WESTERN POWER CORPORATION

Submission to Western Australian Independent Gas Pipelines Access Regulator regarding Epic Energy's proposed Access Arrangement for the DBNGP

First post-judgment submission: Analysis of judgment

8 November 2002

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1. This submission analyses the judgment in *Re Dr Ken Michael AM: ex parte Epic Energy (WA) Nominees Pty Ltd & Anor* [2002] WASCA 231 (23 August 2002) (**"judgment"**).

2. Western Power's **second post-judgment submission** will discuss how the initial Capital Base should be set for the DBNGP in light of the judgment.

Summary of major points

3. The initial Capital Base is to be established by applying ss. 8.10 and 8.11. If policy guidance is needed it will be found in s. 8.1. Section 2.24 has only a very limited role in the process of setting the initial Capital Base, namely in providing policy guidance under the last paragraph of s. 8.1.

4. Each step in this process involves weighing a number of factors. Nothing in the judgment suggests that those factors which might take account of Epic's purchase price are to be given any special weight over other factors which suggest a lower initial Capital Base.

5. When considering each particular factor or objective, nothing in the judgment or the Code **requires** the Regulator to give any particular weight to Epic's purchase price. In every instance the Court has been careful to leave this to the Regulator's discretion.

6. Nothing in the Court's discussion of certain hypothetical examples (eg. a hypothetical pipeline purchaser who paid a fair market value on the reasonable expectation of recovering some monopoly profits) suggests that Epic's circumstances fall within the hypothetical situation. However even in the case of such a hypothetic al purchaser, the Court has left it open to the Regulator to decline to set an inflated purchase price as the initial Capital Base.

7. The policy of the Act and the Code is that access be on terms which are fair and reasonable for **both** Service Providers **and** users (see Appendix 1).

8. The Court affirmed that in "normal" circumstances the initial Capital Base should not exceed DORC. It is for Epic to prove that the DBNGP's circumstances justify a departure from this normal band.

9. Section 8.11 does not replace s. 8.10. Whether or not the DBNGP's circumstances are "normal", it is still for Epic to prove why s. 8.10 establishes any particular initial Capital Base for which it contends.

10. Under s. 8.10(c) and (d) the Regulator may, but is not obliged to, have regard to purchase price in considering alternative valuation methodologies. It is clearly left to the Regulator whether to do so in this instance, and if he does so what weight to give to purchase price. Any valuations under s. 8.10(c) must always be weighed against DAC and DORC under ss. 8.10(a) & (b), as well as the other s. 8.10 factors.

Part 1 – The main provisions for setting the initial Capital Base

1.1 How ss. 2.24, 8.1, 8.10 and 8.11 interact

11. The judgment makes it abundantly clear that the following process applies for setting the initial Capital Base:

    (a) the starting point and most important aspect is ss. 8.10 and 8.11,[1] and the Regulator must give each of the factors in s. 8.10 weight as a fundamental element,[2] and must have regard to the requirement in s.8.11 that the initial Capital Base will normally lie between DAC and DORC;

    (b) the Regulator's policy guidance when exercising his discretion under ss. 8.10 and 8.11 comes from the requirement that the Reference Tariff and the Reference Tariff Policy should be designed to meet the objectives in s. 8.1;[3] and

    (c) to the extent only that the Regulator needs guidance in reconciling the disparate objectives in s. 8.1 or deciding which of them is to prevail, he is to be guided by the factors in s. 2.24, [4] giving each of the s. 2.24 factors weight as a fundamental element,[5] but otherwise it is the s. 8.1 objectives which should guide the process of establishing the initial Capital Base.[6]

12. Western Power wishes to emphasise the three links in this chain: start with ss. 8.10 and 8.11, then look to the objectives in s. 8.1, then only to a limited extent look to the factors in s. 2.24. This emphasis is necessary because the judgment spends more time discussing some provisions, such as ss. 2.24(a) and 8.1(a), that it does discussing other provisions or in contemplating the overall operation of the chain. (This is understandable given the particular issues raised in the litigation, and the fact that the applicant was the Service Provider.) However the Regulator should not interpret this focus by the judgment to suggest that these factors are paramount, or even have any special importance, in the process of setting the initial Capital Base.

1.2 The judgment's treatment of s. 8.10

13. Most of Western Power's submissions on the s. 8.10 factors will appear in Western Power's second post-judgment submission.

(a) s. 8.10(e)

14. The Court noted that no submission had been made that the Regulator's dealing with the first limb of 8.10(e) on the basis that it required consideration of the international best practice in pipeline valuation involved any error. [7]

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[1] Para 163 of the judgment.
2 Para 56 of the judgment
[3] Para 84 of the judgment read with paras 162 and 185
[4] Paras 85 and 136 of the judgment
[5] Para 55 of the judgment
[6] Para 84 of the judgment read with paras 162 and 185
[7] Para 167 of the judgment

15. The Court is clearly inviting the Regulator, if he wishes, to consider a broader assessment of international best practice relating to pipelines. If the Regulator decides to read s 8.10(e) more broadly, not just limited to valuation issues, Western Power may wish to make further submissions on the Regulator's findings of fact in that regard.

(b) s. 8.10(g) – reasonable expectations of persons under prior regulatory regime

(b)(i) This includes expectations of users, not just Epic

16. The Court begins by observing expressly that the reference to the expectations of "persons" in this factor includes users' expectations.[8]

17. However, later in the same paragraph the Court states:

> "**Insofar as** it deals with the reasonable expectations of the service provider … Section 8.10 (f) and (g) … reflect the relevance of the historical returns and tariffs and depreciation, as well as **the reasonable expectations of the service provider** before the commencement of the Code … ."[9]

18. There is no reference in this later passage to the reasonable expectations of users. The Regulator should not misinterpret this narrowing of the Court's analysis as intending to exclude a consideration by the Regulator of users' expectations or to su ggest that Epic's reasonable expectations should be given any more weight under s. 8.10(g) than users'. In responding to Epic's arguments during the litigation, the Court has simply narrowed its discussion to focus on one specific limb of s. 8.10(g). This is made clear by the express finding referred to in paragraph 16 of this submission, and also by the Court's use of the words "insofar as" in the passage quoted above.

(b)(ii) Objects of the Act are fairness and reasonableness to users as well, not just Service Providers

19. The Court's treatment of s. 8.10(g) refers to the Act's and Code's objectives, an issue which is discussed in Appendix 1. As that Appendix demonstrates, the Code is intended to set access terms that are fair and reasonable to **both** the Service Provider **and** users.

(b)(iii) The matter has been left to the Regulator

20. The Court was careful to keep its discussion of s. 8.10(f) and (g) at the level of statutory interpretation. Nothing in the Court's judgment on this matter requires or recommends a particular outcome in the specific case of the DBNGP.

21. The Court notes that depending on the circumstances ss. 8.10(f) and (g) could suggest either a lower or higher initial Capital Base.[10]

22. The Court also observes that in the specific instance of these factors suggesting a higher initial Capital Base, they must be considered. Western Power submits that this does not suggest that, having considered these factors, the Regulator is **obliged** to

[8] Para. 169 of the judgment
[9] Para 169 of the judgment, emphasis added
[10] Para 169 of the judgment

establish a higher initial Capital Base. The obligation is merely to include this factor in the weighing process of ss. 8.10 and 8.11.

(c) s. 8.10(k)

23. Consistently with its finding that each factor in ss. 2.24 and 8.10 is to be given weight as a fundamental element, the Court ruled that this section **requires** the Regulator to consider any other factor that the Regulator considers relevant.[11] Western Power invites the Regulator to determine that Western Power's submissions under this factor in its second post-judgment submission are relevant, and hence to give them weight as fundamental elements.

1.3 The judgment's treatment of s. 8.11

24. The judgment's treatment of s. 8.11 requires careful analysis, to avoid reading more into it than the Court intends.

25. The Court correctly rejected AlintaGas's submission that s. 8.11 imposed an overriding cap on the initial Capital Base.[12] It also observed that in determining whether the circumstances warranted departing from the "normal" band of DAC and DORC, the consideration of each valuation methodology was to be on the basis of its merits (considered under s. 8.10(d)) and not merely on the basis of economic efficiency.[13]

26. However, the most the Court said in relation to Purchase Price Valuation[14] was that there is no reason why such a methodology should **necessarily** be excluded.[15] The Court was once again speaking in the abstract, making it clear that the Regulator may in the specific circumstances of a particular Access Arrangement determine that a Purchase Price Valuation did not provide sufficient justification to move outside the "normal" band.

27. Likewise, the Court said that if the Service Provider had a **reasonable** expectation of monopoly returns under the previous regulatory regime, these should not be excluded from consideration.[16] The Court has thus made it clear that the Regulator is free to exclude from consideration any **unreasonable** expectations Epic may have had in this regard.

28. The Court ruled out any interpretation of s. 8.11 which would determine that pre-Code investment decisions could have **no** relevance to setting the initial Capital Base.[17] This finding is clearly correct, but once again the Court has clearly left it to the Regulator to determine **how much** (if any) relevance and weight should be given to Epic's pre-Code investment decision in this particular case.

[11] Para 174 of the judgment
[12] Para. 175 of the judgment
[13] Para 176 of the judgment
[14] This is the term used by the Court to describe "a valuation methodology which had regard to the present value of anticipated future returns". See discussion in Appendix 3 to Western Power's Second Post Judgment Submission.
[15] Para. 176 of the judgment
[16] Para 176 of the judgment
[17] Para 177 of the judgment

29. In paragraphs 178 and 179 of the judgment, the Court began by reaffirming, on the basis of expert evidence, that the initial Capital Base should normally fall between DAC and DORC.[18] This is an important finding. The Court then went on to discuss, in the abstract, how s. 8.11 might be applied in a particular hypothetical case.

30. The Court's hypothetical example concerned an acquisition of a pipeline on the **open market** (note not a closed tender process) before the Code. The Court observed that this situation **may** (note not "must" or "should") justify departure from the "normal" DAC/DORC band. This was because a sale at **market value** (note not an inflated purchase price) **may** (note not necessarily does) involve the capitalisation of some monopoly returns which will have been paid to the previous owner.[19] The Court had already made it clear that any capitalisation of anticipated monopoly rents must have been **reasonable** in the circumstances.[20]

31. The Court elaborated that if this hypothetical asset was purchased on an arms-length basis and on the basis of a **sound commercial assessment**, then the Code does not intend "**automatically and necessarily**" to "**preclude**" consideration of that investment.[21]

32. The narrowness of the Court's proposition is obvious: the Court did not state that in this hypothetical example the investment **must** or even **should** be considered, merely that the Code does not automatically rule out such consideration. The Court reinforced this by concluding that "in **some** cases",[22] to exclude the interests of this hypothetical purchaser would seriously infringe on its established and legitimate rights. Clearly, the Court considered that in other cases this would not be a problem.

33. Thus, even if Epic were able to bring itself fully into line with the Court's hypothetical example, by demonstrating that its purchase price was based on a sound commercial assessment, was paid on the open market, meets the criteria for a market valuation, and legitimately capitalises monopoly rents; then even in that circumstance the Court was only prepared to say that there may be **some** cases in which Epic's investment would justify setting an initial Capital Base outside the "normal" range. That is, even if Epic fully makes out this hypothetical case (which it is well short of doing at present) the Court has made it very clear that it will be open to the Regulator, in applying the Code provisions, to determine that the DBNGP is not one of those cases, and hence to decline to establish an initial Capital Base higher than DORC.

34. This must be correct. The clear words of s. 8.10 make any other conclusion untenable. Market valuation or Purchase Price Valuation under s. 8.10(c) can never be more than one of the factors, together with DAC and DORC and a range of other matters, which goes into the Regulator's s. 8.10 analysis.

35. It follows unavoidably that if, in contrast to this hypothetical example, a pipeline was purchased **not** on the basis of a sound commercial assessment, in a closed tender and **not** on the open market, **not** at a credible market value, and in circumstances where any decision to capitalise anticipated monopoly rents was **not** reasonable, then the

[18] Para 178 of the judgment
[19] Para 178 of the judgment
[20] Para 176 of the judgment
[21] Para 179 of the judgment, emphasis added
[22] Para 179 of the judgment, emphasis added

Regulator has at the very least ample scope to determine that the purchase price does not justify a departure from the "normal" range.

36. To read into either the Code or the judgment an **obligation**, rather than a discretion, to give weight or primacy to a valuation that capitalised monopoly costs, will be to make another error of law. The Court has emphasised the Regulator's discretion, and that includes the discretion, in appropriate circumstances, to discount or discard a valuation which capitalises an unreasonable expectation of monopoly rents or which is otherwise uncommercial, mistaken or unrealistic.

37. In summary, Western Power supports the Court's observation that "s. 8.11 is to be accepted for what it says".[23] Western Power observes, however, that nothing in the judgment suggests or requires that s. 8.11 be accepted for **less than** what it says. Therefore, it is for Epic to make a credible case to the Regulator not only:

(a) that the current circumstances are sufficient to justify an initial Capital Base higher than the s. 8.11 "normal" range;

but also **as a separate task**:

(b) that any such initial Capital Base derives from an appropriate weighting of all the factors in s. 8.10 as fundamental elements, consistent with the objectives in s. 8.1, where the reconciliation or prevailing of the factors in s. 8.1 is guided if necessary by an appropriate weighting of all the factors in s.2.24 as fundamental elements.

38. Neither one of these is sufficient in itself, for DORC to be exceeded. Merely demonstrating a sufficient reason to go outside the normal band, even if Epic were able to do so, means nothing, unless Epic also demonstrates that the proper Code analysis produces an initial Capital Base higher than DORC. Put even more simply, whether or not the DBNGP's circumstances are "normal" for the purposes of s. 8.11, Epic must still demonstrate that s. 8.10 produces a number higher than $1.234bn. The Court ruled that the onus rests on Epic to prove this.[24] It has not done so to date.

1.4 The judgment's treatment of s. 8.1

39. The judgment makes it clear that the central provisions in setting the initial Capital Base are s. 8.10 & 8.11. The Regulator is required by s 8.10 to take into account factors (a) to (k) and to give to them weight as fundamental elements in establishing the initial Capital Base.[25]

40. Section 8.1 is one step removed from this process. It does not deal with the setting of the initial Capital Base. Rather, it contains a statement of the objectives which are to guide the design of a Reference Tariff and a Reference Tariff Policy. [26] It thus creates the policy framework for the initial Capital Base setting process.

[23] Para 178 of the judgment
[24] Para 189 of the judgment
[25] Para 56 of the judgment
[26] Para 72 of the judgment

(a) s. 8.1(a)

41. The Court considered submissions from AlintaGas and the Regulator regarding whether "efficient costs" were to be assessed only on a "forward-looking" basis. The Court noted that this submission found some support in economic theory, and having made that finding left the determination of what came within "efficient costs" (ie. whether the expression was only forward looking) to the Regulator.[27] In other words the Court **did not rule out** a finding by the Regulator that "efficient costs" in s. 8.1(a) should be **only forward looking**, in the circumstances of this particular case. It remains entirely open to the Regulator to find in his discretion that in the case of the DBNGP, he should have regard only to forward-looking costs.

42. The Court also made it clear, in its discussion of the narrower focus of the concept of efficient costs in s. 8.1(a) of the provision of services over the life of the pipeline (cf. s. 8.10(h)[28] and s. 8.1(e)[29]), that "efficient costs" is still to be evaluated using the three dimensions of technical or productive, allocative and dynamic efficiency.[30]

43. Therefore it is up to Epic to demonstrate:

    (a) that this is a situation in which the Regulator should exercise his discretion, contrary to some economic evidence as found by the Court, to undertake a "backward looking" analysis of efficiency in this particular case; and

    (b) to the extent that Epic succeeds in this, that a Reference Tariff outcome which gives it the opportunity to recover some or all of its investment of $2.4bn meets the statutory requirements of technical or productive efficiency, allocative efficiency and dynamic efficiency (albeit analysed in the narrower[31] context of s 8.1(a)).

44. Finally in relation to s. 8.1(a), the Court noted that this objective should not be read as limiting the revenue stream to either "no more than" or "no less than" efficient costs.[32] Western Power submits that this is a correct conclusion – this limitation can be found in other factors of s. 8.1, so there is no need to import it here.

(b) s. 8.1(b)

45. The Court discussed the Hilmer Report's consideration of the impact of workable competition, and concluded:

> "It appears to be inherent in this [passage from the Hilmer Report] that in a workably competitive market past investments and risks taken may provide some justification for prices above the efficient level."[33]

46. Western Power observes that this is neither a finding of fact nor a ruling on how the Code is to be applied. It is merely a comment, in passing, on an inference that can be

[27] Para 141 of the judgment
[28] Para 170 of the judgment
[29] Para. 156 of the judgment
[30] Para. 141 of the judgment
[31] Para 141 of the judgment
[32] Para. 142 of the judgment
[33] Para. 144 of the judgment

drawn from one passage in the Hilmer Report. The Hilmer Report's views on this particular issue are far from conclusive, and have very little application to interpreting the Act and the Code. As the Court itself noted, the authors of Code did not follow the Hilmer Report's recommendations in all respects.[34] Furthermore the Court's discussion of why the italicised overview at the beginning of s. 8 could not override the operative provisions of the Code,[35] applies with even greater force to prevent an application of the Hilmer Report.

47. This view is supported by the Court's finding that the evidence had failed to demonstrate a settled view as to the most appropriate balance between the interests of pipeline operators and the interests of users and prospective users.[36] Western Power submits that both the Code and the judgment leave the setting of that balance to the Regulator.

48. The Court also found that the evidence suggested that by December 1997 there was:

> "a growing awareness of the long term disadvantages of striking the balance with too great an emphasis on the interest of consumers in securing lower prices, and without due regard to the interest of the service provider in recovering both higher prices and its investment."[37]

49. Western Power submits that the Code addresses this "growing awareness" by including factors which directly reflect the Service Provider's interests (s. 2.24(a), s. 8.10(j)) and also factors which expressly require the Regulator to look at the bigger picture (s. 8.1(d), s. 8.10(h)), to counterbalance those factors which reflect users' interests.

50. Western Power submits that this finding by the Court does not require or justify an approach to applying the Code which gives special emphasis to Epic's interests over the interests of users and prospective users. Furthermore, to give special emphasis to Epic's interests would be inconsistent with the express objective of the Code that access be on terms which are fair and reasonable for both the Service Provider and the user (see Appendix 1). It would also be inconsistent with the Court's finding that a full exploration of the implications of s. 8.1(b) is a matter for the Regulator,[38] although the Court did rule that the purpose of s. 8.1(b) is to replicate a situation where the Covered Pipeline was subject to workable pipe-on-pipe competition.[39]

(c) s. 8.1(d)

51. The Court has reminded the Regulator that although the judgment focuses on the first limb of this objective, the Regulator must consider the second limb of s. 8.1(d) as well.[40]

52. The Court rejected an argument that the Code required past investment to be disregarded,[41] and then made several observations about the risk of adverse regulatory

[34] Paras. 95 and 96 of the judgment
[35] Paras 157-162 of the judgment
[36] Para. 145 of the judgment
[37] Para. 145 of the judgment
[38] Para 128 of the judgment
[39] Para 127 of the judgment
[40] Para. 147 of the judgment

outcomes discouraging future investors. Western Power demonstrates in the next few paragraphs that these observations were made in the abstract rather than by specific reference to the DBNGP, and also that they were heavily qualified.

53. For example, the Court referred to the need to have regard to:

> "the need for … investors to have confidence that … investment decisions … which **were sound when judged by the commercial circumstances existing at the time** of the investment, … do not result in liquidation, by virtue of **future governmental intervention**."[42]

54. This is an entirely appropriate objective for the Code. The questions in Epic's case will be whether the investment was sound at the time, and how much weight should be given to this factor given that in this particular case Epic purchased the pipeline in the full knowledge that the "future government intervention" was just around the corner. Both of these points are addressed in Western Power's Second Post Judgment Submission. Once s. 8.1(d) has been considered on both of these matters, the Regulator will then have to reconcile it against the other s. 8.1 objectives, or decide which prevails, having regard if necessary to all the matters in s. 2.24.

55. Likewise, in paragraph 152 the Court found that s. 8.1(d) was included to deal expressly with the need to address the balance between lower prices for consumers and not producing adverse investment effects. However the highest characterisation the Court was prepared to place on s. 8.1(d), as regards previous investment decisions, was that 8.1(d) does "not [deny] the **potential** relevance of past investment decisions",[43] and that under s. 8.1(d) "[p]ast investment … has not been rendered **necessarily** irrelevant".[44] The Regulator "**in an appropriate case**"[45] may take past investment into account, although not of course reckless, mistaken or highly speculative[46] or uncommercial[47] investment. Similarly, even a prior investment decision which capitalised some anticipated monopoly rents "**would not be irrelevant**", although the Court was alive to the risk that allowing **any** price paid to be recovered could be equally distorting.[48]

56. Western Power wishes to reinforce the point that the Court left this matter fully to the Regulator's discretion. It is up to Epic to convince the Regulator that in the DBNGP's particular circumstances s. 8.1(d) justifies an initial Capital Base, for example, which is higher than DORC. Western Power is confident that the Regulator will heed the Court's warning that any pre-Code purchase price will need to be "carefully evaluated".[49]

57. Paragraph 152 is another instance in which the Court refers to the Act and Code's objectives, see Appendix 1. As that Appendix demonstrates, the Code is intended to set access terms that are fair and reasonable to **both** the Service Provider **and users**.

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[41] Para 148 of the judgment
[42] Para 149 of the judgment, emphasis added
[43] Para 152 of the judgment, emphasis added
[44] Para. 153 of the judgment, emphasis added
[45] Para 154 of the judgment, emphasis added
[46] Para 154 of the judgment
[47] Para 155 of the judgment
[48] Para 155 of the judgment, emphasis added
[49] Para 155 of the judgment

(d) s. 8.1(e)

58. Although this objective was not discussed in the judgment, it remains an equally important objective. Not only the structure of the Reference Tariff, but also its level, must be economically efficient.[50]

1.5 The judgment's treatment of s. 2.24

59. The Court found that the Regulator must be guided by s 8.1, rather than s 2.24(a) to (g), in the establishment of the initial Capital Base insofar as s 8.10 and s 8.11 require the exercise of discretion by the Regulator.[51]

60. The only exception to this is where the objectives in s 8.1(a) to (f) conflict and the Regulator is called upon to determine the manner in which they can best be reconciled or which of them should prevail, as contemplated by the last paragraph of s 8.1. The Court found that in exercising this discretion, the Regulator should take into account the factors in s 2.24(a) to (g),[52] and give each factor in s 2.24(a) to (g) weight as a fundamental element.[53]

61. Thus, the s. 2.24 factors play only an extremely limited, tightly-bounded role in the process of establishing the initial Capital Base. However for completeness Western Power makes the following submissions on the Court's treatment of these factors.

(a) s. 2.24(a): The service provider's legitimate business interests and investment in the covered pipeline

62. For the reasons just given, the only relevance of the Service Provider's legitimate business interests and investment in the Covered Pipeline to the establishment of the initial Capital Base under s 8.10 and s 8.11, is that it can (together with all the other factors in s. 2.24, weighed against each other as fundamental elements) be taken into account by the Regulator in performing his task of reconciling the objectives in s 8.1(a) to (f) or determining which should prevail where the objectives conflict.

63. The fact that the Court has found the Service Provider's interest in recovering its investment to be "legitimate",[54] however imprudent or reckless that investment may have been, does not mean that in the circumstances of this particular pipeline the Regulator is required to give any particular emphasis to that interest. On the contrary, Western Power submits that this factor must be weighed against the other 5 matters expressly included in s 2.24(b) to (f), as well as any other matters that the Regulator considers are relevant under s 2.24(g), each of which must be given weight as a fundamental element.[55]

64. Paragraph 130 is another instance in which the Court refers to the Act and Code's objectives, see Appendix 1. As that Appendix demonstrates, the Code is intended to set access terms that are fair and reasonable to **both** the Service Provider **and users**.

[50] Para 156 of the judgment
[51] Para 84 of the judgment.
[52] Para 85 of the judgment.
[53] Para 55 of the judgment.
[54] Para 130 of the judgment
[55] Para 55 of the judgment.

(b) s 2.24(d) – The economically efficient operation of the Covered Pipeline

65. The Court found that the reference in this section to "efficiency" was intended to reflect the theory of economic efficiency,[56] and the Court suggested that this provision was intended to counterbalance a broader social interest against Epic's interests under s. 2.24(a). That is, society's interest in promoting a competitive market and preventing the abuse of monopoly power. [57]

(c) s 2.24(e) – The public interest, including the public interest in having competition in markets (whether or not in Australia)

66. The Court declined to consider Epic's submission that the public interest **may** extend to protecting the interests of pipeline owners and ensurin g that fair and reasonable conditions are provided.[58]

67. The Court noted that in its latter respect, s 2.24(e) clearly reflects the objective stated in the Act's preamble of the promotion of a competitive market.[59] The public interest at large, which as the Court stated has regard to wider considerations, could be expected to extend to ensuring that those conditions are fair and reasonable for users, which is an objective of the Code (see Appendix 1).

(d) s. 2.24(f) – the interests of users and prospective users

68. The Court expected this factor to be counterpoised against the factor in s. 2.24(a). [60]

69. The Court did, however, note since both users and the Service Provider have a common interest in maximising capacity utilisation, there was some scope for these interests to be aligned.[61] Western Power observes that this commonality is less likely if the pipeline in question is fully utilised, and that in any event it is at most a sideshow to the fundamental tension between the Service Provider's "legitimate business interest" in maximising income, and the users' diametrically opposed "interest" (note that Parliament did not limit this by a requirement of legitimacy or a business link) in minimising tariffs.

Part 2 – Other comments on the judgment

2.1 The principal errors of law identified in the judgment

70. In paragraphs 202 to 207 the judgment identifies a number of specific errors of law.

71. Western Power feels that the issues raised in these paragraphs of the judgment have been adequately addressed by other comments in this submission.

72. If the final resolution of declaratory relief in the litigation raises further issues, Western Power will make further submissions.

[56] Para 120 of the judgment.
[57] Para 133 of the judgment.
[58] Para 134 of the judgment
[59] Para 134 of the judgment
[60] Para 135 of the judgment
[61] Para 135 of the judgment

2.2 The three "further matters" noted by the judgment

73. In addition to identifying the specific errors of law, the judgment notes three "further matters".[62] The Court's intention appears to be simply to identify matters that may need to be borne in mind in the Regulator's further work, but which do not require even declaratory relief.

74. The **first** of these relates to the Regulator's failure to take into account Epic's claim that the volume forecasts it relied on in calculating its purchase price factored in a further $875 million of capital expenditure,[63] and the **second** was an observation that the Regulator's Draft Decision did not disclose whether he had given any consideration to the outcome of Epic's investment decision in the DBNGP under s. 8.1(d). Both of these matters are addressed in Western Power's second post-judgment submission.

75. The **third** was an observation that the Regulator's conclusions about the sale process were expressed inconsistently. At one point in the Draft Decision the Regulator stated that the sale process "would" have led to a reasonable expectation that the regulatory value would not exceed a DORC valuation, and in another place he stated that it "may" give rise to such an expectation.[64] Western Power notes that this distinction is now largely moot. The Court has found unequivocally that due to the clear disclaimers from the Sale Steering Committee and also the anticipated role of an independent regulator, the information provided during the sale process had neither "any level of assurance [n]or provided a reasonable basis for expectation"[65] regarding expected tariffs at or from 1 January 2000. This manifestly correct finding of fact regarding expected tariffs must apply with equal force to the information published during the sale process regarding the impending regulatory asset valuation. The only reasonable expectation Epic could have formed was that the regulatory initial Capital Base would be set by an independent regulator applying the principles set out in s. 8 of the Code, in particular the factors in s. 8.10 and guided by the expectation expressed in s. 8.11.

2.3 Other matters

76. At paragraph 128, in the context of describing a competitive market as a process and not a condition, the Court noted that there may be a lag between a changed pressure or circumstance, and the market adaptation. In this sense, the Court suggested that the market may well "tolerate" a degree of market power.[66] This may be seen as suggesting that the Regulator, when considering a need for a competitive market, should "tolerate" imbalances in market power. However Western Power submits that this would be incorrect. The Court clearly intended the concept of a workably competitive market to recognise that after the "lag" had been remedied, the "tolerance" of an imbalance would be addressed. That is "… market forces will increase **efficiency** beyond that which could be achieved in a non-competitive market …".[67]

[62] Para 208 of the judgment
[63] Para 208 to 211 of the judgment
[64] Para 213 of the judgment
[65] Para 198 of the judgment
[66] Para 128 of the judgment
[67] Para 128 of the judgment, emphasis added

77. At paragraph 182, in its consideration of s. 8.16(a), the Court stated:

> "Such new investment decisions are made in knowledge of the limitations imposed by s [8].16(a), whereas investment decisions made before the Code applied to the pipeline are not."[68]

78. This comment relates to new capital investment, but in case it is read more broadly, Western Power notes that it is a general remark made in the abstract. In the specific case of the DBNGP, of course, Epic Energy knew full well that the DBNGP was to be regulated by the Code. See Western Power's Second Post Judgment Submission.

2.4 The "regulatory compact"

79. The judgment resoundingly rejected Epic's "regulatory compact" argument, which the Court characterised as being that:

> "… the Regulator might properly have regard to the price paid by Epic, and in the circumstances he ought to have reflected it in his establishment of the initial Capital Base."[69]

80. The Court found "more than one difficulty" with Epic's submission.

81. First, the Court made the crucial finding of fact that "the tender process … appears to fall short of providing an adequate factual foundation for the submission."[70] In other words, **Epic has failed to prove that any form of "regulatory compact" ever existed**. This finding is reinforced by the Court's ruling that Schedule 39 of the Asset Sale Agreement "had no contractual force".[71]

82. Second, and even "more fundamentally", the Court found as a matter of fact that:

> "… **it was made clear** that a feature of the anticipated Code was that tariff levels were to be **fixed by an independent regulator**."[72]

83. This finding of fact is critical. As Western Power will make clear in its second post-judgment submission, the fact that Epic was placed very clearly on notice that the Code would apply to the privatised pipeline, fundamentally affects the extent to which the Regulator should give weight to the purchase price and Epic's expectations, in the specific context of this pipeline as distinct from in the abstract consideration of how the Code works in general.

84. Therefore, the Court found **no error of law** in the Regulator's failing to act on, or give the requested relevance and weight to, Epic's submissions regarding the discredited "regulatory compact" or Epic's expectations arising from the sale process.[73] On the contrary, the Court found that the evidence before it "fall[s] short" of establishing a basis for Epic's alleged expectations.[74]

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[68] Para 182 of the judgment
[69] Para 195 of the judgment
[70] Para 196 of the judgment
[71] Para 198 of the judgment
[72] Para 197 of the judgment
[73] Para 200 of the judgment
[74] Para 200 of the judgment

85. The judgment makes it very clear that it is for Epic to establish its case, if it wishes an asset valuation higher than DORC. Western Power may comment on any submissions Epic makes in this regard.

Appendix 1 – Objects of the Act and Code: reasonable terms for users, not just Service Providers

General discussion

1. In a number of places, the judgment refers to an objective of the Act or the Code that access be on terms that are **fair and reasonable for pipeline owners**.

2. This could be read as giving an emphasis or primacy to Epic's interests over the interests of users or the public. However Western Power submits that such a reading would be entirely incorrect. It is not supported by the Act, the Code, policy instruments such as the Hilmer Report, or even, on a close reading, by the judgment itself.

3. The relevant objective, set out in the preamble to the Act and repeated (in substantially similar terms) in the introduction to the Code, is to:

> " (d) [provide] rights of access to natural gas pipelines on conditions that are fair and reasonable for the owners and operators of gas transmission and distribution pipelines **and persons wishing to use the services of those pipelines**".[75]

4. In this Appendix, this is referred to as **"objective (d)"**.

5. Objective (d) makes it unambiguously clear that the Code is directed to achieving a balance between being fair and reasonable to pipeline owners on the one hand, and being fair and reasonable to users on the other.[76] In this Appendix, these two objectives are referred to respectively as the **"first limb"** and the **"second limb"** of objective (d).

6. This position is fully consistent with the policy intention of the Hilmer Report. See passage quoted at para.89 of the judgment.

7. The discussion below shows that nothing in the judgment is inconsistent with giving equal weight to both the first limb (pipeline owners) and the second limb (users), when applying objective (d).

8. A general comment which applies to all of the specific instances discussed below, is that it is logical for the judgment to focus on a discussion of the Service Provider's interests under the first limb of objective (d) because the judgment relates to an application for administrative relief by a Service Provider, aggrieved by the Regulator's failure to take into account certain matters which are in the interest of the Service Provider. In most instances the judgment is responding to a specific argument advanced on Epic's behalf.

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[75] *Gas Pipeline Access (Western Australia) Act 1998*, emphasis added

[76] For simplicity, this Appendix generally refers only to "pipeline owners" and "users", but these references should be read as extending to pipeline operators and to prospective users, respectively.

9. However, before the Court can be said to have intended to overturn the express recognition of users' and prospective users' rights in the second limb of objective (d), clear words would need to be found in the judgment producing that result. As is indicated below, the contrary occurs.

Specific instances

10. At paragraph 130 the Court states:

> "The service provider's legitimate business interests and investment in the pipeline (s 2.24(a)) would appear directly relevant to the objective that access rights by third parties be on conditions that are **fair and reasonable for the owners and operators of a pipeline**."[77]

11. In this instance, the Court has quite correctly linked s. 2.24(a)'s recognition of the Service Provider's legitimate business interests with the first limb of objective (d). However nothing in this passage excludes the second, user-oriented, limb of objective (d), or gives the first limb primacy. Clearly, the second limb of objective (d) is linked to other factors in s. 2.24, most obviously s. 2.24(f).

12. In paragraph 153, in its discussion of s. 8.1(d), the Court states:

> "In particular, there may be seen in s 8.1(d) a reflection of the general scope and policy of the Act, **in so far as** this sought to provide for third party access to pipelines on terms and conditions that were **fair and reasonable to owners and operators**."[78]

13. Once again, the Court has expressly narrowed its remark by the inclusion of the words "in so far as", and as with the discussion of s. 2.24(a) this statement by the Court must be read in the context of its discussion of how s. 8.1(d) protects pipeliners' interests. Had the Court been focussing on the objective of having efficiency in the level of Reference Tariffs, which forms part of s. 8.1(e), it may well have spoken on the second limb of objective (d) rather than the first limb. For the reasons discussed earlier in this Appendix, Western Power submits that it would be entirely wrong to read into the Court's remark, made in the context of a consideration of one aspect of one paragraph of s. 8.1, a general proposition that the Court intended to overturn or gloss the plain words of objective (d) and the two limbs it contains.

14. In its treatment of s. 8.10(g), the Court states at paragraph 169:

> "… these provisions, and particularly s 8.10(g), may be seen to reflect **that part of** the general objective of the Act and Code that rights of access to third parties would be on conditions that are fair and reasonable for the **owners and operators of pi pelines** …".[79]

15. In this instance, the court has expressly observed that the achievement of fair and reasonable terms for pipeline owners is only one "part of" the Act's and Code's objectives. This expressly leaves room for the second limb of objective (d), n amely

[77] Para 130 of the judgment, emphasis added
[78] Para 153 of the judgment, emphasis added
[79] Para 169 of the judgment, emphasis added

fairness and resonableness to users, as well as the other objectives set out in the preamble and introduction.

16. At paragraph 177, the Court states that a conclusion is:

> "… consistent with s 2.24(a) and the general policy objective of the Act for providing access rights to third parties on conditions that are fair and reasonable for service providers, as well as s 8.1(d) …". [80]

17. For reasons set out above, this reference to only the first limb of objective (d) is reasonable in the context of a discussion of ss. 2.24(a) and 8.1(d).

18. Finally, the fact that in some of the above passages the Court refers to the first limb of objective (d) as "the" general policy objective of the Act cannot be read as suggesting that it is "the only" or "the primary" such objective. This is so as a matter of simple grammatical construction, but is reinforced by the fact that to do so would be to require that the following passage of the judgment be read as suggesting (inconsistently, and equally incorrectly) that paragraphs (b) and (c) of the preamble are to be given emphasis or primacy over either limb of objective (d):

> "In this respect, s 2.24(d) most naturally relates to **the objective** in the preamble of the promotion of a competitive market [paragraph (c)] and, perhaps, also to the prevention of the abuse of monopoly power [paragraph (b)]."[81]

[80] para 177, emphasis added
[81] para 133, emphasis added