GGT

GOLDFIELDS GAS TRANSMISSION

GOLDFIELDS GAS PIPELINE

RESPONSE TO AMENDED DRAFT DECISION

Submitted to the

Economic Regulation Authority

8 October 2004

Executive Summary

This submission is made by Goldfields Gas Transmission Joint Venture (GGT) in response to the Amended Draft Decision (ADD) issued by the Economic Regulatory Authority (ERA) on 29 July 2004 concerning the proposed Access Arrangement for the Goldfields Gas Pipeline (GGP).

GGT accepts the majority of the amendments proposed in the ADD in respect to non-tariff matters. However, the amendments proposed in the ADD in relation to value of the Initial Capital Base, rate of return and non-capital costs are not accepted by GGT.

The major matters addressed in this submission are as follows:

A. Initial Capital Base

Error in calculation of economic value

GGT considers that the ADD is correct in adopting the concept of economic depreciation as a major indicator of value of the pipeline. This is consistent with economic theory, the legitimate business interests of all parties, and regulatory precedent. Additionally, it gives proper weight to the provisions of the State Agreement which assured the developers of the GGP the recovery of the capital invested in the pipeline. In its December 2002 submission, GGT calculated an economic value for the pipeline of $568.4 million ($1999). However, the ADD proposes an economic value of $495 million ($1999). The proposed calculation in the ADD understates the economic value of the pipeline and needs to be corrected.

The major difference between the ERA value and the GGT value is the question of what rate of return is to be applied to determine recovery or under-recovery during the period prior to commencement of Code. The ADD proposes that the economic value of the pipeline should be determined on a basis that disregards the legislative regime which applied during the relevant period. This is conceptually incorrect. Additionally, to the extent that calculation of the economic value by the Authority involves an exercise of discretion, it is an unreasonable exercise of that discretion.

When the economic value is properly calculated, and omissions in the December 2002 calculation are corrected, the economic value of the pipeline in December 1999 is no less than $565 million using the ADD model. It is GGT's submission that the Initial Capital Base of the pipeline should be set at no less than this amount as to do otherwise amounts to a deprival of value and fails to achieve a number of the objectives and requirements of the Code, including sections 2.24 and 8.1.

ORC and DORC value

The Optimised Replacement Cost (ORC) of $432 million ($1999) proposed in the ADD is incorrect and understates the ORC value of the pipeline. The correct value for ORC in 1999 is at least $550 million ($1999). In 2004, that value is approximately $710 million ($2004)[1]. Accordingly, the assessments or conclusions which rely on an ORC value of $432 million are incorrect and need to be undertaken on the basis of the correct value for ORC.

On the basis of a 42 year life, then the DORC is at least $510 million. It is relevant to consider that if a seventy year life were adopted, the DORC for the GGP is approximately $525 million ($1999). If the 2004 value for ORC is adopted, then the range of DORC is approximately $570 million to $625 million.

In relation to the calculation of an NPV-based DORC, the ADD makes no effort to calculate such a value. This approach is incorrect and unreasonable. It is possible to identify a feasible range of values for the pipeline using the NPV methodology. Initial modelling suggests values of approximately $540 million ($1999) and $680 million ($2004).

Capital costs for a replacement pipeline

The estimated replacement cost of the pipeline is in excess of $710 million ($2004). The ADD does not include any consideration of the comparability of GGT's proposed tariffs for the existing GGP and those which would be payable were the pipeline built today.

Taking the other elements in the ADD, including rate of return, but setting the Initial Capital Base at this amount in 2004, tariffs payable by customers would be significantly higher than would apply under GGT's proposed Access Arrangement. The capital costs of a new pipeline and the tariffs which would be payable under the Code if the pipeline were built today must be taken into account in the further assessment of the proposed Access Arrangement.

Expectations under prior regime, purchase price

The proposed treatment of these considerations under the ADD is incorrect.

In particular, there must be proper weight given to the fact that under the regime applying prior to the Code, the owners expected the continuation of the Tariff Setting Principles revenues and returns, and users would generally have expected to continue to pay charges consistent with those revenues and returns.

Similarly, the prices paid for the acquisition of the pipeline must be given significant weight. The ADD incorrectly gives little weight to these two matters.

Taken together, the proper consideration of those expectations and the purchase price indicate a value for the Initial Capital Base significantly higher than that proposed in the ADD.

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[1] Including Paraburdoo and Wiluna compressor stations which have been added since 1999.

Depreciated Actual Cost

In relation to the determination of the depreciated actual cost under section 8.10(a), the ADD proposes to deduct an amount for depreciation charged to users prior to the commencement of the Code. The ADD proposes that this establishes a DAC of $434 million. As the economic value proposed in the ADD demonstrates, even using a lower rate of return than that applying at the time,, there was little or no depreciation charged to users prior to commencement of the Code. Accordingly, the DAC is the actual capital cost of the pipeline, being $456 million plus interest during construction, totalling $507 million ($1996).

If adjusted for movements in the CPI, this value is $523 million ($1999).

Conclusion: Proper value for Initial Capital Base

Based on the values in the ADD, and particularly an economic value of $495 million, the ADD proposes an Initial Capital Base of $480 million. When the matters described in this submission are addressed, the Initial Capital Base must be at least $565 million being the economic value of the pipeline determined adopting the ADD model, and could reasonably be established at a value of up to $680 million.

B. Rate of return

GGT does not agree with the proposed rate of return under the ADD. When proper weight is given to the various factors affecting determination of the rate of return, the rate proposed in the ADD does not meet the requirements of the Code.

C. Non-capital costs

In relation to non-capital costs, GGT will provide information to the ERA to support the costs included in the proposed Access Arrangement.

GGT has also identified that the costs in the proposed Access Arrangement do not fully reflect the costs of provision of the Services. In particular, the proposed non-capital costs fail to reflect the ownership or corporate costs of the pipeline owners. Those costs are reasonably estimated at approximately $1,600,000 per annum ($2004).

D. Resubmission of Proposed AA

Pursuant to section 2.15A of the Code, GGT intends to submit a revised proposed Access Arrangement that will address the amendments proposed in the ADD. This revised Access Arrangement will reflect GGT's position on the various matters raised in this response, including incorporation of the amendments accepted by GGT.

This is also regarded as appropriate due to the time elapsed since the submission of the original proposed Access Arrangement in November 1999, the resubmission of substantive portions of the Access Arrangement in December 2002 in response to the Draft Decision and the *Epic* case[2].

[2] *Re Dr Ken Michael; Ex Parte Epic Energy (WA) Nominees Pty Ltd & Anor* (2002) 25 WAR 511

Discussion of Key Matters

A. Initial Capital Base

1. Incorrect range of values considered under section 8.11

GGT considers that the ERA has not properly applied section 8.11 in the reasoning expressed in the ADD. This arises from the adoption of incorrect values for the DAC and the DORC of the pipeline.

In particular, when DAC and DORC are correctly calculated, it is incorrect to consider that the economic value of the pipeline is significantly above the range of values between DAC and DORC and that there is any reason why the Initial Capital Base should not be set at a value at least equal to the economic value of the pipeline. If the NPV DORC is calculated for the pipeline as discussed below, the proposed capital base is within the range contemplated by section 8.11.

When these values are corrected as discussed below, it is clear that the range for the purposes of section 8.11 is $507 million ($1996) (being the actual capital cost of the pipeline) and $525 million (value for straightline DORC). If an asset life of 42 years is assumed, then the straight line DORC value is $510 million. If NPV DORC is taken into account, the range is $507 million to at least $680 million.

2. Depreciated Actual Cost

GGT submits that the ADD is incorrect in its proposed interpretation of section 8.10(a).

The section requires that

- from the actual *capital* cost of the pipeline
- is *subtracted*
- the amount of depreciation charged (or thought to be charged) to users prior to the commencement of the Code.

GGT recognises there have been a range of values and approaches in relation to section 8.10(a) during the review of the proposed Access Arrangement. However, when consideration is given to the actual language of section 8.10(a), and when the provisions of section 8.10(f) are also recognised, the interpretation of section 8.10(a) is straightforward.

Firstly, the actual *capital* cost is to be identified. It is incorrect to limit this value to the actual *construction* cost – there is nothing in section 8.10(a) or elsewhere in the Code that requires such a limited interpretation. For the GGP, the actual capital cost is $507 million ($1996) or $523 million ($1999).

Secondly, the section refers to subtraction – not *recognition* or *adjustment.* It is GGT's submission that section 8.10(a) does not refer to an economic depreciated cost where over or under-recoveries of capital are subtracted/added to the asset value. Where there has been recovery of capital, that amount is to be subtracted. Where there has been no recovery, or an under-recovery of capital, there is no adjustment to the actual capital cost.

Thirdly, it is necessary to identify the depreciation charged or thought to be charged to users. However, in the case of the GGP, even the conservative economic value proposed in the ADD ($495 million) demonstrates that there has been virtually no recovery of capital. When the proper costs of the pipeline over its life are recognised, it is clear that users were not charged depreciation prior to the commencement of the Code.

GGT also notes that section 8.10(f) expressly requires consideration of the basis on which tariffs were set in the past and the economic depreciation of the pipeline. This is inconsistent with an interpretation of section 8.10(a) which treats an economic value as a “DAC”.

GGT's understanding of the reasoning as set out in the ADD is that a Code-based method for determining "look forward" rates of return has been applied on a backward-looking basis to arrive at the value of $434 million. Even if section 8.10(a) does permit some sort of “economic depreciated value” to be calculated, the approach to determining the rate of return to be used to calculate this amount under section 8.10(a) is erroneous.

Further, even if the approach taken in the ADD were a correct calculation of DAC, it would have to be adjusted for the actual revenues earned from gas transportation, and not the notional revenues used in the reporting required by the State Agreement. It would also have to be corrected for the full costs of ownership and operation of the pipeline. Allowing for the need for these adjustments, the “DAC” proposed in the ADD is incorrect and understated.

GGT submits that the value to be taken into account under section 8.10(a) is $507 million ($1996) or $523 million ($1999).

3. Economic value under section 8.10(f) – proper rate of return to be applied

The ADD accepts that the use of a past capital recovery methodology for determining the ICB is consistent with the Code. However, the ADD has applied two different sets of assumptions in its application of that methodology, arriving at two possible values. One of these values, $434 million, is referred to as the DAC. The error in this valuation is discussed above and is not addressed further in this section. The other value of $495 million is suggested in the ADD to be the value established recognising the factors of section 8.10(f) of the Code.

To calculate the economic value of the pipeline, the ADD proposes the use of a Code-based method for determining "look forward" rates of return to be applied on a backward-looking basis. However, this is incorrect and as a result understates the economic value of the pipeline.

The ADD effectively proposes to apply a rate of return derived under the Code principles to a period prior to the existence of the Code. As well as ignoring the best evidence of the relevant rate of return as discussed below, this approach is without proper foundation and amounts to retrospective legislation.

The ADD states in paragraph 162 that:

> *'… calculation of historical capital recovery with reference to a rate of return that is in excess of the cost of capital for the pipeline business would result in an asset valuation that does not reflect efficient costs of providing the pipeline Services.'*

This represents an error in the calculation of the economic value as it fails to take into account the permitted rate of return which actually applied to tariffs for the pipeline during that period.

The rate of return under the Tariff Setting Principles arose from the State Agreement negotiations and was established as being a rate of return reflective of the risks of developing the GGP – including the risks of constructing surplus capacity, and of accepting an obligation to invest in expansion. The rate of return applicable under the State Agreement is the best evidence of the level of risks which were involved in delivering the Services and is the only legitimate approach to the determination of the “efficient costs” of providing Services for the GGP. The negotiations with the State, and the competitive context in which they were determined, provide direct evidence of how the risks of the project were perceived at the time – as well as a real world view of the opportunity cost of capital for this investment. This value eliminates the need to arrive at a second-best value through the retrospective calculation of the rate of return.

GGT also submits that the statements in paragraphs 158 and 159 of the ADD, that the rate of return GGT embodied the Tariff Setting Principles was ”substantially in excess of a commercial rate of return”, are not correct.

In paragraph 179 the ADD recognises that benefits gained by GGT through the charging of tariffs under the State Agreement should not be taken away for reasons relating to the avoidance of sovereign risk, or the perception of sovereign risk by other parties. However the use of a lower rate of return to determine past economic depreciation, of itself, does take away any such benefits. It creates the very sovereign risk which the ADD recognises is to be avoided. For this reason, if nothing else, the rates of return used to derive the proposed economic value of $495 million are incorrect and unreasonable.

For the purpose of determining the past capital recovery in the period prior to the commencement of the Code, the only rate of return to be applied is the rate used in applying the Tariff Setting Principles. In these circumstances, the value of $568.4 million proposed by GGT is the minimum economic value under section 8.10(f); even if the other assumptions and inputs in the ADD model are adopted, and that model is adjusted simply to reflect the rate of return endorsed by the State, the economic value is at least $540 million.

4. Economic value – if approved rate of return not to be used

If the ERA is not persuaded that it must use the rate of return established at the time of construction, GGT submits that the only matters for which ERA could retrospectively adjust that rate of return are for parameters which can be objectively identified as having changed – that is, CPI, risk free rate, and corporate tax rate.

In this submission, this is referred to as the "adjusted rate of return".

If the adjusted rate of return were to be adopted to calculate the economic depreciation, even using the ADD model and its inputs and assumptions, the proposed economic value would increase from $495 million to approximately $515 million.

5. Economic value – use of correct revenues and costs

GGT has previously provided the ERA with the notional revenue for the GGP from the date the pipeline was first used for the transportation of gas. This revenue was used by GGT in the calculation of economic depreciation in its December 2002 submission. The term notional revenue has a particular meaning in the context of the State Agreement – most importantly, it is not representative of the revenue actually earned.

The revenue actually earned by GGT is lower than the notional revenue used in the calculation of the economic value by GGT and the ERA. For the purpose of correctly calculating the economic depreciation, it is necessary to either use actual revenues paid by users or a best estimate where there is no evidence of amounts actually paid.

Additionally, the calculation of the economic depreciation needs to reflect the proper costs of ownership and operation of the pipeline. It appears that in the December 2002 model and thus in the ADD model, there has been no or insufficient allowance for corporate and other "ownership" costs.

If the model underpinning the ADD is adopted, and is corrected for actual revenue and full costs, the value of $540 million discussed above[3] increases to at least $565 million. The value calculated using GGT's December 2002 model can also be expected to similarly increase when actual revenues and costs are recognised.

6. Optimised Replacement Cost

GGT originally proposed an ORC value of approximately $506.7 million ($1999). This was calculated through adjusting the original construction cost for inflation, including an allowance for interest during construction and reflecting foreign exchange variations.

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[3] Economic value under section 8.10(f) – proper rate of return to be applied

GGT submits that the value of ORC proposed in the ADD ($432 million, $1999) should not be relied upon by the ERA. Firstly, this estimate is based on an incorrect premise as it apparently fails to recognise the legislative constraints that applied to the design of the pipeline and effectively relies on a re-design of the pipeline. Secondly, it is unclear whether the value includes an allowance for interest during construction – if this allowance is omitted, then the value of $432 million is significantly understated. If an allowance is in fact included, then there needs to be some explanation as to why the ORC proposed in the ADD is significantly lower than experience indicates would be the full capital cost of construction of a similar pipeline.

GGT has recently commissioned an update of the actual construction cost to provide a more accurate indication of the ORC in 1999. On the basis that the actual design of the pipeline was optimised given the legislative constraints which applied, this indicates an ORC value in excess of $550 million ($1999). However, there has been significant change in the underlying costs of pipeline construction since that time – this must be taken into account in establishing the value of the Initial Capital Base. If the pipeline were to be built today, an ORC in excess of $710 million ($2004) would be expected.

7. Depreciated Optimised Replacement Cost – straight line

As described above, the DORC value in the ADD is based on an understated ORC value.

When this is corrected, taking an ORC value of $550 million ($1999) gives a DORC value in 1999 of between $510 million (using 42 year asset life) and $525 million (using 70 year asset life).

GGT notes that if the Initial Capital Base were to be set in 2004, rather than in 1999 as proposed, the DORC value for the pipeline would range between $570 million and $625 million($2004)[4].

Accordingly, the DORC value of $407 million proposed in the ADD significantly and incorrectly understates the DORC value of the GGP.

[4] Note, this value includes the cost of Wiluna and Parraburdoo compressor stations. Additionally, it may be that the period for calculation of a DORC should commence from completion of construction, not from commencement of construction. On this approach, for the GGP, the period of depreciation would commence in 1996 rather than some three years earlier. Such an approach is consistent with numerous other regulatory decisions and also with accounting standards where depreciation of an asset does not occur until the asset is commissioned. These values have been calculated on this approach, rather than from the date of commencement of construction.

8. NPV DORC

GGT submits that the ERA is obliged to take into account, and to act consistently with, the decision of the Australian Competition Tribunal (Tribunal) in the Moomba Sydney Pipeline case (*MSP case*)[5], including the obligation on a regulator under the Code to make a proper effort to derive an NPV DORC value for the pipeline[6].

The reasons given in Attachment A to the ADD deal primarily with the question of whether the ERA is bound, legally, by the findings of the Tribunal. However, even if not legally binding, the decision of the Tribunal must be highly influential in consideration of the Initial Capital Base. It is GGT's view that where there is no difference between the findings of the Tribunal and the Supreme Court in the *Epic case*, ERA should observe the Tribunal's findings. The only basis on which ERA could properly not recognise the Tribunal's decision would be where there is a clear distinction between the circumstances of the MSP and the GGP. In GGT's view, there is nothing in the case of the GGP to make the findings and observations of the Tribunal irrelevant.

Further, GGT notes that the concept of NPV DORC was not argued before the Supreme Court in the Epic decision. It cannot therefore be the case that there is inconsistent reasoning between the Supreme Court and the Tribunal on the issue of whether or not the ERA is obliged to take account of the NPV DORC value in establishing the Initial Capital Base for a regulated pipeline. Attachment A therefore does not provide compelling reasons why a regulator under the Code, in any jurisdiction, does not have to take account of NPV DORC. There is no basis to form the view that NPV DORC is not relevant in the application in WA of the Code. There is no basis to read down the Tribunal's decision in this way and to do so would be erroneous.

GGT is aware that an appeal has been lodged against the decision of the Tribunal in the *MSP case*. Regardless of the eventual findings of the Federal Court, however, given the current state of knowledge and information regarding the proper interpretation of DORC under the Code, GGT submits that it would be an incorrect exercise of discretion under section 8.10 for a regulator to fail to take into account a value, or range of values, for NPV DORC.

GGT has not completed its assessment of the range of NPV-based DORC values for the GGP. However, the current assessment indicate values of approximately $540 million ($1999) to $680 million ($2004).

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[5] Application by East Australian Pipeline Limited [2004] ACompT 8

[6] Even if the ERA were to form the view that it is not required to take an NPV DORC value into account under section 8.10(b), GGT notes that such a valuation could, and should, be considered under section 8.10(k).

9. Depreciated replacement cost

A depreciated replacement cost ("DRC") of $425 million is reported in paragraph 182 of the ADD. This DRC is based on an estimated replacement cost which does not include an appropriate amount for interest during construction. Accordingly, this DRC is understated and it must be corrected.

10. Cost of new asset and comparable tariffs – section 8.10(i)

The estimated replacement cost of the pipeline today is approximately $710 million ($2004). If the pipeline were built today, then under section 8.12 this would be the Initial Capital Base and users would pay tariffs set on this basis.

If the current assumptions used in the ADD are taken for current and forecast demand, together with the proposed rate of return in the ADD, then the tariff which would apply today would be approximately 50% higher than that proposed in the ADD. While the ADD proposes a tariff 18% lower than the A4 tariff, this "new pipeline" tariff would be approximately 28% higher than the A4 tariff and also higher than the A1 tariff established prior to commencement of the Code.

11. Expectations Arising From under the Previous Regulatory Regime – section 8.10(g)

As GGT has previously submitted, its expectations were established under detailed proposals, all elements of which were subject to detailed negotiations with the State and approved by the Minister. It is also reasonable to assume that the expectations of users were similar, given the nature of the regulatory regime which applied prior to commencement of the Code.

GGT's expectations at the time could be described as follows:

- a uniform national code would apply at some time in the future, to the extent that it did not conflict with the existing provisions of the State Agreement;
- the form of regulation under the Code would be substantially based on the regulatory proposals outlined in the Hilmer Report, and therefore, consistent with the State Agreement;
- economic regulation under the Code would be "light handed";
- Regulators would not set tariffs, but rather act as umpires in access disputes;
- the State Government would honour its obligations, including those under the State Agreement;
- the owners of the GGP would be entitled to recover all expenditure incurred in constructing and operating the GGP, together with a rate of

return established at the time of committing to construction of the pipeline;

- the tariffs determined as part of the final project approval process were payable by users and the fundamental parameters underlying the tariff model would continue to apply over the life of the pipeline;

- economic regulation of the GGP would take into account the tender process and the State Agreement, and would not materially adversely affect GGT's legitimate business interests.

GGT believes that the proposed approach in the ADD is erroneous in that it does not properly take into account these expectations. In particular, the ADD appears not to take account of the important consideration that the tariff setting methodology, Rate of Return and specific tariffs were included in the detailed proposals approved by the Minister under the State Agreement. By confining its consideration to the Tariff Setting Principles – and in attempting to make its own interpretation of the out-workings of these Principles – the ERA has failed to properly take into account detailed evidence of what the pipeline developers and the State specifically agreed in terms of parameter values, Rate of Return etc. This has resulted in an erroneous conclusion being reached in the ADD.

In paragraph 178 the ADD acknowledges that:

> *'..The manner of administration of the State Agreement by the Western Australian Government allowed these tariffs to become entrenched under the Tariff Setting Principles and may have created an expectation that the high rate of return would continue.'*

GGT submits that there is no basis on which the ERA can determine that this manner of administration did not, in fact, give rise to those expectations. There is also no basis to determine that it was not reasonable for the owners to hold such expectations. The evidence is in the approved proposals which embodied the tariff methodology, the Rate of Return and the resulting tariffs. Supporting evidence is also found in the values paid for the assets prior to commencement of the Code.

In paragraph 180 the ADD states that:

> *'… there was no derogation under this agreement providing for the exclusion of the GGP from regulation under the Code, and the current owners of the GGP would or should have been aware of this'.*

Notwithstanding the acknowledgment in the State Agreement about the possible introduction of uniform laws, prior to the introduction of the Code there was no reason for the GGTJV to expect that such laws might deliver different outcomes from those negotiated with the State to underpin the investment. The issue under section 8.10(g) is what the expectations were prior to the commencement of the Code – this can only be assessed in the light of knowledge and behaviour of parties at the time.

While it has now been determined that section 21(3) does not operate in the manner in which it was expected to operate, the statement in paragraph 180 is not a correct representation of the State Agreement. The original owners appear to have believed that Clause 21(3) provided protection from the introduction of "uniform laws", and they made representations to the State to ensure that the protection intended by Clause 21(3) carried through under the Code. This ultimately resulted in the State enacting section 97(4) of the *Gas Pipelines Access Act* in an apparent attempt to effect such a derogation. To now purport to determine the expectations of parties in 1999 having regard to a subsequent court decision[7] is incorrect and unreasonable.

It is also important to consider that a significant indication of the expectations of the new GGP owners prior to the introduction of the Code was the price that they paid to purchase their respective interests. Even if this is not taken into account under section 8.10(g), then this must be taken into account under section 8.10(j), as discussed below.

12. Price paid for assets – section 8.10(j)

The ADD in paragraph 132 expresses the view that a purchase price "may not reflect reasonable commercial judgement", but does not present any evidence that this was the case for the GGP acquisitions. The fact is that AGL/APT, CMS Energy and Transalta – three major energy infrastructure companies – conducted due diligence reviews prior to making an investment decision. The price arrived at represented the commercial judgement of all three on the "business" value of GGP at the time – and therefore their reasonable expectations at the time of purchase. It is also important to recognise that the interests in the pipeline were acquired in 1998 and 1999 through competitive tender processes.

The circumstances surrounding the purchase of the GGP in 1998 - 99 are consistent with those applying to the sale of the DBNGP. Both were "recent" transactions. Both were arms' length transactions by competitive tender. Consequently, the findings of the Epic Decision are relevant to the GGP. These findings include the direction that the regulator must give weight to the value of the sale price in its determination of Initial Capital Base.

13. Conclusion on proper value for ICB

In the ADD, after considering the range of values discussed in the ADD, the ERA proposes that the ICB for the GGP should be $480 million. The ERA's findings in respect of each of these values, and therefore its proposed value for the ICB, are incorrect or unreasonable. When the matters described in this submission are addressed, the correct values must be higher than the value of $480 million proposed in the ADD.

GGT submits that the Initial Capital Base must be at least $565 million (being the ADD modelled economic value corrected for actual revenue, rate of return and proper

[7] *Re Michael; Ex parte WMC Resources Limited* (2003) (27 WAR 574).

costs). Economics and competitive considerations suggest that a value of up to $680 million would be a proper result of the exercise of the regulator's discretion in setting the Initial Capital Base as it would effectively result in users paying tariffs no higher than those payable in a competitive market.

B. Rate of Return

1. Approach to Determination of Rate of Return

GGT believes that the ADD may demonstrate an error of law in the approach taken to the determination of the rate of return. In particular, it appears from the ADD that the decision of the Australian Competition Tribunal in the *GasNet case*[8] has not been observed.

GGT has addressed this matter separately through a letter to the ERA from its legal advisers dated 7 October 2004.

2. Rate of Return – general

GGT does not agree with the proposed rate of return under the ADD. When proper weight is given to the factors affecting determination of the rate of return for the pipeline, the proposed rate of return does not meet the requirements of the Code.

The role of the rate of return in the calculation of economic depreciation has been considered in the previous section of this response to the ADD. In this section, GGT examines the issue of the rate of return to be applied in the determination of Reference Tariffs.

3. Rate of Return Expectations Arising under the GGP State Agreement

GGT believes that in its approach to determining what it regards as an appropriate Rate of Return for the GGP investment, the ERA has not given sufficient regard to the requirements of section 8.30 of the Code to have regard for “the risk involved in delivering the Reference Service”, or the requirement of section 2.24(a) to take into account “the legitimate business interests and investment in the Covered Pipeline.”

In paragraph 257 the ADD interprets section 8.30 of the Code:

> *'… to require that the implied return factored into the assessment of the price controls for a pipeline owner’s regulated activities reflects the opportunity cost of capital associated with those activities, that is, the returns that the pipeline owners would have to make to providers of debt and equity funds to motivate the provision of funds.'*

For a long lived capital intensive asset such as a pipeline, opportunity cost can only be properly measured when the investment decision is being evaluated. Once committed, the investment is sunk and cannot be retrieved. The developers of the GGP participated in a competitive process run by the State Government and successfully argued for a specific rate of return as representing the true opportunity

[8] *Application by GasNet Australia (Operations) Pty Ltd* [2003] ACompT 6

cost of capital relevant to the development of the GGP. The Minister endorsed this rate of return prior to the decision to proceed with construction – and this served as a basis for the investment.

In paragraph 258 the ADD concludes that "section 8.2(e) of the Code requires the Rate of Return to reflect the best estimate of the true cost of capital". GGT believes that the most realistic estimate of the true cost of capital for the GGP is that incorporated in the original proposals and endorsed by the Minister.

In paragraph 259 the ADD proposes that because the Code requires that the rate of return to be the "best estimate of the cost of capital for the GGP business":

> *'The Rate of Return used in historical determinations of third party tariffs under the State Agreement (or submitted by GGT) could only be relevant for the purposes of the Code if those historical determinations provide useful evidence in calculating the forward looking cost of capital for the Access Arrangement Period.'*

GGT contends that the original tariff setting methodology and the agreed economic parameters (including rate of return) are clearly relevant to the calculation of a forward looking cost of capital.

In paragraph 284, the ADD asserts that:

> *'GGT has not presented any evidence to suggest that a relatively high volatility in returns for mining companies is reflected in the demand for energy and thus the revenues and profits of a gas transmission pipeline servicing the mining companies…'*

GGT notes the following ventures highlight the significant risks faced by pipelines servicing remote mining and processing ventures in Western Australia:[9]

- PEPL
- Windimurra/Mid-West Pipeline (X-Strata)
- Telfer Pipeline
- Murrin Murrin Project
- Cawse Nickel
- Bulong Nickel
- Kambalda Nickel Mines.

It is GGT's view that the above risks were properly acknowledged in the negotiations with the State which resulted in an agreed tariff methodology and Rate of Return.

In paragraph 286, the ADD asserts that GGT's submission that it is entitled to a return that reflects the unique risk of the GGP business as well as market risk:

[9] Details of these ventures are contained in the attachment to this submission.

> *'... is contrary to the core assumptions of the CAPM model, which provides only for non-specific or non-diversifiable risks to be taken into account. The historical use of the CAPM for estimating a rate of return for the GGP would suggest that the financial advisers to GGT and the owners of the GGT recognised that unique risks of the GGP business should not be taken into account in determining the Rate of Return for the purpose of calculating regulated tariffs.'*

In presenting this view, the ADD takes an extremely theoretical, as opposed to a practical, view of the application of CAPM, and ignores the whole tariff determination framework enshrined in the State Agreement proposals – which were subject to independent review by **[*CONFIDENTIAL*]** before being approved by the Minister. Tariff Setting Principle 2 in particular states that "Tariffs will be set to provide a commercial rate of return … commensurate with the business risk associated with the project". This makes it clear that as far as the GGP investment was concerned, project specific risks were indeed to be taken into account.

The evidence supplied to the ERA indicates that recognition of specific risks relating to the GGP were accommodated in both the manner of the application of the CAPM methodology in the original Clause 9 Proposals, as well as in the assumptions relating to the demand forecast underpinning the original determination of GGP tariffs.

Accordingly, GGT believes that the ERA has under estimated the unique risks associated with the GGP. These include the following:

- the GGP was developed as a single investment by a group of mining and processing companies which could not therefore offset systematic risks through other pipeline investment (or even if undertaken, not on such a scale as to effectively offset that risk in the manner contemplated in the theory);
- the State imposed additional risks by requiring 50% surplus capacity and a commitment to invest in expansion. None of the surplus capacity was committed when the development decision was made;
- the original tariff calculations employed a forecast of demand which was constrained to contracted volumes only;
- as indicated above, the projects and industries being supplied by the GGP are inherently risky. The DBNGP, while providing services to some mineral processing industries does not face the same uncertainties with respect to process technology, reserve life and commodity price cycle, as the GGP.

In paragraph 293 the ADD states:

> *'... the major Western Australian gas transmission pipelines may be exposed to a greater level of systematic risk than transmission pipelines and distribution systems of the eastern states of Australia… as they … are predominantly markets for supply of gas to mining and mineral processing activities.'*

GGT submits that while this certainly is relevant to the GGP, the risk profile for the GGP is fundamentally different from most if not all other Western Australian pipelines and particularly the DBNGP for a number of reasons:

- the alumina industry which consumes in the order of half the total DBNGP gas throughput is based on very large, long-term reserves and a technology which is well proven;
- the second largest consumer of DBNGP gas is power generation for supply to the SWIS grid for domestic and industrial purposes. Electricity demands – of which small consumers comprise approximately 50% of the market – is subject to steady growth and stable prices;
- large industrial consumers include industries such as oil refining, fertiliser manufacture, industrial minerals processing, nickel refining, brick and tile manufacturing etc. Each of these industries makes a relatively small contribution to total demand, most have well proven technology and stable markets, and none are likely to be impacted in the foreseeable future by a limitations in resource life;
- domestic and commercial demand from the large south west population provides a secure and growing market for gas transportation services.

By contrast, the GGP relies on a small number of large projects – most with significant reserve limitations or technical uncertainties. The two main commodities it supports – gold and nickel – have demonstrably volatile price histories. Further the GGP does not have any significant alternative domestic or commercial market, whether for gas itself or for electricity generated from gas.

In paragraph 312 the ADD asserts that GGT's submission of 17 December 2002 to the effect that 50% gearing was a fundamental element of the original arrangement with the State:

> *'... is not supported by any information available to the Authority and moreover that … the Authority does not consider any precedent on the Rate of Return under the State Agreement to be necessarily relevant to determination of the Rate of Return under the Code.'*

As commented above GGT, believes that this view ignores the basis of the original arrangement with the State, as set out in the approved proposals. It also appears to ignore the requirements of sections 8.30 and 2.24(a) of the Code, the flexibility offered by section 8.31, and the objectives set out in section 8.1 of the Code.

4. How has the ERA approached the estimation of the cost of capital?

There are four distinguishing features of the ADD's proposed approach to estimating the cost of capital:

(1) it has adopted point estimates rather than ranges for each value of the WACC;

(2) it has relied heavily on regulatory precedent under the Code in the estimation of particular parameters to the exclusion of values established prior to, or otherwise outside the Code but relevant to the purposes for which the considerations have been undertaken;

(3) it has dismissed the WACC established at the time the investment was committed to, despite evidence that this WACC was determined on the expectation that it would apply on a "whole of life" basis; and

(4) it has not given any weight to those fundamental components of WACC that were established at the time that the commitment to invest in the pipeline was made.

In paragraph 258 of the ADD, the ERA accepts there exists statistical uncertainty over many of the parameters of the WACC but concludes that considering the ranges associated with particular parameters in building up the WACC represents a "meaningless process".[10] Therefore, the ERA makes point estimates for each component of the WACC, which are then aggregated into a real pre-tax WACC of 8.00%.

Given that point estimates were determined as part of a process to estimate the "true" WACC, it would be expected that the ERA demonstrates that each of the parameter values chosen is clearly and demonstrably the "best" estimate for that parameter given the "statistical uncertainty" over the parameters. However, this seems not to be the approach that the ERA has taken. Ultimately in reaching its decision it has relied heavily on regulatory precedent under the Code in setting key parameter values. While regulatory precedent clearly provides important information, adopting that value as the "best" value assumes other regulators have correctly considered an issue, and that the results of that consideration are directly applicable to the GGP.

Five of the most contentious and important elements in deriving a pre-tax real WACC are the market risk premium, beta, gamma, gearing, and the cost of debt. Each of these parameters can be considered a "structural element" in the context of the application of the Code. Each of these elements is considered below. Short mention is also made of recent developments in relation to credit-rating and debt issuance costs which GGT submits must be taken into account.

(a) Market risk premium

The market risk premium used in the original pre-investment commitment calculation of WACC was 7.60%. In subsequent submissions for the purposes of compliance with the Code which were predicated upon particular perceptions regarding the exposure of GGT and the impact of sovereign risk considering the reliance afforded by the provisions of the State Agreement, GGT proposed a value of 6.5%. In the ADD, the ERA has however adopted a value of 6% for the market risk.

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[10] This statement ignores the ready access to, and common usage of probabilistic modelling techniques commonly employed in all manner of industrial and academic applications.

In its assessment of the appropriate value of the MRP, the ADD considers evidence on historical MRP estimates and survey data as well as referring to regulatory precedent. In paragraph 275, the ADD reproduces a table of historical MRP estimates calculated over different time periods, which was included in the Victorian Essential Services Commission's 2002 decision on the Victorian Gas Access Arrangements. The table includes estimates of the equity (market) risk premium, the standard deviation of the sample and the standard error of the mean. Based on this evidence, the ERA claims support for reductions in the market risk premium in recent years: [11]

> *'The Authority notes that the ability to draw conclusions from this historical evidence is limited by large standard errors of the estimates. The average market risk premium for the period 1882 to 2001 is 7.2 percent with a standard error of 1.55 percent, implying a 95 percent confidence interval of between 4.3 percent and 10.4 percent. Nevertheless, there is some suggestion from the historical data that more recent estimates of the realised MRP are lower than the measurements for earlier periods, suggesting a decline in values over the period since 1882.'*

In paragraph 276, the ADD notes the 95 percent confidence interval for the historical estimate covering the time period 1882 to 2001 (4.3 percent to 10.4 percent). The data used in the ADD plus estimates of the 95 percent confidence intervals for all the periods covered are set out in Table 1.

Table 1 **Historical MRP estimates quoted in ERA draft decision**[12]

Time period	Equity return premium (percent)	Standard deviation (percent)	Standard error of mean (percent)	95% confidence interval (percent)	
				Low	High
1882-2001	7.19	16.97	1.55	4.15	10.23
1882-1950	8.00	11.11	1.34	5.37	10.63
1882-1970	8.16	13.70	1.45	5.32	11.00
1882-1990	7.40	17.33	1.66	4.15	10.65
1900-2001	7.14	17.94	1.78	3.65	10.63
1950-2001	6.51	22.60	3.13	0.38	12.64
1970-2001	3.37	24.38	4.31	-5.08	11.82

These estimates show that for the most recent time periods, volatility in the MRP has increased significantly, with the upper 95% confidence interval actually rising at the same time as the mid point estimates have fallen. Therefore, the upper value for which one can be 95% confident the MRP is not above has actually risen over this period. This weakens any case for concluding the appropriate rate has fallen.

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[11] Amended Draft Decision, paragraph 276.

[12] **Source:** ERA Amended Draft Decision, paragraph 275. Note the confidence intervals have been calculated as the equity return premium plus or minus 1.96 times the standard error of the mean.

In its consideration of the market risk premium, the ADD also takes into account a survey by Jardine Capital Partners, which "indicates an average of market participants' views on the historical MRP of 5.87 percent and expectations about the future MRP about 1 percentage point below this level" (paragraph 278). The fact that the market risk premium estimates differ significantly by class suggests that the interpretation of the results needs to be qualified with consideration of the nature of the participants being surveyed and the likely biases to which they might be subject.

The survey has two unusual findings: first that past MRP, averaged over all participants, was higher in the US than Australia by about 40 basis points; and second that the expected MRP in Australia is about equal to that in the US. For these findings to be true, Australia's equities would have to be no less risky than equities in the US. This seems unlikely for a great variety of reasons, including at the most basic level of consideration, relative market diversity and size.

Therefore, it is not surprising that the Essential Services Commission, who first quoted the Jardine Capital Partners study, chose not to take it into account in its decision on the Victorian gas distributors: [13]

> *'The relevant evidence taken into account by the Commission included evidence on the assumption about the equity premium made by market practitioners. This evidence included advice by Mercer Investment Consulting on the assumptions it uses in making its asset allocation recommendations and its sampling of opinions by other market practitioners, as well as the results of a formal survey of market practitioners undertaken by Jardine Fleming Capital Markets (which had not been considered prior to the Draft Decision). Both of these sources suggested that most market practitioners adopt an assumption about the equity premium that is lower than the assumption of 6 per cent that the Commission has adopted in previous decisions and in the Draft Decision. However, the Commission does not consider this evidence is sufficiently persuasive to revise its past assumption about the equity premium, particularly when weight is placed upon the long-term consequences of the Commission's decisions, and so has retained its assumption of 6 per cent for the equity premium.'*

Based on this evidence, it seems that the ERA has proposed a value of 6% for the MRP because of regulatory precedent under the Code in Australia. The ADD provides little if any insight on why this value is "best", or indeed why this value is "better" than the 6.5% value proposed by GGT or the original value relevant to the time and basis upon which the investment in the GGP was committed. Given the wide variation in estimates of MRP – as set out in Table 1 –the ADD does not conclusively demonstrate that the proposed value is better than all the other potential values.

[13] Essential Services Commission, Review of Gas Access Arrangements, Final Decision, October 2002, p140.

(b) Beta

In the case of beta, the value used in the original pre-investment commitment calculation of WACC was **[*CONFIDENTIAL*]**.[14]

In the ADD, the ERA proposes a value for the asset beta of 0.65, which translates into an equity beta of 1.33 using a debt beta of 0.20 and 60% gearing. This value has been derived:

> *"… taking into account the empirical evidence on beta values for gas transmission and distribution companies, the position taken by other Australian regulators in the face of this empirical evidence, and the view of the ERA in relation to the exposure of the GGP to systematic risk relative to pipeline systems of the eastern states*" (paragraph 294).

The steps taken to reach a value of 0.65 are consistent with regulatory precedent under the Code in Australia. However, it is not clear the value provided is necessarily the "best". For example, in its consideration of beta, the ADD dismisses the need to provide an allowance in the cost of capital for risks that are not captured in the CAPM. Paragraph 286 states:

> *'The view that the Rate of Return estimated for the GGP should take into account the unique risk of the GGP business is contrary to the core assumptions of the CAPM model, which provides only for non-specific or non-diversifiable risk to be taken into account. The historical use of the CAPM for estimating a rate of return for the GGP would suggest that the financial advisers to GGT and the owners of the GGT recognised that unique risks of the GGP business should not be taken into account in determining the Rate of Return for the purposes of calculating regulated tariffs.'*

The implication of this statement is that because the CAPM is being used to estimate the rate of return, by definition no allowance for specific risk should be provided. Taking such a literal approach to the use of the CAPM can lead to serious error depending on the goals of regulation. Where regulation is to permit investors to recoup the opportunity costs of the project, then these need to be evaluated at the time funds are irrevocably committed. This means that the relevant beta value should be referenced to systematic risk at the time of project decision, not at the time of a subsequent decision or by referencing to other comparators.

It is apparent from consideration of the values used to determine the original GGP tariffs that an allowance for risks specific to the development of the GGP had at least been accommodated in the use of a demand forecast which omitted any unduly speculative demand prospects. GGT's later submission of a higher beta in circumstances where it had strong reasons to believe that more optimistic demand forecasts (as have been advanced by major existing pipeline users who seek to benefit

[14] **[*CONFIDENTIAL*]**.

from economic transfers arising from the use of such assumptions), is consistent with an overall accommodation of investment risk by one means or another.

As the ADD does not reference the risks facing investors at the commencement of the project, there is an increased likelihood of error in the form of the parameter value chosen resulting in higher social costs than would otherwise be the case. While the ERA does not believe the approach taken by GGP in estimating beta is consistent with the Code, it has not sought to explain why its proposed value for the equity beta (1.33 for 60% gearing) is superior to the value proposed by GGP (1.40 for 50% gearing) or why no allowance should be included elsewhere for the cost of bearing asymmetric risks.

(c) Gamma

The value attributable to gamma that was used in the original pre-investment commitment calculation of WACC was 0%. The ADD proposes to adopt a value of 0.50 for gamma, rather than the value of zero proposed by GGP and included under the State Agreement. In dismissing the value proposed by GGP the ADD argues that a value of 0.50 – the most typical value applied by regulators in Australia – is "reasonable" (paragraph 325). The ADD notes that other regulators have been strongly influenced by the 1999 study of Officer and Hathaway[15] in adopting a value of 0.50 for gamma.

The value of franking credits (gamma) will be determined at the level of the investor and will be influenced by the investor's tax circumstances. As these will differ across investors, the result will be a value of the franking credit between nil and full value (i.e., a gamma value between zero and one). There has been an increasing body of literature focused on estimating the value of gamma. The early literature, such as the Officer and Hathaway paper, generally found a value of around 0.50. Since this time, debate has become increasingly polarized, with many participants now arguing for zero.[16]

(d) Gearing

GGT submitted a debt proportion of 50% consistent with the value for gearing used in the original pre-investment calculation of WACC for the GGP.

The ADD identifies a wide range of comparative levels of gearing in paragraph 313 but concludes that a value of 60% is reasonable, largely on the basis of regulatory

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[15] Hathaway N. and R.R. Officer (1999), The Value of Imputation Tax Credits, Unpublished Manuscript, Graduate School of Management, University of Melbourne.

[16] For example, Cannavan, Finn and Gray [Cannavan D., Finn F. and Gray S. (2001) "The Value of Dividend Imputation Tax Credits," unpublished working paper, Department of Commerce, The University of Queensland] show that for companies with substantial foreign ownership, the market value of tax credits is close to zero.

precedent under the Code. There is little attempt at substantiation and no particular basis for determining that the ADD value is to be preferred to that proposed by GGT.

As GGT submits, the GGP pipeline faces significantly different risks to that of other regulated pipelines throughout Australia. The risks faced by the pipeline are closely linked to the risks of its end customers and the largest of its end customers has a gearing level closer to 50%.

(e) Debt Margin

The debt margin used in the original pre-investment commitment calculation of WACC was 2.50%. The cost of debt is one of the few observable variables in the cost of capital. However, there is still uncertainty in estimating a forward-looking cost of debt to go into the cost of capital calculations. This uncertainty is recognized in the ADD where it notes that observed debt margins for debt of credit rating BBB+ was around 165 basis during part of 2002, but estimates from recognized financial sources such as CBA Spectrum were around 105 basis points at the time of the ADD.

The ADD also considers debt bonds that have been issued by GasNet, Australian Pipeline Trust and Snowy Hydro. The ADD notes that the debt issued by Australian Pipeline Trust had an “all in” cost 94 basis points above the 90 day bank bill rate (BBSW), with the debt issued by Snowy Hydro being 89 basis points above BBSW, which the ERA equates to 75 basis points above a 10 year bond. For GasNet, the ERA provides evidence of a 5-year Medium Term Note issue in July 2003, for which it estimates a likely 10-year rate would be 6.65 percent. Given that the yield on 10 year bonds at the time of issue (31 July 2003) was 5.45 percent, this implies a debt margin of 120 basis points.

The evidence considered in the ADD suggests the debt margin could be between 75 and 165 basis points. It is therefore, surprising that in paragraph 306, the ADD argues that a “reasonable estimate of a debt margin for the GGP business” is between 40 and 105 basis points. In choosing 105 basis points for the debt margin (exclusive of issuance costs) the ADD is effectively relying on the estimate of CBA Spectrum. However, in paragraph 304 it cautions use of this figure due to the thin trading for debt rated at BBB+:

> *'The Authority recognizes, however, that this indicator of the debt margin should be treated with caution. Rates provided by CBA Spectrum service are not actual market observations, but rather a prediction of yields based on an econometric model, and the market observations upon which the predictions are based are very thin. Currently, only three corporate bonds in the CBA Spectrum database are rated BBB+ and only one of these has a rating in excess of 4 years.'*

Therefore, even on the information considered in the ADD, it is difficult to conclude that the approach to the cost of debt results in the “best” estimate of the cost of debt.

(f) Credit rating

The proposed adoption of a BBB+ credit rating for the GGP is not reasonable. GGT submits that a credit rating of BBB would be more appropriate. As well as the need to determine the proposed credit rating for the GGP "on its merits", GGT submits that adoption of a credit rating above BBB is unsustainable and unreasonable in the light of recent decisions under the Code on this issue.

In particular, in the *MSP case*, the Tribunal determined that the debt margin for the pipeline was BBB. The ACCC's consideration of the debt margin for the MSP had included consideration of the fact that GasNet, Alinta and Envestra had a credit rating of BBB[17]. In the absence of compelling evidence to the contrary, it is difficult to see how a pipeline with the risk profile of the GGP could be given a higher credit rating than pipelines and networks serving established diverse markets.

(g) Debt issuance costs

The Tribunal's orders in *GasNet* included an allowance for an appropriate amount to recognise debt issuance costs. In the *GasNet* decision, about 25 basis points was allowed. This represents the minimum possible allowance for the GGP.

[17] ACCC, Final Decision, Access Arrangement for Moomba to Sydney Pipeline System, 2 October 2003, page 121.

C. NON-CAPITAL COSTS

GGT disagrees with the proposal to disallow some of the Non-Capital Costs proposed for 2004 and 2005.

GGT notes the statement in the ADD that the ERA has to date not received the level of information it requires to be satisfied as to the efficiency of the proposed Non-Capital Costs. GGT will identify what further information it has in relation to the proposed costs and provide this to the ERA to better inform the ERA's consideration of this issue.

GGT has also identified that the costs in the proposed Access Arrangement do not fully reflect the costs of provision of Services. In particular, the proposed non-capital costs fail to reflect the ownership or corporate costs of the pipeline owners. Those costs are estimated at approximately $1,600,000 per annum ($2004).

This arises from the structure of GGT as a joint venture: the proposed Access Arrangement included the "day to day" costs of operating the pipeline and providing Services, but did not include any component for the direct or indirect costs of the participants in the joint venture. While these costs are incurred by the companies which together form the joint venture, rather than being incurred by the joint venture itself, these costs do form part of the efficient costs of providing Services. GGT notes that there is nothing in the Code which requires exclusion of such costs and the recovery of such costs has previously been accepted as being within the Code[18].

It does not appear in the ADD that consideration has been given to the decision of the Tribunal in the *GasNet case* that an appropriate allowance should be made for the variety of other internal costs identified by the Tribunal in that decision. GGT will provide an estimate and supporting analysis of these costs when providing the further information referred to above.

[18] For example, ACCC re Moomba Sydney Pipeline. Independent Pricing and Regulatory Tribunal of NSW re AGL Gas Networks' NSW distribution system,

D. Response to Non-Tariff Amendments

Amendment 1
711. The definition of "Spare Capacity" in the proposed Access Arrangement should be amended to provide that Spare Capacity will only include the "Initial Committed Capacity" (as defined under clause 8 of the State Agreement) to the extent that it does not deprive any person of an existing contractual right.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 2
712. The proposed Access Arrangement should be amended to make provision for an additional Reference Service in the nature of that proposed by GGT but which is capable of accommodating alternative and multiple Inlet Points in a single Service Agreement in the event that additional Inlet Points are established on the Pipeline.

GGT Response:

GGT considers that this additional Reference Service would not be sought by a significant part of the market and that this amendment is unnecessary and unreasonable.

To date no User has requested the establishment of an additional inlet point to the GGP. Accordingly, such a Reference Service does not fall within section 3.3(b) of the Code. Additionally, GGT believes there is no basis for the ERA to otherwise require inclusion of such an additional Reference Service for the following reasons.

Firstly, due to the location of the pipeline, it is unlikely that there will be any requirement for an additional inlet point in the short to medium term. In particular, any future interconnect from the DBNGP (which would in all probability supply gas from other Carnarvon Basin producers) would in all likelihood be located at Yarraloola where provision for such a physical interconnection was established at the time of construction of the GGP. The Reference Service proposed under GGT's Access Arrangement accommodates delivery of gas into the GGP at this point. Accordingly, there seems no benefit to Users and Prospective Users in requiring the inclusion of the additional Reference Service.

Secondly, without knowing where any additional inlet might be located, it is not possible to anticipate in advance the terms and conditions upon which the provision of alternative and multiple inlet points could be accommodated as part of a Reference Service. In particular, inclusion of such an additional Reference Service would require significant revision to provisions of the General Terms and Conditions dealing with matters such as but not limited to gas quality, nominations, metering, interconnection, curtailment, notional and physical backhaul, inlet points, allocation of gas and commingling of gas. In the absence of knowledge as to the source of the gas to be delivered through such additional inlet points, and the location of those inlet points (including whether they are upstream or downstream of an existing delivery point), it would be necessary to develop non-specific and therefore very wide-ranging provisions to enable accommodation of a range of possible sources of gas and locations of inlet points.

Thirdly, development of Reference Tariffs for such a Reference Service would be problematic if not impossible. In particular, without any expectation that such a Reference Service would be utilised, GGT would allocate no part of the Total Revenue to that additional Reference Service, and to require any part of Total Revenue to be allocated to such a Reference Service would be inconsistent with section 8.1(a) which provides "the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering the that Service". As GGT has no expectation that such a Reference Service would be utilised, section 8.38 and section 8.42 of the Code effectively precludes allocation of any part of the Total Revenue to such a Service.

Even if this matter could be overcome, the absence of information as to the location of such inlet points, the likely quantities of gas to be delivered into the pipeline at such point, and the distance such gas would be expected to be delivered renders makes development of Reference Tariffs highly problematic.

GGT also notes that if at any time a User requires an additional inlet point, GGT is obliged to negotiate with the User the terms and conditions necessary to accommodate the inlet point. In this respect, GGT notes that interconnection is expressly recognised by the Code as a "Service". If GGT and a User are not able to negotiate the terms of an interconnection arrangement with GGT, the User has the ability to have the matter resolved through the arbitration process under the Code.

Amendment 3

713. Amendment 3 proposes revised Reference Tariffs and to reflect amended values for the following: Initial Capital Base, working capital, nominal pre-tax Rate of Return, Forecast Non Capital Costs and present value of Total Revenue.

GGT Response:

GGT has addressed this amendment in this submission.

Amendment 4

714. Clause 9.8 of the General Terms and Conditions should be amended to provide a formula for escalation of the component charges of the Reference Tariff to be as follows.

$$C_t = C_{t-1} \times \left\{ \left(\frac{CPI_{t-1}}{CPI_{t-2}} \right) - X \right\}$$

C is the relevant charge in the year t;

C_{t-1} is the relevant charge in the year preceding year t;

CPI_{t-1} is the Consumer Price Index (CPI) for the September quarter of the year prior to year t;

CPI_{t-2} is the Consumer Price Index (CPI) for the September quarter of the year two years prior to year t; and

X is 0.0275 when t is the year 2001 and is zero otherwise.

GGT Response:
It appears that at least in part ERA has proposed that the Reference Tariffs should be escalated on an annual basis based on GGT's submission of 17 December 2002, as evidenced in the text of paragraph 425, which says (relevant text bolded for clarity):

> *" … assuming that the Access Arrangement Period will commence at 1 January 2000, the formula for escalation of charges will require amendment to provide for a correction for the inflationary impact of introduction of the GST (from which GGT is sheltered by itself claiming GST rebates on inputs).* ***To achieve this, and taking into account the implied proposal in GGT's submission of 17 December 2002 of annual rather than quarterly escalation of tariffs****, the formula for escalation of the tariff charges requires amendment as follows."*

This is an unintended interpretation of GGT's model. For simplicity GGT's 17 December 2002 submission included an annualised tariff model, however, it was not intended that any inference would be drawn as to future escalation of tariffs by the escalation methodology within this tariff model.

In addition, GGT notes that its usual business practice is for its tariffs to be escalated on a quarterly basis. For example, since September 1994, GGT has published a number of Terms and Conditions & Tariff Packages (copies have previously been provided to ERA) including the proposed Access Arrangement, which has included provisions for the escalation of Reference Tariffs on a quarterly basis. The Original Owners proceeded with the construction of the GGP with the basis that tariffs would be escalated quarterly, based on the Clause 9 Proposals, which the Minister for Resources Development approved on 27 January 1995. All current GGP customers' tariffs are escalated on a quarterly basis.

It is also common in the gas industry that tariffs are escalated on a quarterly basis.

GGT sees no reason to change to annual rather than quarterly indexation and considers that this amendment is unnecessary.

Amendment 5
715. Clause 8.2(b) of the proposed Access Arrangement should be amended to remove GGT's discretionary power to attach additional conditions to a Service Agreement for provision of Reference Services, other than those conditions stated in the Access Arrangement, including in Appendix 3 of the Access Arrangement.

GGT Response:
The Conditions may relate to any matter reasonably required by GGT to protect or secure its position under any proposed Service Agreement, including:

- the occurrence of a defined event including installation and commissioning of Developable Capacity or third party equipment, processing facilities or infrastructure;
- a Performance Security being provided by the Prospective User, any of its Related Corporations or any other person on terms acceptable to GGT in order to satisfy the requirements of the request for Service; and
- copies of insurance policies or other evidence reasonably required by GGT being provided, which provide reasonable indication to GGT that the Prospective User has insurance policies sufficient to satisfy the indemnities which the Prospective User will be required to provide under the proposed Service Agreement.

Clause 8.2(b) is intended to establish a reasonable and objective set of requirements in relation to a Service Agreement and in practice those requirements operate to constrain GGT's ability to act arbitrarily.

GGT also notes that the provisions in clause 8.2(b) are consistent with provisions that have previously been approved by regulators under the Gas Code in Western Australia. In particular, Clause 19(3) of the approved AlintaGas Access Arrangement for the Mid West and South West Gas Distribution Systems allows AlintaGas the discretion to attach additional conditions to a service agreement other than those listed in the AlintaGas Access Arrangement:

> *The Applications Procedure may waive, add to or vary one or more of the pre-conditions listed in subclause 19(1) or 19(2).*

In view of the above, and in the absence of specific reasons to impose such a restriction in the Access Arrangement, GGT submits that the amendment is unnecessary and unreasonable.

Amendment 6
716. Clause 3.2 (d) of the General Terms and Conditions should be amended to the effect that if the parties to the Service Agreement are not able to agree on deferring the Commencement Date or a reduction in the scope of the Service, they may either terminate the Service Agreements by mutual consent or refer the matter for dispute resolution as provided for in clause 22 of the General Terms and Conditions.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

<u>Amendment 7</u>
717. Clause 6.6 of the General Terms and Conditions should be amended to explicitly allow Users, as well as third parties, to operate and maintain their own Outlet Points.

<u>GGT Response:</u>
GGT submits that this amendment is not reasonable and is not necessary.

GGT has contractual obligations to transport gas safely and reliably to all Users of the pipeline. Additionally, GGT is subject to a range of statutory and licence obligations which impose certain requirements on it as operator of the pipeline. In the last twelve months, GGT as a prudent pipeline operator has adopted a new operations policy that it would own, operate and maintain all new outlet points. GGT implemented this new policy to ensure that it maintained best practice in regard to the safe and reliable operation of the GGP, as required under its pipeline licence, AS2885 and the approved Clause 9 Proposals under the *Goldfields Gas Pipeline Agreement Act 1994*. GGT's obligations under these different regimes are discussed separately below.

GGT is obligated under its pipeline licence to operate the GGP in accordance with AS2885 (refer point 2 below) and

- to meet various conditions covering areas such as:
- Pressure Control;
- Corrosion Control;
- Inspection, Testing and Maintenance;
- Safety Management;
- Audits; and
- Drawings.

GGT is obliged under AS2885 to implement principles, practices and practical guidelines in the following areas:

- Preparation for Operation;
- Pipeline Integrity Management;
- Plans and Procedures – Operating and Safety, Emergency, etc;
- Pipeline Structural Integrity;
- Threat Mitigation;
- Safety and Environment;
- Operating Condition Charges;
- Pipeline Repairs; and
- Records.

Under the Clause 9 Proposals, GGT has the responsibility for the operation of the GGP. GGT and the operator appointed by it are obliged under the Clause 9 Proposals to:

- provide services to a standard to ensure the proper and efficient operation of the GGP;
- provide services in accordance with accepted pipeline practices;
- comply with the *Goldfields Gas Pipeline Agreement Act 1994* and the Goldfields Gas Pipeline Agreement;

- comply with all applicable laws, regulations, rules, licences and other authorities; and
- comply with all obligations under all transportation contracts.

To ensure that it is able to comply with and implement these various obligations, GGT determined that it would operate and maintain all facilities. If third parties are able to operate and maintain such facilities, GGT is practically not in a position to ensure that it will be able to comply with these obligations. For example, the failure of a third party to maintain an Outlet Point may lead to the failure of the Outlet Point to operate properly which, in turn, could adversely affect the safe and efficient operation of the pipeline. While GGT or other Users adversely affected by the failure to maintain the Outlet Point may have contractual or other remedies against the third party, these can be only a second-best alternative to the reliable operation of the pipeline. It is GGT's belief that it is preferable to avoid the risk of such a failure through GGT operating and maintaining the Outlet Points.

GGT is unaware of any reason which necessitates the imposition of this amendment. GGT therefore considers that this amendment is unnecessary and unreasonable, as it fails to take into account:

- the operational and technical requirements necessary for the safe and reliable operation of the GGP; and
- the interests of Users

as provided for under section 2.24 of the Code.

If third parties are to be given the right to operate such facilities, it will be necessary to amend the Access Arrangement to include appropriate obligations and indemnities in favour of both GGT and other Users of the pipeline.

<u>Amendment 8</u>

718. The Second Schedule of the General Terms and Conditions should be amended to recognise that the requirement for Users to supply spare parts applies only where the Outlet Facilities are owned by Users but operated by GGT.

<u>GGT Response:</u>

This amendment is not appropriate given GGT's position stated above in response to proposed Amendment 7.

<u>Amendment 9</u>

719. The proposed Access Arrangement and General Terms and Conditions should be amended to provide that the Accumulated Imbalance Charge, Daily Overrun Charge, Hourly Overrun Charge and Variation Charge may be imposed only where:

- *the conduct contemplated by those charges causes actual pecuniary loss or damage; or*

- *in the reasonable opinion of the pipeline operator the conduct contemplated by those penalties exposes the pipeline to a significant risk (whether or not that risk becomes manifest) that threatens the integrity of the pipeline.*

GGT Response:
GGT considers that the amendment is unreasonable as it fails to reflect the basis for the inclusion of such charges in the Access Arrangement. In particular, charges of this sort are designed to send economic signals to Users about matters where the User's failure to comply with its contractual obligations could adversely affect the operation of the pipeline or the ability of other Users to enjoy the benefits of their contracts. These charges are intended to avoid the suffering of loss or damage to the pipeline, through establishment of incentives for Users to avoid behaviour that could cause GGT or other users loss or could cause damage to the pipeline.

The charges are only applicable when a User fails to comply with contractual obligations and, in the case of all charges except overrun charges, are only payable if the User fails to take corrective action over a reasonable period following the relevant behaviour. The provision for these charges is therefore a reasonable mechanism to encourage Users to comply with contractual obligations where non-compliance could adversely affect the operation of the pipeline or the rights of other Users.

Additionally, if the amendment were imposed, but the current structure of Reference Tariffs remained the same, GGT would not recover the expected Total Revenue – Reference Tariffs are developed on the basis that Users will face meaningful incentives to reserve and pay for the required level of capacity. The absence of such charges means that Users will have no strong incentive to do so and could be expected to reserve and pay for a lower level of capacity, resulting in an under-recovery of revenue by GGT. Retention of the amendment would therefore require GGT to re-calculate the Reference Tariffs. This would have the result that Reference Tariffs overall would increase, effectively meaning that Users who comply with their contractual commitments and manage their capacity requirements properly are paying a higher tariff to accommodate those who do not act in a responsible manner.
In addition, GGT notes that:

- it is standard industry practice for Users to pay Quantity Variation Charges ("QVC") when they breach contractual conditions;
- the lack of incentives to avoid overrun, balancing and variations could result in less economically efficient operation of the GGP due to direct and adverse effects on the provision of services to other users;
- lack of incentives to avoid overrun and variation means that Users can game the system by using capacity in excess of their MDQ with impunity (i.e. they use capacity that they have not fully paid for) with a result that other Users may be disadvantaged;
- lack of sanctions on balancing means that linepack management is made more problematic;
- the dollar value of QVC would not recover actual losses where the failure of the User to manage its gas usage does in fact cause actual loss or damage to GGT or another User;
- the Supplementary Quantity Option has been introduced by GGT to provide Users with the ability to correct their imbalances and avoid incurring a QVC; and

- without the ability to discourage Users from mismanagement by using a financial mechanism, GGT's only alternative is to physically restrict the flow of gas to end users. The potential consequences of this action are considered undesirable and GGT would consider that this action should be avoided if at all possible.

GGT is unaware of any reason supporting the proposed amendment which outweighs the disadvantages outlined above.

In relation to other regulatory decisions, GGT also notes understands that a number of other approved Access Arrangements contain similar provisions, including:

- DBNGP Access Arrangement;
- Moomba to Sydney Pipeline Access Arrangement;
- Central West Pipeline Access Arrangement;
- Moomba to Adelaide Pipeline System; and
- AGL Gas Networks.

The inclusion of similar charges in these Access Arrangements reflects a recognition that the usage of such charges is common throughout the industry and provides an acceptable mechanism to discourage Users from failing to comply with their capacity management obligations.

If the amendment were to be required, the Access Arrangement would require amendment, as GGT would need to implement other alternatives to discourage Users from mismanaging their loads. Possible mechanisms include a ratcheting of MDQ where, if a User persistently breached its contractual obligations, then the User's MDQ would automatically ratchet up by the quantity of capacity used in excess of the User's reserved MDQ.

Consequently, GGT considers that this amendment is unreasonable, as it fails to take into account:

- GGT's legitimate business interests;
- the operational and technical requirements necessary for the safe and reliable operation of the GGP;
- the economically efficient operation of the GGP; and
- the interests of Users.

<u>**Amendment 10**</u>

720. The proposed Access Arrangement should be amended so that 95 percent of revenue generated from the application of Quantity Variation Charges is rebatable as if these charges are in relation to Rebatable Services within the meaning of the Code.

<u>GGT Response:</u>

GGT believes that this amendment is unreasonable and is inconsistent with the Code.

QVC are not charges that are received not for Services within the meaning of the Code. Accordingly, it is not appropriate to classify them as if they relate to a Rebatable Service. Additionally, any rebate could only relate to a limited portion of the pipeline capacity which is available to be taken up as a Reference Service, as distinguished from the larger amount of contracted capacity which pre-existed the application of the Code. In these particular circumstances, rebates of this kind could not be equitable apportioned between pre-Code and post-Code users.

Section 10.8 of the Code defines a Rebatable Service and Service as follows:

*'**Rebatable Service**' is a Service where:*

(a) there is substantial uncertainty regarding expected future revenue from sales of that Service due to the nature of the Service and/or the market for that Service; and

(b) the nature of the Service and the market for that Service is substantially different to any Reference Service and the market for that Reference Service.

***'Service'** means:*
(a) a service provided by means of a Covered Pipeline (or when used in section 1 a service provided by means of a Pipeline) including (without limitation):
(i) haulage services (such as firm haulage, interruptible haulage, spot haulage and backhaul); and
(ii) the right to interconnect with the Covered Pipeline, and
(b) services ancillary to the provision of such services,
but does not include the production, sale or purchasing of Natural Gas.

These charges are not payable by Users for the provision of any "Service" in the usual sense of that term under section 10.8 – they are payable only if a User fails to comply with an obligation under the agreement. Additionally, the circumstances where the charges may become payable are an integral part of a Reference Services (ie. capacity management) which is inconsistent with the concept of a Rebatable Service.

Further, GGT considers the proposed amendment is unreasonable for the following reasons:

- the combined effect of Amendments 9 and 10 is that QVC can only be applied if "actual pecuniary loss or damage" is suffered, but then 95% of all moneys collected from these charges must be rebated to Users;
- this means that unless the charges significantly exceed the amount of loss suffered by GGT, GGT will be up to 95% out of pocket. This is commercially unacceptable and inconsistent with section 8.1(a) which provides "the Service Provider with the opportunity to earn a stream of revenue that recovers the efficient costs of delivering the Reference Service over the expected life of the assets used in delivering that Service;
- the incentive for proper capacity management arising from the imposition of charges will be undermined as a User which failed to properly manage its capacity requirements would recover through the rebate part of the amount payable by it in respect of such failure.

Consequently, GGT considers that this amendment is unreasonable, as it fails to protect GGT's legitimate business interests as provided for under section 2.24 of the Code and misconstrues QVC as Rebatable Services under section 10.8 of the Code.

Amendment 11

721. Clause 7 of the General Terms and Conditions and clause 5 of the Sixth Schedule to the General Terms and Conditions should be amended to remove provision for GGT to change the tolerance limits applicable to the Accumulated Imbalance Charge and Variance Charge, and the rates of Quantity Variation Charges.

GGT Response:

GGT will revise its Access Arrangement to remove provisions that allow GGT to change the tolerance limits applicable to the Accumulated Imbalance Charge and Variance Charge.

However, GGT considers that the proposed removal of GGT's ability to change the rates of QVC is unnecessary for the following reasons:

The objective of QVC is to encourage users to properly manage their loads for the mutual benefit of all Users. GGT has a contractual obligation and also an obligation as a prudent pipeline operator to transport gas safely and reliably to all Users of the pipeline.

The Supplementary Quantity Option has been introduced by GGT if capacity is available to provide Users with the ability to correct their imbalances and avoid incurring a QVC. GGT believes that in this way, Users have every opportunity to meet their balancing requirements. Therefore should a User continue to not manage its load properly to the detriment of the system when capacity is not available then the most effect method of mitigating against this mismanagement would be for GGT to have the ability to provide the User with reasonable notice that it intends to increase the QVC unless the User conforms to responsible practice.

It is not unreasonable to suggest that their could be occasions where a User may decide for commercial reasons that the benefits of mismanaging their load due to the level of commodity prices far outweighs the charges imposed by GGT. In this way, Users can act opportunistically and the Service Provider must have a flexible response which can be used to protect other Users from the adverse consequences of such behaviour. The most effective method of countering this behaviour is that there are provisions, which allow GGT to increase the QVC to a level where such actions would not be sustainable and therefore not implemented by Users.

Accordingly, GGT believes that the proposed amendment that seeks removal of GGT's ability to change the rates of QVC is unnecessary, as it fails to take into account the operational and technical requirements for the safe and reliable operation of the pipeline, as provided for under section 2.24 of the Code.

If GGT had to completely carry out this amendment then GGT considers that the Access Arrangement would require significant amendment, as GGT would need to implement other alternatives to discourage Users from mismanaging their loads. GGT would need to insert provisions for alternatives such as but not limited to:

Ratchet MDQ

If Users breached their contractual obligations and did not remedy their breach within a reasonable time period then the User's MDQ would automatically ratchet up by the quantity (TJ) that was the extent of the breach.

Fixed Rate

If Users breached their contractual obligations and did not remedy their breach within a reasonable time period then the User would be charged a fixed rate (yet to be determined).

Amendment 12

722. Clause 7 and/or the Sixth Schedule of the General Terms and Conditions should be amended so that the Accumulated Imbalance Charge does not apply in respect of the amount of the tolerance allowed.

GGT Response:

GGT will revise its Access Arrangement to reflect this amendment.

Amendment 13

723. Clauses 7.3 and 7.4 of the General Terms and Conditions and clause 5 of the Sixth Schedule to the General Terms and Conditions should be amended so that the Daily Overrun Charge and Hourly Overrun Charge applies only in respect of overrun at Outlet Points.

GGT Response:

GGT considers that the amendment is unreasonable as it fails to consider the safety and integrity of the GGP and the interests of Users.

The need for incentives for proper management of capacity at Users' delivery points also applies to management of deliveries of gas into the pipeline. For instance an unauthorised overrun at an inlet point could result in the pipelines maximum allowable operating pressure (MAOP) being reached. Once MAOP is reached then the GGP's safety systems will prevent flow of any further gas into the pipeline. If this occurs then it will have a number of impacts such as:

- other Users' gas being held out (i.e. prevented from being delivered into the pipeline);
- other Users' contractual requirements for receipt and delivery of gas being prejudiced;
- potentially adversely affecting other User's operations.

GGT notes that application of overrun charges to overruns at receipt points are standard in the pipeline industry, including being part of Australian Pipeline Trust's normal operating practices. For example, the approved Access Arrangement for the Moomba to Sydney Pipeline and the Moomba to Adelaide Pipeline System provide for overrun charges to apply to overruns at receipt points.

GGT believes that this amendment is not reasonable and in particular is inconsistent with section 2.24 of the Code, as it fails to take into account the following:

- operational and technical requirements necessary for the safe and reliable operation of the GGP; and
- the interests of Users.

Amendment 14

724. Clause 7.5 of the General Terms and Conditions should be amended to indicate that the Variance Charge will only apply in cases where the Variance Tolerance is exceeded as a result of a failure by the User to make nominations in good faith.

GGT Response:
Generally this amendment is acceptable and GGT will revise its Access Arrangement to address this amendment. GGT notes that this amendment can not be considered in isolation, however, and its agreement to incorporate this issue is based on its response to amendments 9 to 13 above, particularly amendment 9.

Amendment 15

725. Clause 7 and/or the Sixth Schedule of the General Terms and Conditions should be amended so that the Variance Charge does not apply in respect of the amount of the tolerance allowed.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 16

726. The proposed Access Arrangement should be amended to make provision, to the extent reasonably practicable, for User-specific information to be available to Users on a timely basis sufficient for the User to assess potential liability for Quantity Variation Charges and take action to avoid the charges.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 17

727. Clause 8.2 (alternatively clause 8.3(b)) of the General Terms and Conditions should be amended to specify that GGT will consult Users and give Users at least 30 days notice when planned maintenance is likely to interrupt their Services.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 18

728. The Access Arrangement and General Terms and Conditions should be amended to establish an obligation for GGT to provide Users with information on the quantity of Used Gas and the price(s) paid by GGT for the purchase of gas for system-use purposes.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 19

729. Clauses 9.9 and 9.11 of the General Terms and Conditions should be amended to remove provision for the pass through of tax imposts on GGT either as a charge in addition to the Reference Tariff or as an adjustment to the Reference Tariff, or GGT's Access Arrangement should be amended to provide a relevant mechanism for adjustment of the Reference Tariff in accordance with the provisions of section 8.3A to 8.3H of the Code.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 20

730. Clauses 9 (and clauses 17 and 18, as necessary) of the General Terms and Conditions should be amended to provide for the waiving of charges in circumstances of, and to the extent that, interruption of Services occurs. These circumstances should include interruptions to Services arising by virtue of maintenance requirements where GGT has not given at least 30 days notice of the interruption, and interruptions occurring as a result of a force majeure event where GGT is the party claiming the benefit of force majeure.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment in relation to failure by GGT to give at least 30 days' notice.

In relation to the waiver of charges in the event of a force majeure, GGT will reflect this amendment where the force majeure event directly affects the pipeline and GGT is claiming the force majeure.

GGT notes that Reference Tariffs have been derived on the assumption that Users remain liable to pay capacity charges notwithstanding an event affecting GGT's ability to receive, transport and deliver gas. This assumption is reflected in both the derivation of Reference Tariffs and in the rate of return applied to the pipeline.

Given the manner in which GGT will address this amendment, GGT will to some extent need to revisit the Reference Tariff formulation and also the risk of the pipeline, together with the insurances held in respect of the pipeline.

Amendment 21

731. Clause 9 of the General Terms and Conditions should be amended to provide for the waiving of User liabilities for the Accumulated Imbalance Charge and the Variance Charge where the liabilities are incurred as a result of Service interruptions.

GGT Response:

GGT will revise its Access Arrangement to reflect this amendment to provide for waiver where GGT is responsible for the interruption.

Amendment 22

732. Clause 9.13 of the General Terms and Conditions should be amended to specify a reasonable basis on which a bond, deposit or other surety is determined and to provide for that value to be decreased where there is a decrease in the User's MDQ, on a basis similar to that for determining increases in the value where there is an increase in the User's MDQ.

GGT Response:

The first part of this amendment is acceptable to GGT and the Access Arrangement will be revised to describe the basis on which security is to be determined and that GGT will rely upon guarantees provided by reputable financial institutions and parent company guarantees. However, GGT submits that a requirement to exhaustively describe the nature and extent of surety which may be required of a User would not properly recognise GGT's and Users' legitimate business interests, and would also present an unnecessary level of prescription on this matter. In particular, GGT notes that the level of security provided by a User is a commercial decision between the parties and is significantly influenced by the following factors:

- nature and extent of the User's obligations under the contract;
- financial position of the User and the User's parent company (where applicable);
- riskiness of User's project; and
- whether provision of the service to the User requires expenditure of additional capital.

As with negotiations in many industries (including leases, financing arrangements etc), it is appropriate that the final quantum and form of a security should be determined during the negotiation of the gas transportation agreement. That this is standard practice in the gas pipeline industry is also demonstrated by the fact that no similar restriction was imposed in:

- DBNGP Access Arrangement;
- Moomba to Sydney Pipeline Access Arrangement;
- AlintaGas Access Arrangement.

Accordingly, GGT will set out in general terms the basis on which a surety is to be determined as noted above.

As to the second part of the amendment, GGT submits that this is unreasonable as it fails to properly take account of GGT's legitimate business interests. In particular, the proposed amendment incorrectly assumed there is a necessary correlation between a decrease in a User's level of MDQ and the risk faced by GGT in providing Services to that User. However, a change in MDQ does not of itself reduce the risk to GGT of providing the Service. Additionally, there may be circumstances where the reduction in MDQ in fact is associated with an increase in the risk to GGT – for example, a User may reduce its MDQ due to production difficulties which of themselves increase the risk to GGT of non-payment by the User.

Accordingly, GGT submits that this part of the amendment is unreasonable.

Amendment 23

733. Clause 12.1(m) of the General Terms and Conditions should be amended so as to not prevent a User from entering into contractual arrangements with third parties in which the User guarantees a continuous supply of gas to another person.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 24

734. Clause 13.5 of the General Terms and Conditions should be amended to allow for the non-payment of disputed invoices, or the non-payment of the disputed portion of an invoice, in instances of a manifest error in the invoice.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 25

735. Amendment 25 proposes that the General Terms and Conditions should be amended so that provisions for termination of a Service Agreement are the same for both the User and the Service Provider and the owners of the GGP. A reasonable period of time must be provided for all parties to remedy or remove the cause or causes of default before a Service Agreement can be terminated.

GGT Response:
GGT will revise its Access Arrangement to reflect the portion of the amendment that requires provisions for termination of a Service Agreement to be the same for both the User and the Service Provider and the owners of the GGP.

However, GGT considers that the existing remedy provisions for default for similar causes are symmetrical, i.e., under clauses 16.1(a)(2) and 16.5(a) the User and the Owners have 30 days to remedy a default in performance of its obligations.
GGT submits that this/these clauses provide a reasonable period of time for parties to remedy or remove the cause or causes of default before a Service Agreement can be terminated.

GGT's provisions for default of payment of moneys provide a remedy period of 7 days which GGT understands is standard pipeline practice, as demonstrated by:

- DBNGP Access Arrangement; and
- Moomba to Sydney Pipeline Access Arrangement.

GGT therefore submits that the amendment is unnecessary and unreasonable.

Amendment 26

736. Clause 18 of the General Terms and Conditions should be amended so that any limits on liability or other conditions relating to liability should apply to both the Service Provider and User.

GGT Response:

GGT has not yet received final legal, insurance and commercial advice as to the implications of accepting reciprocal liability provisions. GGT's position will be provided when final advice is obtained.

Amendment 27

737. Amendment 27 proposes that Clause 18.3 of the General Terms and Conditions should be amended so that the clause does not require a User to indemnify:

- *the Owners;*
- *GGT;*
- *any related entity to the Owners or GGT; or*
- *the employees, agents or servants of the parties listed in (a), (b) and (c) above.*

GGT Response:

GGT submits that this amendment is unreasonable and fails to consider the legitimate business interests of GGT.

It is normal practice in the pipeline industry, for a User to indemnify a pipeline operator and other relevant parties concerning actions by that User, which impact on the pipeline operator and related parties. This is consistent with arrangements and obligations in many areas of business where a party at fault provides an indemnity in favour of those adversely affected by its behaviour. GGT is unaware of any compelling reason why this should not apply in the case of the GGP.

In the absence of the provision proposed by GGT, the risk faced by GGT in delivering Services is increased and this risk is mitigated by the User bearing the cost of its actions and this is achieved through the provision of the User's indemnity, rather than passing the risk of loss or damage to other parties.

GGT's position is also consistent with prior regulatory approvals in Western Australia, particularly:

- DBNGP Access Arrangement (clause 13.4); and
- Parmelia Pipeline Access Arrangement

Amendment 28

738. Clause 18.5 of the General Terms and Conditions should be amended to remove the requirement for a User to make application for a refund or credit of fixed charges.

GGT Response:

GGT will revise its Access Arrangement to reflect this amendment.

Amendment 29

739. Clause 9 of the proposed Access Arrangement should be amended so that provisions for the trading of capacity, as currently set out in clause 20 of the General Terms and Conditions, apply generally to all Services provided by the GGP.

GGT Response:

GGT submits that the proposed amendment is unreasonable as it conflicts with existing GGTJV contractual rights and therefore section 2.25 of the Code.

The existing contractual provisions are as follows:

Clause 8(1) of the State Agreement provides as follows:

8. (1) Prior to submitting any proposal in relation to the matters referred to in paragraph (a) of subclause (1) of Clause 9, each of the Joint Venturers shall be entitled (and is hereby authorized 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.

The GGTJVA does not permit unilateral trading of capacity, which is reflected in the Trading Policy in GGT's proposed Access Arrangement for the GGP. Accordingly, the parties to the GGTJV have contractual rights inconsistent with the concept of unilateral rights to trade capacity.

To the extent that the Access Arrangement applies to capacity which is not subject to pre-existing contractual rights arising from the State Agreement and the GGTJVA, GGT will revise its Access Arrangement to make provision for this amendment.

Amendment 30

740. Clause 20.6(b) of the General Terms and Conditions should be amended so that the information required to be supplied by a User to GGT in the case of a Bare Transfer is consistent with the requirements of section 3.10 of the Code.

GGT Response:

GGT will revise its Access Arrangement to reflect this amendment.

Amendment 31
741. The proposed Access Arrangement should be amended to clarify that a User is able to enter into a contract with GGT that provides the User with an option to extend the term of the contract and/or provide for an increase in contracted capacity without either the extension of term or the increase in capacity being subject to the queuing provisions.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 32
742. Clause 10.3 of the proposed Access Arrangement should be amended to indicate that where GGT determines that an extension or expansion to the Pipeline will not be subject to the Access Arrangement, that GGT will provide written notice to the Authority of this determination.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 33
743. Clause 10.2(a) of the proposed Access Arrangement should be amended to remove the requirement for any commitment by a Prospective User to make a contribution to the costs of installing Developable Capacity before the investigations as to the extent of those costs have been completed.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 34
744. Clause 10.4 is to be amended to state that the application of any Surcharge is subject to the Service Provider notifying the Authority in accordance with section 8.25 of the Code.

GGT Response:
GGT will revise its Access Arrangement to reflect this amendment.

Amendment 35
745. Clause 3.2 of the proposed Access Arrangement is to be amended to provide for a Revisions Submission Date of 1 April 2005 and a Revisions Commencement Date of 1 January 2006.

GGT Response:

GGT submits that this amendment is unreasonable for two reasons – the requirement for a nine month review period (rather than the six months contemplated by the Code) and the proposed Revisions Commencement Date of 1 January 2006.

The proposed amendment requires a Revisions Commencement Date which is nine months after the Revisions Submission Date. This period of time is at variance to what is proposed in section 2.43 of the Code, which says:

> *The Relevant Regulator must issue a final decision under section 2.38 (and sections 2.41 or 2.42 if applicable) within six months of receiving proposed revisions to an Access Arrangement.*

GGT believes that the period defined in the Code should be sufficient for ERA to hand down a final decision on revisions to an already approved Access Arrangement. In relation to the Revisions Commencement Date, GGT notes the indication in the ADD that an Access Arrangement Period from establishment of the Access Arrangement to 2009 could be acceptable to ERA if sufficient information regarding costs and forecasts is provided. GGT will collate such information and provide it when submitting its revised Access Arrangement.

Amendment 36

746. Clause 6.12 of the proposed Access Arrangement is to be amended to indicate that GGT cannot require a Prospective User to keep confidential information disclosed by GGT to the Prospective User in the course of an application for a Service in a manner that may obstruct the administration of justice (including any proceedings under section 6 of the Code).

GGT Response:

GGT will revise its Access Arrangement to reflect this amendment.

ATTACHMENT: MINING VENTURES

PEPL Pipeline – This pipeline was originally constructed by BHP in 1995, to supply its HBI plant and power generation facilities at Port Hedland. It is 219 km long and has a free flow capacity of approximately 180 TJ/d, almost twice that of the GGP. It was subsequently sold to Epic Energy in late 1997, and is now owned by Hastings Funds Management. The HBI plant was originally scheduled for completion in 1997 but was subject to serious delays and was not commissioned until 1999. Since its completion the plant has experienced persistent and serious commissioning difficulties, major cost over-runs and significant operational issues, resulting in the full $2.6 billion cost of the plant being written off. A major accident earlier this year led to the plant being placed on a care and maintenance basis indefinitely pending the resolution of technical and safety issues. Given that the HBI plant utilises some 130 TJ/d of the capacity of the PEPL, the impact of these delays and operational problems on the utilisation of this pipeline and its economic performance has been dramatic.

It is also of interest to note that during 2001 Epic commissioned an 85 km lateral linking the PEPL pipeline with Sons of Gwalia's tantalum operations at Wodgina. In September 2004, Sons of Gwalia was placed in the hands of Administrators.

Mid West Pipeline – The pipeline was constructed in 1998/99 at a cost of $72 million by a joint venture between APT and Western Power, primarily to supply the vanadium project at Windimurra owned by Precious Metals Australia. Following a collapse in the price of vanadium pentoxide, the project was closed in February 2003. It was subsequently decided that the closure would be permanent and the owners have as a result substantially written off their investment.

Telfer Pipeline - This pipeline is being constructed from Port Hedland to the Telfer minesite by Gasnet, to supply new mining and processing facilities being developed by Newcrest. The pipeline was scheduled to be completed in June 2004 but a one in 200 year cyclone event (Cyclone Fay) in March 2004 resulted in severe flooding of the pipeline route. This will lead to substantially increased construction costs and the delay of up to six months in the construction programme. It provides a good example of the serious construction and completion risks faced by pipelines operating in these remote locations.

Murrin Murrin Project – Since commissioning in 1999, this project has been supplied with its gas requirements of up to 13 TJ/d via the GGP. The operations are based on a large low grade lateritic orebody and the utilisation of relatively untested high pressure acid leach technology. The original design basis was for production of 45,000 t/a of nickel, but serious cost over-runs, delays and commissioning problems were experienced. Production in the year 2001/02 had not reached two-thirds of this level. This led to the bulk of the original investment being written off. In November 2002 the company entered into a Scheme of Arrangement with its creditors leading to a recapitalisation of the operations.

As far as GGT is concerned, this has resulted in erratic and volatile throughput at times, delayed payments, and significant revenue uncertainty. The significant expectations which were held for Murrin Murrin Expansion, Murrin Murrin Stage 2 and Mt Margaret projects – leading to nickel production of over 200,000 t/a have not been realised. It was these expectations on the part of GGT and the State which in large part contributed to the decisions to introduce tariff discounts and the EDT in 1999.

Cawse Nickel – The Cawse Nickel Project is another of the new generation projects based on a large lateritic orebody. At 9,000 t/a it was substantially smaller than Murrin Murrin – more in the nature of a demonstration plant. Supplied with gas via the GGP it produced its first nickel in January 1999. Its owner Centaur Mining & Exploration Ltd was placed into administration in March 2001. The operations were subsequently purchased by the OM Group. The result for GGT has been:

- substantial losses in relation to funds owing for gas transmission services at the time Cawse was placed into administration;
- significant lost revenue while the operation was sold and restructured;
- a significantly lower level of throughput for the restructured operations – and therefore lost revenue – as compared with the original contract;
- loss of the prospect of increasing the plant up to full commercial scale of 45,000 t/a.

Bulong Nickel – This project was another small lateritic nickel producer and, while Bulong was not supplied directly with gas from the GGP,**[*CONFIDENTIAL*]**. The project was placed in receivership in June 2003, with creditors owed approximately $600 million. The loss of this operation has clearly had an impact on GGP throughput and future expectations.

Kambalda Nickel Mines – The decision by WMC in 1998 to close and/or sell its nickel mines in the vicinity of Kambalda, resulted in concentrates production dropping from 34,000 tonnes in 1998 to 11,000 tonnes in 1999. This has impacted on GGP throughput as a result of a reduced level of power demand from these mines and the concentrator. While a number of the mines have been recommissioned under new ownership, the short-term nature of their resource underpinning means that their future is limited and uncertain.