Submission being made to

The Office of Gas Access Regulation, Western Australia

Submission on the Proposed Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline, Draft Decision.

Submission by

The Australian Council for Infrastructure Development

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AusCID is the principal industry association representing the interests of companies and organisations owning, operating, building, financing, designing and otherwise providing advisory services to private investment in Australian public infrastructure.

The Council formed in 1992 and currently has 98members, drawn comprehensively from all economic infrastructure sectors including electricity generation, transmission and distribution, gas transmission and distribution, roads, rail, telecommunications, water, airports and ports. As a result of our membership base, AusCID is in a unique position to consider the views of infrastructure owners, equity investors and debt financiers and combine them with the views of infrastructure operators.

As a representative of investors in infrastructure assets, including major investors in pipelines in Western Australia, AusCID is concerned with the broader consequences of the Office of Gas Access Regulation's Draft Decision on the Dampier to Bunbury Pipeline, and also the long-term effects on investment that the decision may have.

AusCID believes that the issues that must be considered are:

- the balance between short-term benefits to consumers in the form of lower prices and long-term gains to the community from investment in infrastructure in terms of adequacy and security of supply as well as better and more reliable infrastructure

- community benefits already provided by privatised infrastructure through sale processes and cost reductions.

- the perception that there is no " upside" to any investment in regulated assets in Western Australia

- the perceived degree of regulatory risk in Western Australia

- long-term reluctance for private sector funding of new investment in infrastructure vital to the continued development of Western Australia

- the equity in regulators clawing back gains from investors after the Government has already benefited through the asset sales process

- consistency in the messages sent to investors from both governments and regulators

- investors the lack of confidence in commitments by governments

- consistency in regulatory decisions

- regulatory transparency and consistency between state and national regulators

In this submission, AusCID will not comment on the detail of the regulatory process, but will rather focus on the wider impacts of the results of that process. We believe that other parties are better equipped and closer to the regulatory process than ourselves and can offer a better assessment of that process. The value that we can provide OffGAR is in our relationship with investors and our understanding of the investment process and the long term impacts of investment.

These long-term issues are not specific to the DBNGP, or indeed to Western Australia. Investment in infrastructure is vital to the continued growth of the Western Australian and Australian economies.

Balance

AusCID believes it is vitally important for a regulator to be aware of, and to strike a balance between the short-term gains to consumers and the long-term issue of ensuring that the stock of infrastructure is maintained and expanded.

In the long term, the objectives of every community in Western Australia include adequate and secure delivery of essential services. These objectives can only be delivered through increased investment in infrastructure. The private sector cannot deliver these community objectives if the regulated prices they receive do not give them the incentive to do so. There is no benefit to consumers if unsustainable access prices do not ensure continued maintenance and investment in infrastructure.

During the sale process, Epic Energy committed to investing in expanding the pipeline, and has already spent $160 million, funded out of revenues from the pipeline. The reference tariff proposed by OffGAR leaves no incentive to invest in pipeline expansion by Epic, or indeed for anyone else to invest in pipeline assets in WA. The long-term losses to the economy and community in terms of foregone investment or higher returns necessary to attract investment will be far greater than any short-term gains through slightly lower access prices.

The Productivity Commission expressed this in their Position Paper as part of the current review of the National Access Regime:

> *Access regulation itself is not without costs. Paramount among these is the potential for it to deter investment in essential infrastructure. Any such impacts are a cause for concern. This is because the costs of failing to invest in essential infrastructure are likely to be larger than the costs of monopoly pricing of the services it provides. Hence, it is crucial that access regulation gives proper regard to incentives to invest.*[1]

The ACCC, in their May 1998 draft decision on Access to Victorian Gas Transmission Pipelines expressed a similar sentiment:

> *The key adverse consequence of too low a value [of WACC] is considered to be the possibility that the service provider will not have*

[1] Productivity Commission, *Review of the National Access Regime Position Paper*, March 2001, p XII

the incentive to invest in new capital when it is required with ensuing consequences for the integrity of the system and the plight of users seeking to expand their usage of gas. Such circumstances are unlikely to be compensated for by slightly lower tariffs for all users. By contrast, the consequences of a slightly high WACC are considered relatively minor.[2]

It is often easy to forget the benefits that consumers have already received from private investment in formerly publicly owned infrastructure. In the case of the DBNGP, costs to consumers have already fallen significantly, from $1.20 to $1. The role of the regulator should not be to squeeze as much as possible out of a regulated business. Rather, the goal of regulation should be to share gains, not to deliver all of them to consumers. A well run, efficient privately operated infrastructure asset will produce the gains, as has been demonstrated in the electricity, gas and telecommunications industries in Australia.

The government of Western Australia has been well served by its sale of the DBNGP, obtaining an excellent price for the asset, and having the opportunity to retire debt and increase funding to schools. Funds from sales of infrastructure assets across Australia have been used in similar ways, benefiting the community significantly.

Private sector funding of investment in infrastructure is vital to the continued development of Western Australia and particularly its aspirations for a greater degree of downstream value added processing of resources. Given these aims, WA can not afford for two arms of Government to be giving contrary and conflicting signals to existing and new investors.

Double Jeopardy

Investors are also concerned with the fact that it is exceedingly difficult under the current regulatory framework, both in WA and in other jurisdictions, to see an upside to investing in a regulated asset. If an investment in an asset is unsuccessful, there will be no applications for access, and the investor will lose money on an unprofitable investment. If the investment is successful, the investor cannot reap the full reward for the risk taken due to regulatory capture of investment returns.

AusCID is concerned that after asset sales have been completed, regulators are attempting to claw back any gains that investors have made. Investors are effectively being asked to pay twice for their assets, once upfront and then again through forced reductions in tariffs and access decisions.

The equity in this process deserves to be questioned, particularly when investors have bought these assets in good faith, and provided benefits to the community. A significant proportion of the funding for these investments comes from the superannuation savings of individuals. It is these small investors that are in danger

[2] ACCC, *Draft Decision, Access Arrangements by Transmission Pipelines Australia and Victorian Energy Networks Corporation*, May 1998, p 65

of having their retirement funds reduced because of short-sighted regulatory decisions.

Political Risk

Regulatory decisions can not be made in a vacuum. They affect not just a particular pipeline or other infrastructure, but also help form expectations and influence operational decisions by other firms. As such regulatory decisions should have regard for the impacts that a regulatory decision may have, both to the immediate market and to wider, long-term actions by businesses and consumers.

The degree of regulatory risk perceived in a jurisdiction is one of the key drivers of decision making in regulated businesses. We do not argue that regulatory decisions should seek to protect excessive returns to investors. Rather, an investor in a regulated asset is entitled to expect some consistency in regulatory decisions, and to receive a reasonable return on investment, considering the level of risk faced by the investor. The message that is communicated to investors is that Epic may not recover its initial investment after having an understanding on tariffs at the time of investment.

The level of risk faced by investors in infrastructure is often misunderstood by regulators. The return on an infrastructure project cannot be compared to stock market returns, as the level of risk faced, both through market and sovereign risk is much greater. Therefore, a greater return is needed to encourage investors to take that risk and invest. In a world of global capital flows, investments that do not have an attractive weighting of risk to return can be easily ignored in favour of the multitude of other opportunities that offer more attractive terms.

Consistency

In its initial purchase of the pipeline, Epic took on board significant risk, believing it could maximise pipeline usage and revenue, based upon an expected set of tariffs. The purchase price agreed upon between Epic and the WA Government was, as AusCID understands, a direct result of this expected set of tariffs, encouraged by the Government of the day.

The "regulatory compact" between the Government and Epic is particularly important for two reasons. Firstly, without some understanding on the expected level of tariffs, the WA government could not have maximised the sale price of the pipeline. As regulatory practice and decision making has a huge effect on the profitability of regulated assets, there is great incentive for a government to represent expected regulated returns at a higher level, to maximise sale price.

Secondly, the compact included an understanding on both the tariff to be charged and the commitment of extra investment in the pipeline on the part of Epic. This shows that the WA Government was aware of both the importance of future investment in the pipeline, and the importance of the linkage between the tariff charged and the investment going ahead.

If investors do not trust the representations of government on expected returns due to the experience of previous asset sales of regulated businesses, it would be prudent for investors to take a very conservative view of revenues. This would significantly reduce future sale prices, even if the government gave accurate representations of regulated pricing.

Regulatory Transparency

OffGAR should be congratulated on the way that they have conducted the process of making this draft access decision. Openness and transparency in regulatory decision making breeds confidence not only in the regulator but in the wider economy as well. Transparency should be matched with consistency to form best practice regulation. We encourage OffGAR to be consistent not only in regard to its own decisions but also consistent in its processes and decision making with other national and State regulators.

The factors outlined in this submission combine to make investment in regulated assets increasingly unattractive in Australia. An investment characterised by a high degree of regulatory risk with a limited upside and an unlimited downside will not attract private sector capital. Given that these assets are regulated because of their importance to the Western Australian economy and the amenity that they provide the community, a short-term, limited view of regulatory decision making will hinder the process that regulation was designed to achieve.

We urge the Office to consider the long-term benefits that investment in infrastructure, particularly gas infrastructure has to Western Australia. The lowering of the Reference Tariff will have a significant impact on investment by Epic directly and by other investors indirectly. Given the significant falls in transmission prices for the DBNGP already, we believe that a more reasonable pricing arrangement would guarantee growth, a reliable supply of gas and a better gas pipeline network for many years to come.