilst the Original Owners intended that they should have access to direct usage of the pipeline for their own vertically integrated

31 These were the detailed proposals put forward by the original GGT Owners which were subsequently approved by the Minister.
32 Goldfields Gas Pipeline Agreement Act 1994, Clause 8(1).
33 Goldfields Gas Pipeline Agreement Act 1994, Clause 9(5)(a) & (b).
34 Goldfields Gas Pipeline Agreement Act 1994, Clause 9(5)(d).
35 With the notable exception of certain preferential rights to access retained by the Original Owners, including WMC.

mining processes, under the Current Owners, utilisation of ICC has no value unless it involves a contract to transport gas for some other party. By contrast with the Original Owners, the Current Owners are solely in the business of transporting gas for others. It is patently inaccurate to assert (as the WMC Submission does on page 27) or even imply (as it does on page 28 in regard to Commercial Risk) that the entitlement of an asset owner to the use of that proportion of the asset which they own, is the same thing as a risk free, revenue-earning contractual commitment of capacity.

5.3.2 Commercial Rate of Return

While the WMC Submission is reasonably accurate in its initial references to the Owners' rights under the State Agreement to earn a commercial rate of return, by page 23 the submission develops this into an assertion that the right exists as an ability to earn *"<u>no more than</u> a commercial rate of return"*. This is not accurate. Considering that the objective of the State Agreement at the time it was written was to facilitate an initial "over-investment" of capital (that is, spare Third Party capacity was mandated in the uncertain hope that future gas demand would eventuate), it is more accurate to conclude that the Owners' right under the State Agreement is to earn "<u>no less than</u> a commercial rate of return". This is clearly reflected in tariff setting principles 2 and 12 under the State Agreement.

The discussion in Section 3 of the WMC Submission also fails to make any distinction between the WACC-based rate of return calculation previously employed by the Regulator under the Code, with the concept of a "commercial" rate of return. The establishment of a rate of return which only just permits a project to repay its funding costs and no more than this, is representative of a project which just barely meets the minimum hurdle of financial viability. That a project might barely meet the hurdle of financial viability may or may not be sufficient to confirm the economic rationalist's expectation of pricing based on "efficient costs". However, this precondition of theoretical viability falls well short of what is required by an investor in order to establish a "commercial" project, an issue which has been identified in recent work by the Productivity Commission, as well as more specifically by the Supreme Court in the DBNGP Court Decision. As discussed earlier in this submission, a commercial rate of return must satisfy a number of criteria in addition to being (barely) viable,[36] including but not limited to a suitable allowance for anticipated investment risks.

5.3.3 Relationship between risk, tariff and investment

In Section 4, the WMC Submission makes a number of claims in regard to the quantification of risks and the need to revise (downwards) the calculated tariff. This follows from earlier assertions relating to the Regulator's consideration of Initial Capital Base on page 7, which state:

> *"WMC submits that although there may be a valid argument for using the acquisition price of an asset in determining the applicable Reference Tariff,*

36 In fact, to be considered "commercial", the rate of return must be such that the investment is not merely (barely) viable, but must be <u>attractive</u> to the relevant potential investors.

> *this price needs to be adjusted to remove those elements attaching to assets which do not form part of the Pipeline.*
>
> *In addition, the rate of return constructed by the Regulator in its Draft Decision is inappropriately high if it is applied to an asset acquisition price which has not been adjusted accordingly to take account of the reduced risks inherent in purchasing an existing, operating asset.*
>
> *WMC submits that whilst use of the acquisition price is not irrelevant, it should only be considered where the Pipeline Owners are prepared to make full disclosure of the breakdown of the acquisition price and acquisition arrangements."*

It should be noted that the issue of removing from the acquisition valuation, those assets which do not form a part of the regulated pipeline has already been addressed by GGT. Most recently, this is discussed in section 4.3 of GGT's "Public Submission on STAGE 1" of the 17 December 2002.

In regard to the assertion that the rate of return should be adjusted, this is spelt out elsewhere in the WMC Submission to be on the basis that "completion risk" and "construction risk" formed substantive elements in establishing the original rate of return,[37] and that these risks have now both been resolved.[38] However GGT requests the Regulator to give consideration to the observations of the Productivity Commission in regard to the effect of later regulatory truncation of expected pre-investment returns (this issue is also referred to in GGT's "Public Submission on STAGE 1"). GGT agrees with, and requests the Regulator to consider the following observations presented to the Energy Regulation and the Role of the Regulators Conference in Melbourne last year:

> *"Secondly, risks exist at a point in time and, whilst they may be confronted and overcome, they warrant a return going forward. Life would be great if we could insure against completion risk, but we can't. [...] one-off project completion risk is not reflected in a company's WACC.*
>
> *The point is, that the cost of managing risk does not evaporate just because a risk is confronted and overcome. The cost is ongoing and is usually manifest as a return to equity. Where is that return in the CAPM model when that model is applied to substantial projects?"*
>
> *[...]*
>
> *We will know that the current problems* [with the application of the Code] *have been resolved when our regulatory community can acknowledge that the difference between the cost incurred in developing pipeline infrastructure, and the price subsequently paid for the special purpose company in which that pipeline is embedded, is not the proceeds of some*

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37 WMC Submission, 17 December 2002, page 19 & 24.
38 WMC Submission, 17 December 2002, page 24 & 25.

> *dastardly monopolistic plot but a return for risk taking, risk management and the creation of a business built around a physical asset."*[39]

Furthermore, GGT urges the Regulator to consider that the relationship between risk perceptions and commercially acceptable rates of return hinge significantly upon the capital investment associated with them. It is consistent with WMC's assertions to observe that the sale (or purchase) price of an asset is related (usually inversely) to the perceived levels of risk associated with recouping one's investment in that asset. For the Original Owners, including WMC, the relationship between the expected capital cost of the pipeline and the anticipated levels of investment risk, combined to establish an acceptable (in fact, required) rate of return. However following construction and at the time of the sale of its interests, WMC - knowing that it was to be the most substantive future customer of the pipeline - had a choice. It could;

(i) accept that the risks which now faced the constructed asset had diminished if this is what WMC truly believed, and hence downwardly revise its own rate of return expectation, thus permitting the asset to be sold at a price which would enable future revenue requirements (and hence, for the same given demand forecast, tariffs) to be lower, or

(ii) seek to receive a price which fully compensated it for the risks which it had contemplated at the time of making the initial investment, in effect monetising the risk premium and, although receiving the future value of its investment upfront, committing itself to maintaining the future revenue path upon which its sales valuation was based.

In the event, WMC apparently chose the second option, meaning that future tariffs can only be expected to be reduced if and when a higher demand for gas transportation services eventuates. Not until this eventuality can it be expected that tariffs are able to be reduced whilst still maintaining the revenue expectations of both the original and new Owners of the GGP project.

5.3.4 Satisfaction of Development Objectives

On page 28, the WMC Submission attempts to counter statements made by GGT in regard to its role in fulfilling its own part in the development objectives which the State Government has declared it has for the Pilbara and Goldfields. While the role of GGP in the context of these objectives is discussed in more detail in GGT's "Public Submission on STAGE 1" of the 17 December 2002, in particular reference to the WMC Submission, the following should be noted:

(i) To the extent that the Government's development objectives have included the provision of essential infrastructure, including a gas pipeline to connect to Western Australia's offshore gas supplies in order to allow existing projects and potential projects in remote resource-rich regions to access cheaper energy, the GGP has and

[39] "The Australian Gas Pipeline Market – Competition Policy and Reforms", Mike Lauer, Immediate Past President, The Australian Pipeline Industry Association, 31 May 2002.

continues to substantially realise that objective to the extent that inherent pipeline economics permit.

(ii) The original GGP tariff schedule represented a tariff path which had a lower starting point than if a cost of service approach had been taken, instead of the whole-of-life levelised methodology actually used. In this sense, it can rightly be said that the GGP tariffs were lowered in the early years of the project in order promote the use of the pipeline (and hence provide the opportunity to further the development objectives of the State). The reference in the WMC Submission to tariffs being lowered in the early project years, is actually a reference to further discretionary tariffs discounts which were offered by GGT, consistent with its additional obligations under the State Agreement to further promote the use of the pipeline. There is no inconsistency between the lack of success of these measures, the withdrawal of such discounts or the rights of the GGP Owners to seek either a commercial rate of return under the State Agreement, or an appropriate rate of return under the Code.

6. Conclusion

In summary, GGT urges the Regulator to consider in regard to the WMC Submission that WMC:

(i) Assigned all of its rights (except certain associate rights which provide continued preferential access to pipeline capacity) and obligations under the State Agreement to the new Owners, having received a sale price which factored in the proffered worth of those rights and obligations.

(ii) Played a significant historical role in the establishment of the current regulatory and contractual framework associated with the GGP, being instrumental in defining the terms appertaining to both of these aspects.

(iii) Devised and wrote the contractual terms of the Gas Transmission Agreement to which it is now a party, and under which one of the pipeline owner's, SCPA, is required to provide gas transportation on the GGP, and hence WMC has no direct contractual relationship with GGT as a shipper.

(iv) Has received substantial historic and potential future benefits from the construction and sale of the GGP, as well as other commercial advantages and benefits, consideration of which should not ignore WMC's upstream and downstream interests.

(v) Has derived a tariff outcome which it has calculated using circular and inconsistent logic.

(vi) Has, in its submission to the Regulator, made a number of errors of fact, and misrepresented certain aspects of the State Agreement as discussed in this supplementary submission.

(vii) Stands to gain an uncompetitive advantage in its own downstream market which does nothing to further the objectives of the Code in promoting third party access for potential new entrants in the downstream market.