

OffGAI
12 NOV 2002

8 November 2002

Mr Robert Pullella
Office of Gas Regulation
PO Box 8469
Perth Business Centre 6849

Dear Mr Pullella

**Access Arrangement for the Dampier to Bunbury Natural Gas Pipeline (DBNGP) -
Decision of the Full Court of the Supreme Court of Western Australia**

I refer to the Information Paper dated 2 September 2002 published by the Office of Gas Access Regulation inviting submissions in respect of the above.

Nufarm Limited (represented in this state by Nufarm Australia Limited and Nufarm Coogee Pty. Ltd) has an ongoing interest in this matter as a direct consumer of natural gas transported via the DBNGP.

We understand key aspects of the Supreme Court decision to be as follows.

1. Factors which the Regulator may take into account in determining whether the initial Capital Base for the DBNGP should fall outside the range of values determined under the *National Third Party Access Code for Natural Gas Pipeline Systems* (that is, values determined using the Depreciated Actual Cost (DAC) and Depreciated Optimised Replacement Cost (DORC) methodologies) include:
 - (a) the purchase of the DBNGP by Epic on 25 March 1998;
 - (b) the circumstances of that purchase including the price paid; and
 - (c) any value according to a recognised asset valuation methodology which may be revealed by the price paid in those circumstances.
2. The decision of the Court does not suggest that the Regulator's draft decision (including his determination of the appropriate initial Capital Base / Cost of the DBNGP and the appropriate reference tariffs) will, necessarily, be altered.

3. The Regulator will now take into account the purchase price paid by Epic for the DBNGP in considering the initial Capital Cost of the pipeline and other relevant matters.

In this regard, we understand that the Regulator will now be required to revisit his view as to whether the purchase price paid by Epic for the DBNGP represented a reasonable valuation of the capital purchase price paid by Epic for the DBNGP represented a reasonable valuation of the capital cost of the pipeline based on a conventional valuation methodology. The Regulator will also consider the relevance of the price paid by Epic for the pipeline in determining whether the reference tariff proposed by Epic in its proposed access arrangement complies with the reference tariff principles set out in the Code.

With respect to the above, we submit the following comments, which are intended to assist the Regulator in his deliberations and to address our concerns as a major user of gas transmission in the DBNGP.

Interests of Users and Prospective Users of the DBNGP

The judgement of the Supreme Court, in foreshadow possible declarations, refers specifically to the factors in section 2.24(1) to (g) of the Code as guides for the Regulator in reconciling the objectives in section 8.1(a) to (f). We are concerned that the emphasis in the judgement on the Regulator taking into account various factors related to the purchase price of the DBNGP should not result in disproportionate consideration of the interests of Epic to the detriment of users and prospective users of the DBNGP (s 2.24(f) and the public interest (s 2.24(e)).

DBNGP Valuation

The details of the valuation methodology used by Epic in order to strike its bid price for the DBNGP are not in the public domain and, accordingly, we are unable to express a view on that methodology. Based on public domain data, the price paid by Epic for the DBNGP appears to be significantly greater than any price that would be arrived at by application of conventional valuation methodologies and adoption of conventional forecasting assumptions.

Furthermore, it is understood that the price paid by Epic was substantially higher than offers made by other bidders in the DBNGP sale process and therefore was substantially higher than what might be regarded as a "market price" valuation.

In bidding to acquire the DBNGP, Epic was, of course, entitled to tender whatever premium it saw fit, over and above the value for the DBNGP that would have been arrived at by application of conventional valuation methodologies. In other circumstances, that would be a private matter for Epic.

However, Epic's internal approach to valuation of the DBNGP becomes a matter of public concern if it is proposed that Western Australian gas users should now financially compensate Epic, by way of increased reference tariffs, for the premium paid to acquire the DBNGP.

In our view, it would be to the detriment of the Western Australian economy for a purchaser of a privatised monopoly asset, in practical effect, to be compensated by Western Australian industry for having chosen to pay a discretionary premium over and above the objectively determinable Capital Base of that asset. We are not aware of any relevant precedent for such a proposition in any other jurisdiction and are concerned at the implications of such an approach.

Expansion Potential and Incentives

If, as may be inferred, Epic's purchase price allowed for a value contribution from the expansion potential of the gas transmission business, then the recovery of this value should be from such future expansion and not from existing users of the DBNGP. Therefore, taking into account the purchase price of the pipeline together with all other necessary factors, we suggest that the Regulator should consider any premium over an objectively determined Capital Base to be relevant only to the expansion potential, to be recovered from any future expansion volumes.

Furthermore, it is in the interests of existing users and prospective users of the pipeline and in the broader interests of the Western Australian community, as well as Epic, for the expansion potential of gas based industries in the state and associated gas transmission infrastructure to be achieved. It is submitted that the Access Arrangement should facilitate such expansion opportunities, in which case the reference tariff should provide incentive for development of gas based industries not the reverse, as would be the case if tariffs were unduly influenced by the purchase cost of the pipeline.

Users' Tariff Expectations

Previous statements by the State Government and other relevant authorities associated with the sale of the DBNGP has resulted in a general expectation by Western Australian industry that gas transmission tariffs would fall to \$1 per GJ in 2000 and continue to fall in real terms over time. In addition, there was no indication in those Government statements that a premium might apply to gas users in Kwinana, where significant gas volumes are consumed.

Investment decisions were made and business planning was undertaken in this context. To change the context of these decisions by endorsing Epic's proposal to apply higher tariffs in the Kwinana industrial area in excess of \$1 per GJ would be contrary to the interests of users.(s 2.24(f)).



Competitiveness of WA Industry

Section 2.24(e) of the Code requires the Regulator to take into account the public interest, including the public interest in having competition in the markets (whether or not in Australia). It is contended that to satisfy this requirement a reference tariff should be developed from an economically competitive capital base and should not therefore compensate Epic for the premium paid for the DBNGP. To do otherwise would add a competitive cost penalty for users of the DBNGP, putting those users at a commercial disadvantage against their competitors in other states and overseas.

Conclusion

We strongly oppose any proposal by Epic or others that transmission tariffs should be based on the purchase price for the pipeline paid by Epic, as this would reflect an inefficient use of capital and make many Western Australian industries less competitive nationally, regionally and globally.

We would support the Regulator in ensuring that the reference tariff regime for the DBNGP is properly determined in accordance with established objective benchmarks for the determination of the initial Capital Base. Such a regime should also properly take into account the legitimate business interests of users and prospective users as well as those of the service provider, Epic.

Yours sincerely

A handwritten signature in black ink, appearing to be 'CL', written in a cursive style.

Chris Lee
Manufacturing Manager
Nufarm Australia Ltd.