Goldfields Gas Transmission Pty Ltd

Public Submission No. 1

on

Draft Decision

for

Goldfields Gas Pipeline

Proposed Access Arrangement

13 July 2001

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Goldfields Gas Transmission Pty Ltd (GGT) makes the following submission in response to the Draft Decision concerning the Proposed Access Arrangement for the Goldfields Gas Pipeline (GGP) issued by the Gas Pipelines Access Regulator (Regulator) on 10 April 2001.

Overview

1. GGT as operator on behalf of the Joint Venture Owners, is of the opinion that in regard to the majority of the specified non-tariff amendments, workable outcomes can be achieved by a cooperative approach.

2. GGT contends however that in other respects, and in particular in the area of tariff determination, the Draft Decision contains serious flaws in regard to both legal and technical matters and is of the opinion that the Regulator should give consideration to re-issuing an amended Draft Decision.

3. What is of greatest concern to GGT is the treatment in the Draft Decision of the prevailing GGP State Agreement (State Agreement). GGT's Access Arrangement is intended to be consistent with the applicable provisions of the National Code, having regard to the pre-existing provisions of the State Agreement.

4. The Regulator's apparent disregard of the effect of a State Agreement in this manner gives rise to serious concerns regarding existing and future economic developments undertaken via the security of a State Ratified Agreement. The Joint Venturers are all significant investors in energy infrastructure. We are disappointed that the Draft Decision, despite our earlier submissions, proposes an outcome which is not consistent with the Joint Venturers' legitimate business interests.

5. GGT intends to work with OffGAR to resolve these matters in a manner that is consistent with prudent pipeline operator-ship and its ability to meet its legal and pre-existing contractual obligations yet does not compromise the Joint Venturers' rights under the State Agreement.

6. GGT wishes to emphasise that while these issues are being resolved, it is very much business as usual. As a pipeline operator whose sole business is the transportation of natural gas, we are always keen to talk to existing and prospective Users.

7. It is intended that this submission will provide the Regulator and other interested parties with a fuller appreciation of the salient issues currently faced by GGT as well as advance notice as to its revised stance in regard to previously volunteered offers of a discounted tariff.

8. This submission does not address in detail the complex legal issues which arise from the Regulator's approach in the Draft Decision. These legal issues will be dealt with separately on the basis of legal advice, and nothing in, or omitted from, this submission should be taken to constitute our agreement or concurrence with the position taken on such matters within the Draft Decision.

1.0 Relationship Between Goldfields Gas Pipeline Agreement Act 1994 and the Gas Pipelines Access (Western Australia) Act 1998

GGT considers that the Regulator has not given proper consideration to the provisions of the Goldfields Gas Pipeline Agreement (**State Agreement**) as it is required to do as a matter of law. As a consequence, GGT considers the Draft Decision to be seriously flawed.

The State Agreement was made on 23 March 1994 by the then Premier on behalf of the State of Western Australia. This Agreement was ratified and its implementation was authorised by the Parliament of Western Australia through the Goldfields Gas Pipeline Agreement Act 1994 (**State Agreement Act**).

The current owners of the pipeline (noted in the Preface of the Draft Decision) are the Joint Venturers which have assumed and continue to have rights and obligations under the State Agreement.

The Gas Pipelines Access (Western Australia) Act 1998 (**GPAA**) provides for third party access to gas pipeline systems and reflects an agreement between the Commonwealth and the Australian States for an enactment of a uniform national framework of legislation for third party access to all gas pipelines. The GPAA comprises three parts:

- the enabling legislation (ss 1 to 97);
- schedule 1; and
- schedule 2, being the Code

with schedules 1 and 2 being referred to as the Gas Pipelines Access Law or **GPAL**.

Section 97 of the GPAA makes specific acknowledgment of the State Agreement. Contrary to the implication underlying the Regulator's comments at paragraphs B2.1 and B5.4.3.7 the State Agreement has not been replaced by the Code and continues to operate alongside the GPAA.

Under the State Agreement the Joint Venturers have the right to determine tariffs based on tariff setting principles approved by the Minister pursuant to the procedures under that Agreement.

The tariff setting principles were approved by the Minister in January 1995 and continue to remain in effect. This right came into existence prior to the date the proposed access arrangement was submitted (15 December 1999).

The combined effect of Section 97(4) of the GPAA and clause 21(3) of the State Agreement is that the GPAL:

- will not apply to the Pipeline to the extent that the Joint Venturers are able to demonstrate that it has or is likely to have a material adverse effect on their legitimate business interests; and

- in any event, insofar as it may purport to apply to the Initial Committed Capacity, will only apply to the extent that the Initial Committed Capacity in the Pipeline is from time to time unutilised.

So in summary the GPAL does not apply to:

- the Pipeline's Initial Committed Capacity that is from time to time utilised, which capacity continues to be covered by the State Agreement or any applicable transmission contracts with Initial Customers; and

- the Pipeline's other capacity to the extent the Joint Venturers are able to demonstrate that the GPAL has or is likely to have a material adverse effect on their legitimate business interests, and where that is demonstrated, that capacity continues to be covered by the State Agreement, the Tariff Setting Principles approved thereunder and any applicable transmission contracts.

Furthermore, the Code itself preserves certain of the Joint Venturers' pre-existing contractual rights (Section 2.25).

Under the State Agreement, the Joint Venturers, which were selected originally by the State through a competitive process, are entitled to a commercial rate of return on all project capital and operating costs relating to the construction and operation of the pipeline. To achieve this rate of return a levelised tariff model was developed from which was derived a tariff known as A1, applicable from 1 January 1997. The assumptions underlying this tariff model were set out in, and along with the tariff model, were approved under, the January 1995 approved proposals.

The tariff model, its underlying assumptions and the A1 tariff therefore encapsulate the legitimate business interests of the Joint Venturers to which the protection provided under clause 21(3) must be applied.

The Joint Venturers contend, and in March of this year so advised the Regulator and the State, that the GPAL and in particular Section 8 (Reference Tariff Principles) of the Code, has or is likely to have a material adverse effect upon their legitimate business interests and therefore is, to that extent, not applicable to the Pipeline. This has been confirmed by the content of the Draft Decision which, by applying the Section 8 Reference Tariff Principles, foreshadows a reduction of greater than 40% in the tariffs which were previously justified.

The effect of clause 21(3) and other provisions of the State Agreement on the exercise of the Regulator's powers under the GPAA is fundamental to many aspects of the Draft Decision and involves complex matters of law.

Some of these matters concern the legal effect of:

- clause 21(3) of the State Agreement and Section 97(4) of the GPAA and in particular whether or not the GPAL, the Regulator's decisions made thereunder, or both, can apply at all to the Pipeline and if so, to what extent;

- the tariff setting principles at Section 8 of the Code on the "legitimate business interests" of the Joint Venturers; and

- Section 2.25 of the Code on the Joint Venturers' pre-existing contractual right to determine tariffs in accordance with the State Agreement.

These matters together with other related legal issues are being considered further by the Joint Venturers on the basis of legal advice. Nothing set out in, or omitted from, these submissions should be taken to constitute our agreement or concurrence with the Regulator's understanding of the effect of the State Agreement or the GPAA as summarised in the Draft Decision.

2.0 Amendments Proposed in Draft Decision

Amendment 1

Amendment 1 proposes that GGT include an Interruptible Service as a non-reference service.

While it was offered as a service under the previous General Terms and Conditions (under the State Agreement), GGT has not received any request to date for an interruptible service and therefore does not agree with the conclusion in the Draft Decision. The public submission by the Chamber of Minerals and Energy in which it was indicated "that there may be some demand from some users for other services such as an interruptible service" is not reflective of the statement in the Draft Decision that an interruptible service is "likely to be sought by a significant part of the market".

However, to provide additional flexibility for Users of the Reference Service, GGT has offered the option of a Supplementary Quantity Option. The Supplementary Quantity Option is intended to allow Users to correct imbalances or transport gas in excess of their MDQ on an occasional basis, and is offered on an interruptible basis.

Further, in regard to any service, GGT as a matter of commercial practice and also as required under the Code, will negotiate with its customers to provide a service which reasonably meets the customer's requirements. This is provided for in the proposed Access Arrangement by way of the Negotiated Service.

Additionally, to require GGT to describe in detail a service that has never before been requested and which, given the nature of current and potential Users of the pipeline, can not reasonably be expected to be requested for the duration of the term of this Access Arrangement, will give rise to unnecessary costs having to be incurred by GGT for little or no benefit to either GGT or potential Users.

Accordingly, GGT believes that this amendment is unnecessary and unreasonable.

Amendment 2

Amendment 2 proposes the provision of alternative and multiple inlet points in a single service agreement.

To date no User has requested the establishment of an additional inlet point to the GGP. Due to the location of the pipeline, it is unlikely that there will be any such requirement in the short to medium term. Any future interconnect from the DBNGP (which would in all probability supply gas from other Carnarvon Basin producers) would unquestionably be located at Yarraloola, that is at the existing inlet, and hence in itself would not necessitate the proposed amendment.

GGT considers that without knowing where any other possible 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.

Should there be a requirement for an additional inlet point in the future, GGT will 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" (see Code, section 10.8) and that as a consequence Users are therefore entitled to negotiate the terms of an interconnection arrangement with GGT and have access to the arbitration process provided under the Code.

To require GGT to describe in detail hypothetical aspects of services that have not previously been requested and, given the nature of current and potential Users of the pipeline, are unlikely to materialise within the duration of the term of this Access Arrangement, would give rise to unnecessary costs having to be incurred by the Service Provider for little or no benefit to either GGT or potential Users.

Consequently, GGT considers that this Amendment is unreasonable and unnecessary.

Amendment 3

Amendment 3 proposes GGT remove the discretionary power to add extra conditions in addition to those already in General Terms and Conditions.

GGT will address this issue in the revised Access Arrangement which it will lodge with the Regulator.

Amendment 4

Amendment 4 proposes that Users (ie. Shippers) may operate and maintain their own Outlet points.

GGT will revise its Access Arrangement to address this issue but will include provisions in the terms and conditions of the revised Access Arrangement which require the User to ensure that any outlet point does not adversely affect the operational and structural integrity of the pipeline.

Amendment 5

Amendment 5 proposes that a User cannot be prevented from guaranteeing continuous supply to another User.

GGT will revise its Access Arrangement to address this issue.

Amendment 6

Amendment 6 proposes that Users can not to be required to indemnify GGT against liability for blameless proximate events.

GGT will revise its Access Arrangement to address this issue, taking into consideration the extent to which the User is not liable for events not caused by the User, its customers or persons under their control.

Amendment 7

Amendment 7 proposes that a Service Agreement can be terminated by mutual consent or referred to dispute resolution if its commencement date or a reduction of scope of service can't be agreed.

GGT believes that this issue is already satisfactorily addressed in the proposed terms and conditions by Clause 22(1) of the General Terms and Conditions which already provides for recourse to dispute resolution applicable to the circumstances outlined by the Regulator.

Accordingly, GGT believes that this amendment is unnecessary and unreasonable.

Amendment 8

Amendment 8 proposes that planned maintenance affecting a service should require User consultation and 30 days notice.

GGT will revise its Access Arrangement to address this issue.

Amendment 9

Amendment 9 proposes an index of reliability linked to reductions in fixed charges for reliability short falls.

The operating costs contained in the proposed Access Arrangement reflect the current operating costs and practices of the pipeline. Any increase in the current levels of reliability may result in an increase in operating costs and thus an increase in the Reference Tariffs.

GGT notes that any User which requires a service with particular reliability features may seek to negotiate the terms of such a service with GGT, subject to the provision of such a service not affecting GGT's ability to perform its obligations under existing transportation agreements.

GGT will revise its Access Arrangement to address this issue.

Amendment 10

Amendment 10 proposes fixed charges be waived for force majeure or emergency shutdown events and that imbalance and variance charges be waived for interruptions attributable to GGT.

GGT will revise its Access Arrangement to address this issue.

Amendment 11

Amendment 11 proposes that the basis upon which a bond or surety is determined is to be specified with provision for decreases.

GGT will revise its Access Arrangement to address this issue.

Amendment 12

Amendment 12 proposes that a grace period is required before interest is accrued on under/over-payments.

This is unnecessary as clause 13.7 of the General Terms and Conditions affords symmetry regardless of which party is the payor and reflects normal commercial practises. Accordingly, GGT submits that the proposed amendment is unreasonable, unnecessary and does not properly recognise GGT's or User's legitimate business interests as required under Section 2.24 of the Code.

Amendment 13

Amendment 13 proposes provision for non-payment of all or part of disputed invoices where manifest invoice error is evident.

GGT will revise its Access Arrangement to address this issue.

Amendment 14

Amendment 14 proposes provisions for termination of an agreement to be reciprocal and that reasonable time to remedy cause/default be provided.

This Amendment is addressing the issue of reciprocity which is already adequately provided for in clause 16 of the General Terms and Conditions. In particular reference is made to clause 16.1(a) which contains provisions for reasonable periods for rectifying default conditions to apply to User's as a prerequisite to the Service Provider's option to terminate.

Consequently, GGT believes this Amendment is unnecessary and unreasonable.

Amendment 15

Amendment 15 proposes that limits to liability etc, and proximate loss should be reciprocal.

GGT will revise its Access Arrangement to address this issue after consideration of the extent to which the risk profile of GGT and a User may or may not be symmetrical and hence determination of the appropriate treatment of liability and indemnity.

Amendment 16

Amendment 16 proposes invoices to be automatically adjusted consistent with reliability index (specified in Amendment 9).

GGT will revise its Access Arrangement to address this issue.

Amendment 17

This amendment proposes that provision for filters may be unnecessary in certain circumstances depending on the type of metering equipment installed.

The requirement in the Second and Third Schedules to the General Terms and Conditions to include filters is designed to:

> prevent contamination of the measurement system, and in particular the Meter.

The "measurement system" is described as:

> comprising a primary volume or mass measurement device (**Meter**), temperature, pressure, and density measuring devices, and a device for the correction of primary measurements to standard conditions.

The type of meter is not the decisive factor as to whether there is a requirement to install a filter for its protection. Protection of the other devices within the measurement system is also required to ensure the safe and efficient operation of the complete measurement system.

Additionally, the provision of filters protects not only the metering equipment but also the end User's facilities from contamination which may compromise personal safety and asset integrity. Non-inclusion of a filter could result in a failure of downstream equipment with potentially catastrophic consequences, including the risk of injury to personnel. GGT believes that the inclusion of a filter is consistent with the technically robust and safe practices expected of a prudent pipeline operator.

GGT believes that this Amendment is not reasonable and in particular is inconsistent with Section 2.24(c) of the Code which requires recognition of the requirements for the safe and reliable operation of the pipeline.

Additionally, GGT notes that the Code recognises that an arbitrator can not require the service provider to behave in a manner which the service provider believes is not consistent with the safe and efficient operation of the pipeline (Code, Section 6.21). GGT submits that the Regulator in exercising its powers under Section 2 should similarly recognise the inappropriateness of over-riding the service provider's technical requirements.

Amendment 18

Amendment 18 proposes that a User only need to supply spares for outlet facilities not owned by GGT.

GGT will revise its Access Arrangement to address this issue.

Amendment 19

Amendment 19 proposes that information required from User for Bare Transfer to be in line with Section 3.10 of the Code.

GGT will revise its Access Arrangement to address this issue.

Amendment 20

Amendment 20 proposes that the Trading Policy is to apply to Reference and Non-Reference Services.

Due to the interaction of the State Agreement and the Code, it is not possible to simply apply the trading policy requirements of the Code to all capacity in the pipeline. To the extent that the Code applies to capacity in the pipeline from time to time, the Trading Policy under the Access Arrangement will apply to both Reference and Non-Reference Services.

GGT will revise its Access Arrangement to address this issue.

Amendment 21

Amendment 21 proposes clarification of when a User is a "Prospective User" and whether more than one queue is contemplated in Queuing Policy.

GGT will revise its Access Arrangement to address this issue.

Amendment 22

Amendment 22 proposes that a Service Agreement should have the option to extend its term without being subject to Queuing Policy.

GGT will revise its Access Arrangement to address this issue.

Amendment 23

Amendment 23 proposes that GGT may elect for a pipeline extension or expansion to not be subject to the Access Arrangement subject to providing written notice to the Regulator.

GGT will revise its Access Arrangement to address this issue.

Amendment 24

Amendment 24 proposes that the basis upon which a surcharge for use of incremental capacity not funded by GGT is determined needs to be specified and must be subject to notifying the Regulator as provided for under Section 8.25 of the Code.

GGT will address this issue in the revised Access Arrangement which it will lodge with the Regulator.

Amendment 25

Amendment 25 proposes that Prospective Users should not be required to commit to contributing to expansions prior to cost studies being completed.

It was not the intention of GGT that Users be required to commit to contributions in such circumstances and GGT will revise its Access Arrangement to clarify this matter.

Amendment 26

This amendment proposes that GGT should supply data which extends beyond the five year Access Arrangement period (being 1 January 2000 to 31 December 2004) proposed by GGT in the Access Arrangement lodged in December 1999.

In order to minimise the imposition of undue sovereign risk associated with the vagaries of the regulatory process, GGT sees the adherence to at least a five year term from the time of submission or renewal of an Access Arrangement period as being a minimum requirement for appropriate consideration of a Service Provider's legitimate business interests. In certain circumstances, longer terms may be appropriate.

In this regard, unless the Regulator is contemplating additional information for the purposes of mandating an extended Access Arrangement Period, perhaps for the purposes of providing for specific risks unique to the pipeline, GGT considers that Amendment 26 is unnecessarily increasing regulatory uncertainty. This is because GGT interprets the intent of Amendment 26 to be in respect of the time taken by the Regulator to issue a Draft Decision and hence, the implication is that further extensions to forecast requirements will be made by the time the Final Decision is reached.

GGT considers that it is not reasonable that a Service Provider should be required to update an Access Arrangement proposal on a rolling basis as a result of the extended time taken by the Regulator to evaluate it. Nor is it reasonable to expose a Service Provider to the risk of retrospective regulatory action. Such impositions have significant flow on effects in terms of internal budgeting, forecasting and business planning requirements as well as external reporting obligations to both equity and debt holders. The latter two obligations include matters of legal requirement, as well as, in regard to debt holders, the maintenance of critically important short and long term debt service ratios.

It should be noted that while GGT itself originally undertook to set the term of its Proposed Access Arrangement from the Effective Date, (as opposed to the submission date) this was based on a presumption that the Regulator would reach a decision in a reasonable time, consistent with the base timetable defined in the Code, and only after adequately addressing all of the relevant issues. Neither of these expectations has been fulfilled and as a result, the regulatory process is likely to take even longer than it otherwise could have. This is an unacceptable imposition. Regulatory tardiness should not translate into increased costs and uncertainty for industry.

Amendment 27

Amendment 27 proposes the revisions submission date to be 4 years & 3 months after the Effective Date to allow the Regulator a 9 month assessment period.

GGT considers a nine month period for the Regulator to assess revisions to the Access Arrangement is excessive, given the intent of Section 2.21 of the Code. However, GGT will comply with the Code.

Amendment 28

This amendment proposes specific events to trigger a revision of the GGP Access Arrangement. The proposed trigger events relate to exceeding forecast gas throughput by 25% or more in any preceding year, and in the event of any changes in regulation or taxation giving rise to the likelihood in the ensuing year of a cost reduction which amounts to 5% or more of forecast total revenue for that year.

For the reasons set out below, GGT believes that the proposed amendment is unreasonable and unnecessary, and is inconsistent with the provisions and intention of the Code.

Purpose of trigger events under Code

The effect of a trigger event is that it triggers a review of the Access Arrangement, requiring GGT to submit revisions to the Access Arrangement and the Regulator to undertake a full public consultation process. Accordingly, the effect of a trigger event occurring is to shorten the effective term of the Access Arrangement from that approved by the Regulator.

Such shortening of the term has implications for the costs of regulation, regulatory certainty, and the effectiveness of the incentive mechanism in the approved Access Arrangement. The Code recognises that short regulatory periods can have such undesirable effects – it is for this reason that the Code only suggests that trigger events should be considered where an access arrangement period is more than five years (Code, Section 3.18).

Additionally, the circumstances in which the Code indicates that it may be appropriate to incorporate the use of trigger events is to address significant errors in load forecasts, not as a means of seeking to reflect changes in taxes or underlying costs.

As well as being reflected in the words of Section 3.18, this is demonstrated by the introduction to Section 8 of the Code which states (emphasis added by GGT):

> "[Section 3 permits] the Reference Tariff Period to be any length of time that is consistent with the objectives for setting Reference Tariffs. However, the Relevant Regulator must consider (but is not bound to require) inserting safeguards *against excessive forecast error* if the Reference Tariff Period *is over five years*."

Clearly, imposition of trigger events during a five year Access Arrangement, or trigger events which address matters other than the risk of excessive forecasting error, is inconsistent with the intent of the Code.

Regulatory treatment of trigger events

In support of the proposed trigger for load forecasts, the Draft Decision refers to the Regulator's own decision in regard to the AlintaGas Distribution Network, the September 1999 the Australian Competition and Consumer Commission (ACCC) Draft Decision on the Central West Pipeline, and the October 1999 Draft Decision by IPART on the AGL Gas Network in NSW.

In relation to the Draft Decisions by the ACCC and IPART, GGT notes that these Draft Decisions have been superseded by Final Decisions in which no trigger events were required.

In the Final Decision on the Central West Pipeline, the ACCC reconsidered its proposed requirement for a trigger mechanism. In the event, it not only revoked the requirement for a trigger mechanism, but also for any alternate revenue sharing mechanism as well.

In the Final Decision on the AGL Gas Network, IPART removed the proposed requirement for a trigger mechanism. In its consideration of the merits of a trigger mechanism, IPART also makes the following statement (Section 18.6.4).

> Unless the benefits outweigh the disadvantages, the Tribunal prefers not to use trigger mechanisms within the Access Arrangement. The disadvantages are:
>
> * trigger mechanisms may create regulatory uncertainty
> * a trigger mechanism may lessen the impact of any incentive mechanism
> * the effect of a trigger event is a full review of the Access Arrangement, notwithstanding that the trigger would normally be designed to address a specific issue.

Furthermore, in the Draft Decision for the Dampier to Bunbury Natural Gas Pipeline (DBNGP) issued shortly after the release of the GGP Draft Decision, the Regulator states (on page 17, Part A);

> In regard to a trigger mechanism in respect of gas throughput, the Regulator notes that for the DBNGP a 25 percent increase in pipeline throughput would not be possible without substantial New Facilities Investment, which has not been taken into account in determination of Reference Tariffs. Given this, the Regulator does not consider that it is necessary to make provision for triggering of a review of the Access Arrangement on the basis of realised gas throughput.

GGT wishes to emphasise that for the GGP, the circumstances in regard to the necessity for New Facilities Investment in order to be able to meet a 25 percent increase in gas throughput are no different to those of the DBNGP. In proposing a trigger for the GGP, it appears that the Regulator has failed to exercise consistency with either the precedents of the other regulatory authorities to which the Draft Decision makes reference, or within the Regulator's own jurisdiction.

<u>Impact of proposed trigger events on form of regulation</u>

The imposition of a tariff redetermination during a five year Access Arrangement Period has the effect of rendering ineffective the Incentive Mechanism adopted by GGT in the Access Arrangement, and is also inconsistent with the price path form of regulation adopted by GGT and accepted in the Draft Decision. The Code permits the Service Provider to determine the manner in which Reference Tariffs are to vary during the Access Arrangement Period and, in particular, Section 8.3 of the Code provides (emphasis added by GGT):

> "Subject to … the Relevant Regulator being satisfied that it is consistent with the objectives contained in section 8.1, the manner in which a Reference Tariff may vary within an Access Arrangement Period through implementation of the Reference Tariff Policy *is within the discretion of the Service Provider.*"

Section 8.3 then goes on to specifically distinguish between a *price path form of regulation*, under which Reference Tariffs are determined in advance and are *not adjusted* to account for subsequent events, with a *cost of service form of regulation* under which Reference Tariffs are continuously adjusted in light of actual outcomes.

The combined effect of the proposed trigger events may be that the Service Provider's discretion in choosing the form of regulation is over-ridden and the proposed price path form of regulation is converted into a de facto cost of service approach.

Impact of proposed trigger events on Incentive Mechanism

The Incentive Mechanism underlying the proposed Access Arrangement is the ability of the Service Provider to retain returns according to Section 8.44 of the Code. The relevant sections of the Code state (emphasis added by GGT):

> 8.44 The Reference Tariff Policy should, wherever the Relevant Regulator considers appropriate, contain a mechanism that permits the Service Provider to **retain all, or a share of, any returns** to the Service Provider from the sale of a Reference Service during an Access Arrangement Period that exceeds the level of returns expected at the beginning of the Access Arrangement Period (an Incentive Mechanism), particularly where the additional returns are attributable (at least in part) to the efforts of the Service Provider. Such additional returns may result, amongst other things, from lower Non Capital Costs or **greater sales of Services than forecast**.
>
> 8.45 An Incentive Mechanism may include (but is not limited to) the following:
>
> (a) specifying the Reference Tariff that will apply during each year of the Access Arrangement Period based on forecasts of all relevant variables (and which may assume that the Service Provider can achieve defined efficiency gains) regardless of the realised values for those variables;
>
> 8.1 A Reference Tariff and Reference Tariff Policy should be designed with a view to achieving the following objectives:
>
> (a) providing 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;

It is apparent that if GGT achieves sales in excess of 25 percent of that forecast, or if the changes in taxes or regulation occur, then a full Access Arrangement review and tariff redetermination will result with the new value of Reference Tariff being determined with regard to the increase in load. This in turn would lead to a loss of revenue which would otherwise have been retained as part of the Incentive Mechanism underpinning GGT's Access Arrangement.

However any significant additional load which might materialise will almost certainly necessitate additional capital expenditure in order to accommodate the increased capacity requirements, as well as a commensurate increase in non-capital expenditure. Furthermore there is the possibility that the facilitation of some or all additional load growth may be associated with further tariff discounts. Consequently it is clear that potential future increases in load are unlikely to result in proportional increases in revenue.

GGT recognises that the Regulator has discretion in the treatment of an Incentive Mechanism. However, GGT is of the firm opinion that Incentive Mechanisms are included in the Code so that the Regulator may fulfil its obligations under Sections 8.1(b), 8.1(d), and 8.1(f) of the Code, namely:

(b) replicating the outcome of a competitive market;

(d) not distorting investment decisions in Pipeline transportation systems or in upstream and downstream industries;

(f) providing an incentive to the Service Provider to reduce costs and to develop the market for Reference and other Services.

Consequently, GGT considers that the Regulator has not reasonably exercised its discretion in specifying a trigger mechanism in respect of volumes in an access arrangement period not exceeding five years.

In the event that the Regulator remains of the view that a trigger dealing with load forecasts should be included, GGT requests the Regulator to consider that such a trigger should recognise that an increase in throughput will not necessarily be accompanied by a commensurate increase in revenue particularly given the additional capital and operating costs which may be incurred, and the fact that additional throughput may have been provided at reduced tariffs. Accordingly, any trigger such should not apply purely on the basis of volumes being exceeded by a certain amount.

General comment on terms of trigger

The remaining trigger events specified relate to changes in taxation or regulation which are likely to reduce costs by 5% of total revenue in the subsequent year. GGT believes that these triggers are an unnecessary imposition and that imposition of such triggers is inconsistent with the form of regulation and incentive mechanism adopted by GGT. In addition, it will often not be possible for the impact of changes in taxation or regulation to be quantified with any reliability (and certainly not within 5% accuracy) for some considerable period of time after the introduction of the relevant change.

The motivation underlying this proposed amendment by the Regulator is provided in the Draft Decision (on page B73). It appears to stem from an interpretation of Section 8.1(b) of the Code, whereby the Regulator associates the Code objective of replicating the outcomes of a competitive market with nothing more than a pass through of "cost reductions" to yield lower prices to consumers. If this is the case, GGT submits that the Draft Decision has incorrectly interpreted the Code and has failed to recognise the form of regulation proposed by GGT.

Amendment 29

Amendment 29 proposes a review of Access Arrangement if there are increases in charges as a result of Government taxes (excluding income tax), duties, imposts and GST rate changes.

The Code does not prevent an Access Arrangement providing for the automatic pass through of changes in government imposts as contained in the proposed Access Arrangement, and a number of regulators (IPART, ICRC and ACCC) have accepted this and approved Access Arrangements containing such provisions without issue. In fact, such a mechanism was also approved by the Regulator in the Final Decision for the Parmelia Pipeline.

Additionally, if implemented, this amendment will have the effect of adding an unnecessary cost burden incurred in the preparation of;

* a revision to the Access Arrangement ;
* revisions to the Access Arrangement Information; and
* the approvals process.

Although the costs associated with a review (which includes those incurred by both GGT and the Regulator, OffGAR and consultants employed by both the Regulator and OffGAR) would be included in any tariff re-determination and hence will ultimately be borne by Users, GGT considers that such additional costs are an unnecessary cost to achieve a result which can dealt with through a pass-through mechanism under the Access Arrangement.

GGT therefore submits that this amendment is unnecessary and unreasonable.

Amendment 30

Under Amendment 30 of the Draft Decision, the Regulator proposes that GGT should allow information disclosed by GGT to a Prospective User in the course of an application for a service, to be disclosed to the Arbitrator, the Regulator or a Court of Law.

GGT would not object to such an amendment which provided that Users could disclose information to a regulator, arbitrator or court where a User is required to make disclosure pursuant to statutory, ASX or similar obligation. This is consistent with the intent of GGT in drafting the original provision.

Otherwise, it should be noted that the Regulator already has significant powers to obtain any information from "any person" (i.e. this is not limited to the Service Provider but includes Users or <u>any other person</u>) which it believes will assist the Regulator in the performance of its prescribed duties, under Section 41 of Schedule 1 of the Act. Given the existing provisions of the law, this amendment seems to be unnecessary regulatory intrusion. The existing provisions of the Gas Pipelines Access Law provide the Regulator with strong powers to obtain information. GGT believes that these provisions are adequate, and that further requirements that GGT should be required to disclose confidential information in circumstances which are broader than those under which ordinary entities in the normal course of business are compelled to disclose such information are unnecessary.

In considering the Final Decision, GGT requests the Regulator to give specific regard to the issue of information acquisition and disclosure in the competitive context outlined above.

Amendment 31

Amendment 31 proposes that twelve specific Key Performance Indicators (KPI's) be included in the Access Arrangement Information.

The widespread conclusion in regard to the use of KPI's for comparisons between transmission pipelines and gas distribution networks, is that they provide little if any relevant or useful guidance. In fact, the inappropriate and simplistic application of some KPI measures can be misleading.

As acknowledged by the ACCC in its final decision on the Access Arrangement submitted by Transmission Pipelines Australia (6 October 1998), there are "challenges in identifying KPIs and benchmarks especially in a newly deregulated environment such as the Victorian natural gas industry".

It is also noted that the final Access Arrangement Information for the Central West Pipeline (as approved by the ACCC in September 2000) acknowledges that "before performance indicators can be used to benchmark operating efficiency, an appropriate range of such measures must be developed for comparable pipelines in relation to the service offered. While it is anticipated that such measures will be developed over time to suit the Australian industry, they are not currently developed."

Given the various factors which affect the range of activities required to operate and maintain a pipeline, it is difficult to develop meaningful performance indicators for a pipeline such as the GGP.

In view of the above, GGT considers that the requirement to include the proposed KPIs is both inappropriate and an unreasonable imposition at this point in time. However, GGT is willing to work with the Regulator and industry to develop appropriate KPI's in due course.

Amendment 32

Amendment 32 proposes that the Access Arrangement Information be amended to set the Initial Capital Base (ICB) of the GGP at $438.0 million at 31 December 1999.

In its December 1999 submission, GGT proposed an ICB of $452.6 million. The Regulator responded in the Draft Decision with a proposed ICB of $438.0 million. GGT's submission was based upon Depreciated Optimised Replacement Cost (DORC) and units of production (UOP) depreciation; the Draft Decision was based upon historical cost and straight line depreciation

Based upon further review, GGT has determined that the ICB calculations are incomplete because they failed to provide any mechanism to recover cost of service revenues deferred during the first three and one-half years of project life. GGT is therefore proposing a revised initial capital base of $596.6 million consisting of $460.8 million of plant and $135.8 of Unrecovered Capital, or "regulatory asset".

Section 8.10 of the Code provides eleven factors which must be considered in establishing an ICB for an existing pipeline. Section 8.11 further provides that the value for ICB should normally lie within the range between DORC and historical cost (emphasis added by GGT):

> 8.11 The initial Capital Base for Covered Pipelines that were in existence at the commencement of the Code **normally** should not fall outside the range of values determined under paragraphs (a) and (b) of Section 8.10

GGT, however, believes that there are unique circumstances for the GGP related to regulation under the State Agreement and regulation under the Code. These relate to the existence of a "life of the project" constant dollar levelised tariff which was accepted under the GGPA. As a result of these unique circumstances, GGT believes that it is entitled to an ICB which significantly exceeds historical cost and DORC.

Moreover, GGT believes that Sections 8.10(f) and 8.10(g) of the Code justify establishment of the ICB at this level. Specifically, the Code requires that the Regulator also consider:

> (f) The basis on which Tariffs have been (or appear to have been) set in the past, the economic depreciation of the covered Pipeline, and the historical returns to the Service Provider from the Covered Pipeline.
>
> (g) The reasonable expectations of persons under the regulatory regime that applied to the Pipeline prior to commencement of the Code.

As discussed below, GGT's position is that $135.8 million in revenues were deferred; that this revenue deferral is the equivalent of negative depreciation, referenced in Section 8.10(f); and that this negative depreciation should be added to GGT's cost base in the pipeline to establish its ICB under the Code. If this is not done, GGT may face the situation where it will never be able to recover the full capital cost of the pipeline.

In the paragraphs that follow, we will argue that GGT's historical depreciated cost is $458.2 million, that the deferred revenue or Unrecovered Capital balance is $135.8 million and the value of ICB including $2.6 million of working capital is equal to their sum, or $596.6 million.

<u>Historical Cost - Interest During Construction</u>

The Regulator established a value of $435.4 million for the Depreciated Actual Cost (DAC) for the GGP. Adding $2.6 for working capital, the Regulator has developed a value for ICB of $438.0 million.

The Regulator's determination of DAC <u>excludes</u> Interest During Construction. This is inconsistent with the intent expressed in the statement at page B100 of the Draft Decision (emphasis added by GGT):

> The Regulator considers that, in principle, a relevant WACC value may be used **for calculating interest during construction**. For the purposes of estimating the Depreciated Replacement Cost (Table 8) and DORC (Table 8) described above, **the Regulator's technical consultant assumed** an interest rate of 8 percent for calculating interest during construction.

It is therefore apparent that the Regulator has made a significant omission in the determination of the proposed ICB.

Based upon the 8% interest rate for calculating interest during construction used for calculating DRC and DORC, and monthly expenditures for a construction period extending from April 1, 1994 to June 30 1996, GGT calculates interest during construction of $40.9 million. Based upon the current best estimate for initial construction cost (inclusive of other assets and working capital) of approximately $460 million GGT, therefore, believes that the appropriate value for initial construction cost is approximately $500 million.

The Regulator's exclusion of Interest During Construction is also in contradiction to the determination of tariffs under the Tariff Setting Principles applicable under the State Agreement (which appear as Attachment 1 to part B of the Draft Decision, and provide for "a commercial rate of return on all project capital"). Under Section 8.10(f) of the Code the Regulator is required to take this matter into consideration. As such, the Regulator has not complied with his obligations under the Code.

Treatment of Inflation

The Regulator uses 'real' (i.e. constant as at 31 December 1999) as distinct from 'nominal' (i.e. money of the day) dollar values to express revenues, projected capital and operating costs, depreciation, etc. in the determination of the Reference Tariff presented in Section 5.11.4 (pages B177 and B178) of the Draft Decision. However, the determination of the ICB is done in terms of the money of the day value during construction.

The values of revenues, projected capital and operating costs, depreciation and ICB are critical to the determination of the Reference Tariff.

Section 8.5A of the Code states (emphasis added by GGT):

> Any of the methodologies described in section 8.4 or permitted under section 8.5, may be applied:
>
> (a) on a nominal basis (under which the Capital Base and Depreciation are expressed in historical cost terms and all other costs and revenues are expressed in current prices and a nominal Rate of Return is allowed); or
> (b) on a real basis (under which the Capital Base, Depreciation and all costs and revenues are expressed in constant prices and a real Rate of Return is allowed); or
> (c) on any other basis in dealing with the effects of inflation,"
>
> provided that the basis used is specified in the Access Arrangement, is approved by the Relevant Regulator and is **applied consistently** in determining the Total Revenue and Reference Tariffs.

It is apparent that the Code requires consistency of approach regarding the treatment of inflation when determining Total Revenue. As the value of ICB is a critical input to required revenue, GGT firmly believes that similar consistency of approach should be applied to the determination of ICB.

Meaning and Determination of DORC

In the Draft Decision, the Regulator states (page B98) that:

> Estimates of Depreciated Replacement Cost and DORC were based on straight line depreciation of [Replacement Cost and Optimised Replacement Cost] … over an assumed economic life for each asset class, corresponding to a weighted average asset life of 65 years.

This approach to construction of DORC from Optimised Replacement Cost (ORC) is inconsistent with the definition of DORC given in a number of decisions and regulatory documents – in particular in the 1998 Final Decisions of the ACCC and the Office of the Regulator General, Victoria (ORG) in relation to gas assets in Victoria, and in the *Draft Statement of Principles for the Regulation of Transmission Revenues,* 27 May 1999 where the ACCC states at page 39:

> The main economic principle for assessing the economic value of any assets is that their value to investors is equal to the net present value of the expected future cash flows generated by those assets. The practical difficulty in making this assessment for regulated monopoly businesses is that the future revenue derived from the assets is itself determined by the regulator – hence the issue of circularity associated with the use of ODV as a methodology to value sunk assets.
>
> This potential circularity is eliminated by the use of DORC. The DORC of a network is the sum of the depreciated replacement cost of the assets that would be used if the system were notionally reconfigured so as to minimise the forward looking costs of service delivery. There are two definitions of what DORC attempts to measure:

- One interpretation of DORC is that it is the valuation methodology that would be consistent with the price charged by an efficient new entrant into an industry, and so it is consistent with the price that would prevail in the industry in long run equilibrium.

- The second interpretation is that it is the price that a firm with a certain service requirement would pay for existing assets in preference to replicating the assets.

and at page 40:

> Finally, another justification for DORC setting the upper limit to valuations comes from what a DORC valuation actually is attempting to measure. This is the maximum price that a firm would be prepared to pay for 'second-hand' assets with their remaining service potential, higher operating costs, and (old) technology - given the alternative of installing new assets which embody the latest technology, and which generally have lower operating costs, and which will have a greater remaining service potential. Therefore, if prices reflect a value that is in excess of DORC, then users would be better off if the existing system were scrapped and replaced by new assets. Similarly, if assets are sold for prices above the DORC valuation, then this implies that scarce investment funds are being inefficiently applied: in this case, it would have been a more efficient use of investment funds for the existing assets to be scrapped and a duplicate system installed. [1]

This definition of DORC is consistent with the statements of principle contained in the 1998 Final Decisions of the ACCC and the ORG in relation to gas assets in Victoria. In fact, the second passage above appears in essentially identical form in both of the Victorian Final Decisions.[2]

The ACCC has more recently referred to or paraphrased these definitions in its Draft Decisions on the Moomba to Adelaide Pipeline, the Moomba to Sydney Pipeline, and the Amadeus Basin to Darwin Pipeline.

The common thread to all the statements is that the DORC is a market value concept.

Attached to this submission are copies of papers on the proper derivation of a DORC valuation submitted to the ACCC by Agility Management[3] and Professor Stephen King[4]. These papers demonstrate that, to be consistent with the statements of principle by the ORG and ACCC, the DORC for existing assets is the Net Present Value (NPV) of the future income from those assets, where the income is consistent with the prices that would be charged by an efficient new entrant, and recognising that the life of the income stream will be equal to the remaining life of the existing assets. i.e. DORC is the NPV of the first "n" years of the hypothetical new entrant's income, where "n" is the remaining economic life of the existing assets for which DORC is being evaluated. The price to be assumed for the purpose of evaluating that NPV is the price which the hypothetical new entrant would require in order to generate a NPV equal to ORC over the life of the ORC asset (the "Agility NPV approach").

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1. It should be noted that the Regulator has referred to this same page (and page 41) of the Draft Statement of Principles as providing "A useful discussion on the advantages of using DORC as the basis for valuing assets" (Draft Decision page B103).
2. ACCC Final Decision, pages 32 and 33; ORG Final Decision, page 51.
3. Agility Management, *The Construction of DORC from ORC*, August 2000, Submitted by Agility Management to ACCC in relation to the Draft Decision for the Moomba-Sydney Pipeline.
4. King, S. P., *Report on Construction of DORC from ORC*, 14 February, 2001

Professor King comments on a number of matters that follow from the ACCC and ORG definition of DORC. In particular he examines the alternative approaches to the construction of DORC from ORC in the context of that definition. Professor King concludes that "the Agility NPV approach to the construction of DORC from ORC as set out in the Agility submission of August 2000, is consistent with the interpretation of DORC presented by the ACCC and the ORG. In fact, it can be argued that the Agility approach is the only form of adjustment of ORC to DORC that is consistent with these interpretations.". Professor King also concludes that the straight-line adjustment to transform ORC to DORC, i.e. the approach adopted in the Draft Decision, "is arbitrary and appears to lack any economic justification"; and "is clearly inconsistent with the [ACCC's] stated economic underpinnings and justification of DORC."

GGT believes the positions taken and conclusions reached by Agility and Professor King are correct. These have significant consequences for the GGP. The primary consequence is that the value of DORC is Replacement Cost (i.e. $450 million) and not $407 million as suggested in the Draft Decision at page B99.

An assumption which is embodied in the Draft Decision is that the market/demand for GGP services will extend beyond the technical life of the existing pipeline and beyond the technical life of a new pipeline if it were built today.

Neither assumption is valid.

The limitations on the economic life of the GGP are discussed elsewhere in this submission. In summary, the non-renewable nature of the minerals mined by the current and potential future customers of the GGP, the comparatively short lives of those mines, and the prohibitive cost of servicing customers which are not located close to the pipeline result in the economic life of the GGP being shorter than the technical life assigned in the Draft Decision.

The result is that the remaining technical life of the GGP exceeds its economic life which will be determined by market demand.

A new pipeline built today would have the same, demand-limited, life. Thus, in terms of the Agility NPV approach to the construction of DORC from ORC, the life of the ORC pipeline and the remaining life "n" of the existing pipeline are the same. The hypothetical investor in the ORC pipeline will invest only if the NPV of future cash flows is (at least) equal to ORC. Thus, <u>in the case of the GGP, the value of DORC is ORC</u>.

In relation to the determination of DORC, the usual approach to optimisation is not relevant to the GGP, as its configuration is specified (at the behest of the Western Australian State Government) under the terms of the State Agreement.

In the same way that environmental and design standards are reflected in an optimised mechanical design (for example, emission controls and safety features detract from the acceleration performance of a passenger motor vehicle), optimisation in the context of the Code also has to recognise legal constraints affecting the design of the GGP. Accordingly, GGT submits that any optimised replacement cost can only be derived having regard to *all* relevant technical requirements, including those in the State Agreement.

The Regulator has observed (page B104) that "a DORC valuation that does not recognise these design constraints may be regarded as unfair to the pipeline owner …". Therefore, in the case of the GGP, ORC is equal to Replacement Cost from which it follows (by the Agility NPV approach) that "DORC" is equal to Replacement Cost.

The ACCC has established and repeated a logical, consistent and economically sensible definition of DORC. Further, the Regulator has referred to passages in the Draft Statement of Principles where that definition is enunciated as being authoritative on the subject of DORC. The Regulator should adopt the definition established by the ACCC, and the only approach to construction of DORC from ORC (i.e. the Agility NPV approach) which is consistent with that definition. When this is done having regard to the design constraints imposed by the State Agreement and the pipeline's economic life, the DORC for the GGP is equal to its Replacement Cost.

The Regulator's value for Replacement Cost, $450 million, is almost equal to depreciated historical cost. If GGT had operated under cost of service regulation and fully recovered its costs during the initial years of operation, then the appropriate value for ICB would have been around $460 million. Because GGT has operated in a levelised tariff environment, however, it has not fully recovered costs and, thus, requires an amount equal to the revenues deferred due to levelisation to be added to ICB as discussed below.

Under-Recovery of Capital

The tariffs currently applicable to the GGP were established using an NPV methodology accepted by the Western Australian Minister for Energy. This methodology is discussed in Section 3.3.1 of the GGP Access Arrangement Information. For convenience, an extract from this section is presented below:

> Under the State Agreement the GGTJV was required to construct a pipeline which was larger in size and hence greater in cost than what was required to satisfy the needs of the individual Participant companies. This meant that the GGTJV faced from the outset the commercial risk associated with the uncertainty surrounding the development of a third party gas transport market. Further, the GGTJV determined initial and subsequent third party tariffs on a 'levelised' basis in order to yield tariffs which remained constant in real (i.e. inflation adjusted) terms. This methodology reduced tariff levels in the early years of the project, and hence promoted the use of the pipeline. This tariff reduction in the early years of the project resulted in capital recovery being displaced to later years of the project. This deferment of capital recovery imposes further risk upon the GGTJV.
>
> The State Agreement recognises the "legitimate business interests" of the pipeline owners. Such recognition is appropriate given that the State Government did not underwrite the project in any way.
>
> The State Government's objectives for regional development in the East Pilbara and Goldfields regions would not have been realised without the GGTJV base load and the commitment of capital by the GGTJV to the construction of the pipeline.

This 'NPV over life' approach embodies levelised tariffs, which by definition, result in under-recovery of project capital cost during the early years of the project's life.

Part of the capital cost of the project was incurred in providing additional gas transport capacity which was mandated but not financed by the Western Australian State Government.

Capital under-recovery represents a risk to the project proponent. However, both the previous and current owners of the pipeline accepted this risk because of their perception that it was mitigated by the provisions of the State Agreement.

The Regulator's method for determining capital recovery, which is based upon straight line depreciation of the initial construction cost, does not provide for recouping any capital under-recovery prior to the Access Arrangement coming into force.

The Regulator is aware of the assumptions and methodology leading to the determination of the currently applicable tariff. The Regulator is also aware of Tariff Setting Principle 2 under the State Agreement, which states, in part:

> Tariffs will be set to provide a commercial rate of return on all project capital, including all Owners' costs, reasonably incurred in the construction and operation of the Pipeline ...

Section 8.1 of the Code states, in part:

> A Reference Tariff and Reference Tariff Policy should be designed with a view to achieving the following objectives:
>
> (a) providing 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;

It is clear that both the State Agreement and the Code provide for recovery of all capital costs associated with providing third party access to natural gas pipelines. Unrecovered Capital to date constitutes part of such costs.

Further, it is reasonable that the owners of the GGP should be allowed to recover the capital cost of providing capacity mandated by the Western Australian State Government. In particular, it would be consistent with the legitimate business interests of the Service Provider, and the reasonable expectations of the Service Provider and Users under the prior regime for the Regulator to establish the ICB at a level which permits recovery of all project capital.

To address the issue of capital recovery, GGT has calculated the extent of capital under-recovery for the period 1996 to 1999 inclusive.

This calculation involves data which is of a commercially sensitive nature. Consequently, GGT has included the details of the capital under-recovery calculation in a separate report, submitted to the Regulator concurrently with this Public Submission under conditions of commercial confidence.

The value of capital under-recovery, combined with depreciated historical cost, yields an ICB of approximately $597 million. This value corresponds to within 5% of the (approximate) asset purchase price of $624 million as identified in Section 4.1.2 of the GGP Access Arrangement Information.

It is therefore apparent that the realised sale price of the GGP reasonably reflects a valuation of that asset based on the assumption that the provisions of the State Agreement intended to protect the interests of the pipeline's owners would be recognised and honoured. In particular, the tangible market valuation of the pipeline reflects the anticipation that Tariff Setting Principle 2 under the State Agreement, which provides for the recovery of all capital costs, would be honoured.

Setting an ICB which is too low in value has the effect of delivering an unjustified windfall to the previous owners of the GGP by confiscating asset value from the current owners.

The Regulator has not addressed the issue of capital under-recovery in the Draft Decision. Further, in not considering this aspect of capital recovery, the Regulator has not addressed the provisions of the prevailing State Agreement. As such, he has not addressed Sections 2.24 and 8.10(f) of the Code.

As discussed below, GGT believes the Regulator also should provide for recovery of Unrecovered Capital in order to address the requirements of Sections 8.10(g), (h),and (j) of the Code.

Past Tariffs, Historical Returns and Economic Depreciation

The Regulator states in the Draft Decision (page B106):

> In view of the special arrangements provided for by the State Agreement Act, a historical record of revenues from third party tariffs would not be reflective of the returns to the pipeline.

GGT accepts that insofar as it goes, this statement is correct, because Third Party throughput does not constitute total pipeline throughput. However, Tariff Setting Principle 2, approved under the State Agreement, states, in part (emphasis added by GGT):

> For the purpose of this Principle, the Owners will be **ascribed a notional tariff based on third party tariffs** for their utilisation of Pipeline capacity reserved to the Owners pursuant to clause 8(1) of the GGP Agreement.

Therefore, historical revenues are relevant, but have not been considered.

Section 8.10 of the Code states, in part (emphasis added by GGT):

> When a Reference Tariff is first proposed for a Reference Service provided by a Covered Pipeline that was in existence at the commencement of the Code, the following factors should be considered in establishing the initial Capital Base for that Pipeline:
>
> ...
>
> (f) the basis on which Tariffs have been (or appear to have been) set in the past, the **economic depreciation of the Covered Pipeline**, and the historical returns to the Service Provider from the Covered Pipeline;

In not considering historical returns, the Regulator has not addressed the issue of economic depreciation. As discussed above, both the Code and the State Agreement provide for full recovery of project capital. GGT understands from the Draft Decision that the Regulator believed it did not have sufficient information to enable consideration of these matters. Accordingly, GGT has set out in this submission and the accompanying confidential submission further information on these matters.

It is therefore apparent that the value for the ICB proposed in the Draft Decision is incorrect, as it was developed without any consideration of past revenues and their adequacy in recovering GGT's cost of service (a significant part of which is capital recovery). It therefore follows that the Regulator has not adequately considered the basis on which tariffs have been set in the past and the associated impact on current tariffs in accordance with Section 8.10(f) of the Code.

Reasonable Expectations Under the Previous Regulatory Regime

The Regulator states (page B106, emphasis added by GGT):

> The Regulator has interpreted section 8.10(g) of the Code as requiring that the Regulator consider **the expectations that persons may reasonably hold** as to the value of pipeline assets in light of the previous regulatory regime applying to the Goldfields Gas Pipeline.

However, Section 8.10(g) of the Code states that what must be considered are (emphasis added by GGT):

> the reasonable expectations of **persons under [the State Agreement]**

It is therefore apparent that it is the expectations of those persons which were subject to the provisions of the State Agreement which should be taken into account in setting the value of the ICB. Such persons are GGT, the State of Western Australia, the previous owners of the pipeline, and Third Party Users of the pipeline.

Given the existence of the Tariff Setting Principles and the State Agreement and given that the current Users of the pipeline have all operated under the State Agreement in one form or another, it is reasonable that all parties would have expected that:

i. Tariffs would be set by GGT and not by the Regulator (State Agreement clause 22(3)),

ii. GGT would recover all project capital costs of the pipeline,

iii. Tariffs would be set to provide a commercial rate of return on all project capital where that commercial rate of return is commensurate with the business risk associated with the project (Tariff Setting Principle 2), and

iv. introduction of the Code would have no material adverse effect on the legitimate business interests of the Owners (State Agreement clauses 21(2) and 21(3)).

The original owners of the pipeline, as current major users, were also parties to setting tariffs initially at low levels, and so must have expected that tariffs would not decrease in the longer term in light of Tariff Setting Principle 2 approved under the State Agreement. Similarly, Third Party Users, in obtaining the benefit of tariffs which were deliberately set at initially low levels, must expect that tariffs would remain at their levelised value in the future.

The State of Western Australia states its intentions regarding State Agreement Acts in its publication "In Agreement: How Major Developers Obtain Project Security Through State Agreement Acts", released by the Department of Resources Development (DRD), dated August 1997. At page 2 of that publication, the statement is made (emphasis in original):

> State Agreements **bind** both Government and developer to **specific responsibilities**, provide an additional **level of security** over the life of a major project, ...

At page 3, the DRD states:

> Certainty of project operation and management is assured because Agreement provisions can only be changed by mutual consent of State and developer.

This point is emphasised by the DRD at page 10:

> ... primary objectives for entering into State agreements are to:
>
> ... enhance the long-term certainty and investment security to the mutual economic advantage of developers and the State

and at page 14 by the statements:

> By entering into a State Agreement, the Western Australian Government demonstrates support for a specific major resource development.
>
> By formalising the division of responsibilities between developer and Government in advance, the developer and its financiers are assured there are no major impediments to the project before investment occurs

Acceptance by the State Government of the initial 'A1' tariffs and the methodology by which they were determined provides a clear indication of the expectations of the State.

In summary, it is reasonable to conclude that the reasonable expectations of all parties under the prior regulatory regime (i.e. Open Access under the State Agreement) would be that the then-current tariffs would maintain their levelised value over the designated life of the pipeline so that the NPV of cash flows would match the Present Value of all initial and ongoing costs. Further, Users would not be disadvantaged if ICB were set on this basis since they would not be paying more than the cost of the pipeline over its life.

As discussed above, a reasonable expectation by GGT is that it should be able to recover all project capital costs in accordance with both the Code and the State Agreement.

The Regulator has not considered these important issues in his Draft Decision.

The preceding discussion indicates that, given the interpretation of Section 8.10(g) in the Draft Decision, the Regulator has not properly considered the reasonable expectations of persons under the State Agreement, but has instead considered only a particular aspect of those expectations. As a consequence the Draft Decision does not adequately address Section 8.10(g) of the Code.

Utilisation of Gas Resources

The Regulator states in the Draft Decision (page B189):

> the Regulator considers that the conclusion reached by GGT that gas transport markets in the East Pilbara and Goldfields are comparatively price inelastic has not been adequately demonstrated.

During the first and second quarters of 2001, the owner of a major mining project serviced by the GGP has made a series of widely reported public announcements regarding the magnitude of operating costs for that project.

It is apparent from this data that gas transport cost constitutes a small fraction (i.e. a few percent) of the total operating expenditure for that project. Further, the project in question is representative of the mining operations which obtain natural gas supplies via the GGP.

The Regulator has not considered these matters in his Draft Decision and accordingly the Draft Decision does not address the requirements of Section 8.10(h) of the Code.

Purchase Price

In the Draft Decision, the Regulator states (page B109):

> Under the circumstances, the Regulator considers that sale price is of limited relevance as an asset valuation methodology for the Goldfields Gas Pipeline.

On the basis of the discussion above, and in particular on the basis that the purchase price of the GGP reflects its asset value and that both the State Agreement and the Code provide for full capital recovery, it is apparent that the Regulator has not addressed the requirements of Section 8.10(j) of the Code.

Summary and Conclusion

The preceding discussion identifies that the Regulator has not properly considered:

1) interest during construction,

2) the effect of inflation,

3) the concepts underpinning the value of DORC,

4) under-recovery of capital resulting from the adoption of levelised tariffs under the State Agreement,

5) the reasonable expectations of persons under the prior regulatory regime,

6) the impact of gas transport costs on the cost structures of the mining and related operations served by the GGP, and

7) the purchase price

when establishing the ICB for the GGP.

To address this deficiency, GGT has redetermined the ICB. On the basis of revisions addressing the issues above, the appropriate value of ICB for the GGP is $597 million.

This value of capital base corresponds closely to the purchase price of the pipeline, reflecting the operation of market forces.

GGT respectfully requests that the Regulator addresses the issues regarding the determination of ICB discussed above as a matter of priority, and includes it in a revision to his Draft Decision issued pursuant to the provisions of clause 21 of the Appendix to Schedule 1 of the Gas Pipelines Access (Western Australia) Act 1998.

Amendment 33

Amendment 33 proposes an adjusted schedule of Non-Capital Costs with the following qualification. The Regulator states in the Draft Decision (page B116):

> The Regulator sought to benchmark the Non-Capital Costs proposed by GGT against those of other pipelines in Australia, but was unable to identify another pipeline that would provide a useful basis for comparison. The Amadeus Basin to Darwin Pipeline is one that potentially could be used for benchmarking the Goldfields Gas Pipeline. A proposed Access Arrangement has been lodged with the ACCC for the Amadeus Basin to Darwin Pipeline and a Draft Decision is pending. Once the Draft Decision for the Amadeus Basin to Darwin Pipeline has been issued, the opportunity to benchmark this pipeline against the Goldfields Gas Pipeline may be available.

The Regulator is correct in identifying the difficulties which surround the entire issue of benchmarking natural gas pipelines which operate in disparate technical, commercial, and economic circumstances. As a case in point, GGT sent a request for Key Performance Indicator information to 16 key industry, government, and regulatory organisations when writing the Access Arrangement Information for the GGP. None returned data other than that which has been quoted in Access Arrangements previously submitted in other Australian states. Comments from representatives of several of these organisations (including both government agencies and industry associations) indicated that comprehensive, current, appropriately organised, public domain benchmark data for the Australian transmission pipeline industry does not exist.

However, the Regulator then proposes that operating costs for the GGP be benchmarked against the Amadeus Basin to Darwin Pipeline. This approach is clearly contradictory.

The Regulator makes the statement (page B117) that:

> In order for management costs, as proposed by GGT, to be included in the Access Arrangement, GGT will need to provide further justification of its proposed management costs in order to demonstrate that such costs would be those incurred by a prudent Service Provider.

GGT is, and has been in the past, most willing to discuss its operating costs with the Regulator. To this end, GGT has provided additional information under cover of commercial confidence to the Regulator upon request.

When read in conjunction with Sections 8.37 and 8.36 of the Code, the definition of Non Capital Costs includes the operating, maintenance and other non capital costs incurred in providing all of the Services on the Pipeline being those costs which would be incurred by a prudent Service Provider acting efficiently in accordance with accepted and good industry practice. GGT contends that the non capital costs set out in the proposed access arrangement are such costs, in particular the management costs.

GGT's largest shareholders, CMS Energy and Australian Pipeline Trust, are major Australian and international natural gas transmission companies with significant expertise in the management and operation of pipeline assets. Furthermore, they often provide their management and professional expertise and experience to the GGT Joint Venture without specifically logging and charging their time. On many occasions these companies have retained outside consultants and assigned internal experts to perform certain tasks on behalf of the Joint Venture. The fees for the consultants are absorbed by parents and are not charged to the Joint Venture. It will be impossible for GGT to secure access to such a level of pipeline expertise without incurring significantly higher expenses.

GGT looks forward to the opportunity to demonstrate that its operating costs as proposed are reasonable.

Amendment 34

In Amendment 34 (page B175) of the Draft Decision the Regulator proposes that:

> The proposed Access Arrangement and Access Arrangement Information should be amended to adopt a pre-tax real rate of return (WACC) of 7.95 percent.

Third Party tariffs for the GGP determined under the State Agreement were based on rates of return which are significantly different to the value required by the Regulator.

GGT is considering the entire issue of allowed rate of return, and may further elaborate on this matter in a future submission.

The following comments regarding allowed rate of return are offered to illustrate some (but not necessarily all) of the shortcomings inherent in the determination of Weighted Average Cost of Capital (WACC) in the Draft Decision.

Inflation Rate

GGT proposed a 2.5% inflation rate in its Access Arrangement Information. This rate represents the midpoint of the 2% to 3% rate for future inflation forecast by the Reserve Bank of Australia and is consistent with the average relationship between 10 year fixed rate and 10 year indexed government bonds over the past several years.

The Regulator has required a 2.14% inflation rate. This rate was based upon the spread between fixed rate and indexed 10 year government bonds for a 20 day period ending 21 February 2001. The Draft Decision states that this approach has been adopted due to a preference for a financial market-based measure in lieu of a forecast.

The value of 2.14% for the inflation rate for the GGP Draft Decision is significantly less than the 2.85% and 2.78% specified by the Regulator in the Final Decisions for the Access Arrangements for the Parmelia Pipeline and AlintaGas Distribution System respectively.

Notwithstanding the precedent which some stakeholders attribute to the Victorian Decisions and other regulatory proceedings, GGT continues to believe that relying on short-term data (i.e. averages over less than one month) to make decisions for long-lived infrastructure assets makes little sense and may not be in the best interest of customers during regulatory resets when prevailing interest rates are high.

GGT encourages the Regulator to look to the California electricity industry experience as an exemplar of short term thinking. There, electricity prices were set on a short-term marginal cost basis and no long-term electricity purchase contracts were allowed. Electricity prices were therefore kept low for several years. At the same time, however, low electricity prices and stringent environmental regulations led to a situation where no electricity generation infrastructure was built for over ten years. In 2000 and 2001 California demand caught up with and exceeded supply and Californian customers paid very high prices - prices that could have been avoided.

At the time of writing, the rate for 10 year fixed rate bonds was 5.95%, and the rate for 10 year indexed bonds was 3.36%, implying a 2.6% expected inflation rate.

Academic and government forecasts continue to predict 2-3% inflation, current financial markets conditions imply a 2.6% inflation rate, the Regulator has recently stipulated inflation rates of around 2.8%, and longer-term historical averages point to a 2.5% inflation rate. In view of this evidence and the obligation on the Regulator to not stifle infrastructure development, GGT continues to believe that 2.5% is an appropriate value for inflation.

Risk Free Rate

GGT proposed a value of 6.7% for the risk free rate in its Access Arrangement Information. This value reflected the 10 year bond rate prevailing at the time of submission. The Regulator has required a value of 5.35% in his Draft Decision, representing the 20-day average of 10 year bond rates ending 21 February 2001.

Over the past year, the yield on 10 year government bonds has ranged from 5.2% to 6.4% with an average of 5.9%. The rate in mid-July 2001 has risen to 6.2%, having moved up sharply from a low of 5.2% in February 2001 (just five months prior). Over the five-year period ending March 2001, 10 year government bond rates ranged from 5.2% to 8.9% and averaged 6.4%. It is therefore clearly apparent that bond rates do vary significantly over time.

Over the past few years interest rates have generally trended downwards. Therefore, an historical average in this environment will produce a higher value for the risk free rate than the current period's rate and may also be expected to produce higher rates than might be expected in the near future. Interest rates, however, appear to be near the bottom of the cycle and are now lower than the five year average. In turn, it is reasonable to expect that rates will rise in the mid to longer term.

Moreover, given the variability in interest rates and the five year term of the Access Arrangement, GGT believes that it is inappropriate to select a risk free rate that is based upon the last 20 days of data.

The Regulator's recent Final Decisions for the Parmelia Pipeline and AlintaGas Distribution System provide cases in point. In the Final Decision for the Parmelia Pipeline Access Arrangement, the Regulator required the nominal risk free rate to be 6.21%. For the AlintaGas Distribution System Access Arrangement Final Decision, the value was 6.27%.

Applying a risk free rate of 6.27% to the Regulator's WACC calculation for the GGP Draft Decision yields a pre-tax real value of 8.91%. This value is significantly different from the required value of 7.95%, and would deliver a significantly higher tariff than that required in the Draft Decision.

It is apparent that GGT and other Service Providers face a virtual 'lottery' for determination of the applicable rates of return for Access Arrangements which span substantially overlapping periods of time.

To remedy this inequity, GGT proposes that the Regulator establishes the applicable value of risk free rate based upon long term averages. Use of such a long term average also dispels any possible perceptions of either the Service Provider or the Regulator 'gaming' the time of submission and release of their respective documents.

Market Risk Premium

GGT proposed a value of 6.5% for Market Risk Premium in its Access Arrangement Information. The Regulator responded in the Draft Decision by requiring a value of 6.0%.

The Market Risk Premium (MRP) is the difference between market return and risk free return (i.e. the Rm - Rf term in the Capital Asset Pricing Model (CAPM) equation). It is a dynamic parameter, fluctuating as a result of variations in both market return and interest rates. This MRP, when applied in the CAPM above, is a forward looking estimate, which is typically based on long-term historical data.

Market studies have established the range for the market risk premium in the 6% to 8% range. In 1989, Officer computed the long run risk premium for Australian stocks, based upon over 100 years of data, to be 7.85%. In a similar study in the U.S., Ibbotson Associates also calculated the rates of returns for stocks and bonds over the period 1926 to 1994 to be 7.0%.

More recently, some experts and the Australian regulatory community have argued that the risk premium has declined. Hathaway has recently developed an estimate of 6.6% for the risk premium. Others consider that the appropriate value to use in the CAPM is 6% or even lower. Recent decisions by the ACCC and the Regulator have applied a 6% Market Risk Premium.

Officer's 1989 study showed that ten year measures of MRP over the 105 years ranged from 0.36% to 11.87%. In the calendar year 2000, the All Ordinaries index finished the year marginally below its starting value. This indicates the inherent nature of the risk for which the investor seeks compensation by way of higher returns. This empirically observed volatility of the MRP indicates that taking a short term view is not useful in trying to predict the market return for the next regulatory period.

GGT does not believe that the evidence supporting a reduction in the MRP is convincing nor do all respected academics accept this view. To quote from the current edition of "Principles of Corporate Finance" by Brealey, Myers, et al (whose methodology is favoured by many regulators):

> Our bottom line is simple. It is premature to jettison the evidence of our financial history. The generally accepted view is that the risk premium lies in the 6 per cent to 8 per cent range and we tend to favour the 8% percent end of the range.

GGT believes that the MRP's currently being observed in the marketplace reflect the capitalisation of the value of franking credits and not a reduction in the cost of equity capital. As a result, the Regulator's current methodology for calculating pre-tax WACC which uses a both a low value for the MRP, 6%, and a high value for franking credit utilization, 50%, is double counting the benefits of dividend imputation.

GGT believes the values for MRP and the franking utilisation factor are inter-related. If the Regulator chooses to adjust the pre-tax return downward to reflect the impact of imputation tax credits, then he should select a high value for the MRP, i.e. 7% to 8%. If the Regulator chooses a low value for the MRP, i.e. 6% to 7%, then he should choose a low value for franking credit utilization, i.e. zero.

The MRP is an important variable in determining the applicable rate of return. It is demonstrably volatile. Therefore, discretion must be exercised when assigning it a value. GGT respectfully requests that the Regulator properly recognises the legitimate business interests of the Service Provider, and also particularly recognises the conditions in the market for funds as required by the Code.

Beta Value and Risk

At page B136 of the Draft Decision, the Regulator states:

> The Regulator therefore considers that an assessment of asset betas for companies within the gas pipeline industry remains appropriate.

and

> The Regulator concurs with the views expressed in submissions that mining companies do not provide a reasonable set of companies for comparison purposes, but rather other infrastructure and energy companies should form the basis for comparison.

The majority of natural gas pipelines in Australia serve major population centres. Demand in these centres is distributed across a number of industry sectors. Further, a large proportion of demand growth is directly underpinned by population growth in those centres.

Neither of these circumstances apply to the GGP. It serves (almost exclusively) the mining industry. Load growth resulting from population increase in the area served by the GGP is, for practical purposes, infinitesimal.

The mining industry is widely acknowledged as a risky one. However, the risk faced by the GGP is greater than that applicable to the industry as a whole, because the pipeline can serve only a small segment of the industry. This limitation is imposed by geography. For the GGP to successfully gain new business, the mining operations providing such new opportunities must be located close to the pipeline. If they are not, the economics of constructing lateral pipelines to serve typically short lived mining projects simply do not prevail over the ever present alternative - liquid hydrocarbon fuels.

The risk of new mining operations being located near the GGP is extraordinarily greater than the risk that load will not increase in established population centres.

Mining comprises the exploitation of non-renewable resources. Consequently, as mines are 'worked out', they close, and their operators seek new opportunities elsewhere.

The GGP faces the certainty that over time the mines which provide it with its current business will decline and then disappear. This risk is simply not faced by pipelines supplying Perth, Adelaide, Melbourne, Sydney, Brisbane, and other major population centres.

The GGP also faces a substantially higher risk of contract default. Recent events in the Goldfields provide grim illustration of this potential.

It is therefore apparent from consideration of both the present and the future that the risk faced by the GGP is substantially greater than that faced by the majority of Australian pipelines.

The Regulator has not addressed this difference. As such, he has made a serious error in his analysis of the risk which the GGP faces at the present time and in the future.

The Draft Decision suggests a value of 1.33 for the equity beta associated with the GGP. GGT contends that, pending further analysis, this value needs to be a minimum of 1.40 for the GGP.

A further, fundamental, error appears at page B136 of the Draft Decision, where the Regulator states (emphasis added by GGT):

> In particular, the Regulator notes that many of the risks that GGP has raised as particularly important to it could be characterised as largely diversifiable risks. For example, a number of the potential events that would give rise to these risks would only affect a small geographic area. **These risks could be largely eliminated by investors in the GGP also holding shares in assets in other Australian States.**

The Regulator has made a serious error in not taking into account the issue at hand - the risk of the GGP as a stand-alone entity. The issue at hand is the risk faced by a particular pipeline and the commensurate requirement for return on investment from that same particular pipeline.

The risk of a portfolio containing a variety of equities (some more risky, some less risky) is simply irrelevant.

GGT is of the firm opinion that the Regulator has misinterpreted and misconstrued the issue of risk in the Draft Decision.

Summary and Conclusion

In his Draft Decision, the Regulator has made a number of errors regarding values for input variables to the calculation of WACC. The following table presents values which GGT believes are appropriate.

WACC INPUT PARAMETER	PARAMETER VALUE
Inflation Rate	2.5%
Gearing Assumptions	
Debt	50%
Equity	50%
Cost of Debt	
Debt Margin	1.2%
Nominal Cost of Debt	7.6%
Cost of Equity	
Nominal Risk Free Rate	6.4%
Australian Market Risk Premium	6.5%
Beta (equity)	1.4
Dividend Imputation Factor	
Value of Franking Credits	0%
Taxation	
Company Tax Rate	as actually applicable
WACC	
Nominal Pre-Tax WACC	**15.1%**

GGT respectfully requests that the Regulator addresses the issues regarding the determination of WACC discussed above as a matter of priority, and includes it in a revision to his Draft Decision issued pursuant to the provisions of clause 21 of the Appendix to Schedule 1 of the Gas Pipelines Access (Western Australia) Act 1998.

Amendment 35

The Regulator proposes (at page B161):

> In view of the above, the Regulator considers that the Access Arrangement and Access Arrangement Information should be amended to reflect a weighted average asset life of 65 years and not 40 years as proposed by GGT.

This view is predicated on the statements (pages B158 and B159 respectively, emphasis added by GGT):

> ... the asset life of 42 years assumed by GGT is too low
>
> The Regulator is therefore of the view that the **licence period is not a relevant consideration** in making assumptions as to asset life for the purposes of depreciation.

In making the first and third statements, the Regulator has simply ignored key provisions of the State Agreement. Clause 16(1) guarantees the issue of a pipeline licence for two 21 year terms (i.e. 42 years). Clause 46(1) specifies the term of the State Agreement to be 42 years.

Section 8.10(f) and 8.10(g) of the Code require the Regulator to consider the provisions of the State Agreement when establishing a value for ICB. He has not done this.

The Regulator's assessment of the economic life of the GGP is at odds with even the most optimistic of the public comments the Regulator cites in the Draft Decision, which refers to "potential life-spans of up to 50 years" (page B86).

There are other factors which point to a life for the GGP which is considerably shorter than 65 years.

The Australian Taxation Office (ATO) has to date determined that the effective life of pipelines for taxation purposes should be 20 years. Recent deliberations have considered extending this to as much as 50 years, however current indications are that the ATO may be reconsidering the merits of such an extension.

Tariffs under the State Agreement were set on the basis of a 42 year pipeline life. This project life was accepted by the Western Australian State Government as being appropriate.

As identified during the Public Forum of 15 May 2001 to discuss the Draft Decision, a recent study by Treasury considers planning horizons for resource projects to be 30 years.

GGT further believes that a 65 year life is excessively long because of the possibility that minerals reserves which are located within economic reach of the GGP may be depleted well within the Regulator's required pipeline life.

The long-term outlook for the mining industry in Western Australia is good and new mines can be expected to commence operation in the future. There is no guarantee, however, that they will be within an economically viable distance of the GGP.

The GGP is not like a drilling rig or a piece of construction equipment. It can not be moved from place to place. If a pipeline’s business goes away, the pipeline becomes economically obsolete. It can not follow its customers. Further, the scrap value of a disused pipeline is small and likely to be consumed by abandonment costs.

The GGP was constructed by mining companies who knew the prospects for mining activity along the path of the GGP. These mining companies established the 42 year life. Absent compelling evidence for a change, the Regulator has no justification for increasing depreciable life without evidence and a very high degree of certainty of substantial and continued use.

This issue is discussed further in GGT's discussion of risk.

Notwithstanding all indications to the contrary, the Draft Decision proposes an unreasonably long asset life which simply does not reflect commercial reality. Such action has an immediate, direct, and adverse impact upon tariff calculation. Further, adoption of an unrealistically long asset life substantially increases the owners' risk of capital recovery and obtaining a reasonable return on capital employed. This imposition of risk is particularly onerous given the Regulator's failure to adjust his view of permissible rates of return to provide commensurate return.

GGT respectfully requests that the Regulator addresses the issues regarding asset life discussed above as a matter of priority, and includes it in a revision to his Draft Decision issued pursuant to the provisions of clause 21 of the Appendix to Schedule 1 of the Gas Pipelines Access (Western Australia) Act 1998.

Amendment 36

In Amendment 36, the Regulator proposes annual values for depreciation. The Regulator also states (page B161) that:

> In view of the above, the Regulator considers that the Access Arrangement and Access Arrangement Information should be amended to reflect a weighted average asset life of 65 years and not 40 years as proposed by GGT.

Simple application of straight line depreciation over 65 years does not result in the values for depreciation required in Amendment 36.

GGT accepts that depreciating different assets according to the asset lives specified in Amendment 35 may result in the values for annual depreciation required in Amendment 36.

However, because the Regulator has not specified the aggregate value for each asset class included in his valuation of the pipeline, GGT is unable to establish the validity or otherwise of the annual depreciation values required.

As depreciation is an important element of the determination of tariffs, GGT respectfully requests that the Regulator provides to GGT the aggregate value of each asset class used to establish the values of depreciation appearing in Amendment 36 as a matter of priority, with the view that, if GGT considers it appropriate, they may be included in a revision to his Draft Decision issued pursuant to the provisions of clause 21 of the Appendix to Schedule 1 of the Gas Pipelines Access (Western Australia) Act 1998.

The Regulator also states (page B92) in regard to items of additional capital expenditure:

> The value of these items is $3.8 million, which after depreciation is $2.7 million assuming straight line depreciation.

The footnote applicable to this statement indicates that the depreciated value was obtained by straight line depreciation over 65 years.

A depreciated value of $ 2.7 million arising from an initial value of $ 3.8 million implies that the remaining life of the asset is approximately 46 years.

Construction of the GGP was completed in 1996, implying a total asset life of approximately 49 years.

It appears that the Regulator has made an arithmetic error in this depreciation calculation.

GGT respectfully requests that the Regulator addresses this issue, and includes it in a revision to his Draft Decision issued pursuant to the provisions of clause 21 of the Appendix to Schedule 1 of the Gas Pipelines Access (Western Australia) Act 1998.

Amendment 37

The Regulator states (Section 5.7.11, page B154):

> Using the above estimates of the equity beta, risk free rate and market risk premium and on the basis of the methodology discussed in section 5.7.3, the nominal post-tax return on equity, R_e, was determined by the Regulator to be 13.3 percent, compared with 15.8 percent proposed by GGT.
>
> The real post-tax and both nominal and real pre-tax rates of return on equity equivalent to the 13.3 percent nominal post-tax return on equity have been derived using the Fisher equation and Officer methodology. These rates of return on equity are presented in Table 25 below.

GGT has constructed financial statements - balance sheets and income statements - from the data presented in the Draft Decision. From these, Returns on Equity for each year of the Access Arrangement period may be calculated from first principles. The Returns on Equity thus calculated are substantially lower than that stated by the Regulator.

GGT seeks the opportunity to review the Regulator's tariff model and the assumptions which underpin it with him and the appropriate members of his staff.

Amendment 38

Amendment 38 of the Draft Decision states:

> The proposed Access Arrangement should be amended to reflect a Reference Tariff (exclusive of GST) that will generate Total Revenue having a present value of $208.1 million as at 31 December 1999 using the WACC of 7.95 percent as the discount rate.
>
> Based on the parameters used in determining Total Revenue, information will need to be provided to the Regulator to verify that the Reference Tariff will generate a Total Revenue having a present value of $208.1 million.
>
> The proposed Access Arrangement should also be amended to specify a GST inclusive Reference Tariff.

Inconsistency Between Amendments

Amendment 26 of the Draft Decision states:

> The Access Arrangement Information should be amended to include all relevant data for the years covered by the Access Arrangement Period including those extending beyond 31 December 2004.

The combined effect of these two Amendments is to constrain the Total Revenue for any year(s) beyond 2004 on the basis of decree and not calculation.

Section 8.1 of the Code states (in part):

> A Reference Tariff and Reference Tariff Policy should be designed with a view to achieving the following objectives:
>
> (a) providing 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;

Requiring a Total Revenue with disregard to efficient costs incurred in years beyond 2004 clearly violates Section 8.1(a) of the Code.

GGT respectfully requests that the Regulator addresses this error as a matter of priority, and issues a revision to his Draft Decision accordingly pursuant to the provisions of clause 21 of the Appendix to Schedule 1 of the Gas Pipelines Access (Western Australia) Act 1998.

Revision of Tariff Calculation

GGT is concerned that the Regulator has handed down a Draft Decision which requires a substantial cut on tariffs which in turn are substantially lower than those accepted by all stakeholders at the time funds were committed to construct the pipeline.

GGT is also concerned that the methodology and calculations employed by the Regulator to establish these tariffs contain fundamental methodological flaws.

GGT therefore is considering means by which these errors may be avoided in the future.

GGT's original tariff design delivered levelised (i.e. constant in inflation adjusted terms) tariffs. These were established using an NPV methodology spanning the entire 42 year life of the pipeline under the State Agreement. The levelised tariff methodology was specifically utilised to explicitly deliver tariffs in early years which were lower than those calculated under a Cost of Service methodology. By definition, therefore, tariffs applicable to the GGP under the State Agreement were designed to under-recover pipeline costs in the early years of project life and over-recover costs in the later years in order to achieve the same NPV as it would have achieved using a Cost of Service tariff setting methodology.

GGT utilised a levelised NPV tariff calculation in its Access Arrangement in order to remain consistent with the State Agreement (to the extent possible under the provisions of Section 8 of the Code). It did this in the expectation that Decisions by the Regulator would deliver outcomes which were consistent with the Joint Venturers' legitimate business interests under the State Agreement.

However, the content of the Draft Decision provides graphic and compelling evidence that the Regulator does not intend to maintain any sort of alignment with the tariffs established under the State Agreement. The tariff determination methodology employed by the Regulator is esoteric and arcane, and appears to contain flaws which can be unravelled only by delving deep into the often implicit assumptions underpinning his calculations.

On the basis that the Regulator has not properly observed the requirements of the State Agreement and has calculated tariffs in a manner which is difficult to understand and prone to delivering erroneous results, GGT considers that a simple Cost of Service tariff calculation may serve to eliminate many of the problems associated with the tariff determination in the Draft Decision. Consequently, GGT has developed a replacement for the methodology used previously for developing Reference Service Tariffs. Specifically, the form of the tariff model used to determine the Reference Service Tariff is revised.

GGT believes that the tariff model used to develop tariffs for the Access Arrangement period should be transparent and straightforward. To this end, a Cost of Service methodology facilitates ease of understanding by virtue of its simplicity.

Further, GGT believes that developing real (constant value dollar) returns and forecasts adds an unnecessary level of complexity to the tariff setting process, since results are reported (to shareholders and wider stakeholders) in nominal terms. Inflation in Australia is low, and, thus, any distortion due to inflation is small. Thus, it is much simpler to establish the capital base, set rates of return, and establish tariffs in nominal terms.

The Code does not prescribe that there is any particular or preferred manner of addressing the treatment of inflation. In particular, Section 8.5A of the Code expressly recognises that adoption of a particular methodology under Section 8.4 in determining total revenue is not determinative of whether a real or nominal approach is to be applied. The only requirement of Section 8.5A is that the approach taken to deal with the effects of inflation is to be specified in the Access Arrangement and applied consistently in determining the Total Revenue and the Reference Tariffs.

The Code does not prescribe any specific matters which are to be taken into account by the Regulator in determining whether to allow a Service Provider's proposed treatment of inflation. GGT submits that in exercising discretion under Section 8.5A, the Regulator is bound by the general requirements of the Code including Sections 2.24 and 8.1. In particular, if the Regulator proposes to reject the approach proposed by the Service Provider, the Regulator should only do so if satisfied that the balance of considerations in Sections 2.24 and 8.1 require application of a different approach.

Consistent with the considerations discussed above, GGT has developed a simple, nominal dollar, Cost of Service model.

The main elements of the model are as follows:

I. Return is calculated on a annual basis and is equal to the product of WACC and beginning capital base

   A. Pre-tax nominal WACC of 15.10% as per GGT's revised proposal, with WACC being calculated according to the following formula:

$$WACC = k_e \frac{(1-t_c)}{(1-t_c(1-\boldsymbol{g}))} \times \frac{E}{V} + k_d(1-t_c)\frac{D}{V}$$

Where

k_e	=	after tax cost of equity
k_d	=	nominal pre tax debt rate
t_c	=	corporate tax rate
D	=	market value of interest bearing debt
E	=	the market value of equity
V	=	market value of the entity (V = D+E)
γ	=	franking utilisation rate

B. Initial Capital Base of $596.6 million

INITIAL CAPITAL BASE ($ Millions)	
Initial Construction Cost	$499.9
Less: Accum. DD & A	41.7
Net Plant	458.2
Unrecovered Capital	135.8
Working Capital	2.6
	596.6

C. Capital base in subsequent periods is equal to ICB plus capital additions less depreciation

D. Markets: MDQ and throughput as accepted by the Regulator in the Draft Decision

II. Depreciation calculated on 42-year straight line basis based upon Initial Construction Cost of $499.9 million. The Regulatory Asset is amortised on a straight-line basis over remaining pipeline life of 39.5 years.

III. Operating and Maintenance (O & M) costs based upon the O & M costs proposed in GGT's Access Arrangement submission.

IV. Tariffs are calculated for each year by a two step process

A. Revenues are allocated to the toll, capacity and throughput charges as follows:

Category	Share
Toll	11.3%
Capacity	72.5%
Throughput	16.2%

B. Unit charges are calculated for Toll, Capacity and Throughput Charges based upon forecast values for MDQ, Throughput and Average Mileage as follows:

Toll $$\frac{\text{Total Revenue * Toll Share}}{\text{MDQ * 365}}$$

Capacity $$\frac{\text{Total Revenue * Capacity Share}}{\text{MDQ * Average Distance * 365}}$$

Throughput $$\frac{\text{Total Revenue * Throughput Share}}{\text{Avg. Daily Throughput * Average Distance * 365}}$$

GGT has used this model to calculate annual tariffs for each of the five years of the five year Access Arrangement period. These tariffs would then be fixed for the remainder of the Access Arrangement period.

Parts of the Cost of Service model incorporate data which is of a commercially sensitive nature. Consequently, GGT has included its details in a separate report, submitted to the Regulator concurrently with this Public Submission under conditions of commercial confidence.

Cost of Service Model Tariffs

Based upon the assumptions discussed above, the model establishes the following nominal dollar toll, capacity and throughput charges for the 2000-2004 period. Unit transport costs for transport to Kalgoorlie at 100% load factor are also presented.

GOLDFIELDS GAS PIPELINE
COST of SERVICE MODEL REFERENCE SERVICE TARIFF

year	Toll ($/GJ)	Reservation ($/GJkm)	Throughput ($/GJkm)	100% LF Kalgoorlie ($/GJ)
2000	0.367264	0.002156	0.000669	4.26
2001	0.360498	0.002116	0.000657	4.18
2002	0.340057	0.001976	0.000613	3.91
2003	0.340092	0.001953	0.000607	3.87
2004	0.353168	0.001998	0.000620	3.96

GGT presents these tariffs as the 16 to 20 year Reference Service Tariff over the remainder of the Access Arrangement Period. These tariffs would not be varied for changes in costs, throughputs, or variations in the Consumer Price Index except via the mechanism of an Access Arrangement resubmission.

Amendment 39

Amendment 39 proposes that "Cb" must be shown to be referenced to 1 Oct 1997.

GGT will revise its Access Arrangement to address this issue.

Amendment 40

Amendment 40 proposes that the CPI for quarter ending 30 Sep 2000 is to be reduced by 2.75% points to back out the impact of GST.

GGT will revise its Access Arrangement to address this issue.

Amendment 41

Amendment 41 proposes that GGT cannot vary the parameters used in the calculation of Quantity Variation Charges (QVC).

The objective of a 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. Therefore 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. The Supplementary Quantity Option has been introduced 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, 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 with responsible practice.

It should be emphasised that the QVC is however non-discriminatory in that it would be uniformly applied and only in response to abuse affecting other Users. It is a system management mechanism and is not intended to be of a punitive nature.

Amendment 42

Amendment 42 proposes that 95% of the revenue generated from the application of Quantity Variation Charges should be rebatable as if these charges are in relation to rebatable services within the meaning of the Code.

The concept of rebating within the Code relates to the sharing of revenue generated from a non-reference service rather than any rebate of charges incurred by a User for performance non-compliance under a reference service. Furthermore it is not a requirement within the Code nor has it been general practice by industry nor have Regulators in other jurisdictions required the rebate of such charges as Quantity Variation Charges.

The Regulator has also not indicated how any such charges would be allocated. The GGP has only a small number of Users and therefore there are issues of logic in the application of the rebates that would need to be considered. For example for a large User, a proportional rebate will negate the effectiveness of the QVC required to protect all Users should transgressors receive a rebate of a charge which is designed to prevent their transgression.

GGT submits that this amendment is unreasonable.

Amendment 43

Amendment 43 proposes that GGT provide Users with greater flexibility regarding provision of System Use Gas, to provide Users with information on the cost and quantity of System Use Gas.

GGT has in place a workable and accepted system with current Users which has operated successfully without contention under the existing open access regime to provide Users with the cost and quantity of System Use Gas. GGT will provide any prospective User with the same options as that which currently exists.

GGT will revise its Access Arrangement to address this issue.

Amendment 44

Amendment 44 proposes that the Accumulated Imbalance Charge should not apply in respect of allowed tolerance.

GGT will revise its Access Arrangement to address this issue.

Amendment 45

Amendment 45 proposes that the Daily Overrun Charges should only apply to daily overrun outlet variations.

GGT will revise its Access Arrangement to address this issue.

Amendment 46

Amendment 46 proposes that Hourly Overrun Charges only apply to hourly overrun outlet variations.

GGT will revise its Access Arrangement to address this issue.

Amendment 47

Amendment 47 proposes that the Variance charge should not apply where variance tolerance is exceeded unintentionally and infrequently.

GGT will revise its Access Arrangement to address this issue.

Amendment 48

Amendment 48 proposes that the Variance Charge should not apply in respect of allowed tolerance.

GGT will revise its Access Arrangement to address this issue.

Amendment 49

Amendment 49 proposes that User specific information should be available to Users on a timely basis to assist them to manage operations and avoid penalty charges

The Draft Decision suggests provision of an electronic bulletin board with continuous updates. To date the current system of the provision of daily faxes to Users of their quantities has proven adequate to the task. It should be noted that the cost of implementing and maintaining an electronic bulletin board would not be insubstantial and that, as the GGP has only a relatively small number of Users, the benefits are likely to be limited.

GGT is uncertain as to what authority the Regulator has to impose a more expensive system, the cost of which would be borne by Users, if this is what is intended in the Draft Decision. GGT would have to investigate the costs and practicality of providing such a system and, in the event, would have to canvas all Users for their input as to how these requirements would be met and their acceptance of the overall benefits outweighing the costs. In the meantime, GGT will continue the provision of faxed data.

Furthermore, it seems obvious that given the cost of complying with the nature of the Regulator's Amendment and negligible perceived benefit that would be afforded to Users and Prospective Users (given that the number of Users in the foreseeable future, and certainly for the duration of the access arrangement period, are not going to increase to a great degree over and above current levels), the Regulator has failed to take into account the legitimate business interests of the Service Provider when assessing this provision of the proposed Access Arrangement.

Accordingly, GGT submits that this amendment is unnecessary and unreasonable.

3.0 Other Key Issues (not addressed by specific Amendments)

GGT feels compelled to comment on a number of aspects of the Draft Decision which, while not specifically identified as amendments required to ensure the Access Arrangement is approved, are intrinsic to the subject matter of some of the required amendments.

3.1 Continuity of General Terms and Conditions

The Regulator, in the Draft Decision, has given no recognition to the fact that the majority of the proposed amendments which deal with non-tariff matters, actually seek to modify Terms and Conditions which were accepted under the pre-existing State Agreement regime. Further, these Terms and Conditions were established by the original owners, who now form the main customer base for the pipeline, in conjunction with the State Government who represented the interests of equitable access for other, third party, customers.

Clearly such Terms and Conditions have been established in circumstances which reflect the best possible representation of the interests of both the pipeline's customers and owners. The fact that they have been in operation without serious contention since inception merely supports the validity of this.

That such circumstances precede the proposed amendments contained in the Draft Decision is a matter which should be taken into account in considering the interests and expectations of the Service Provider and Users. However, this does not appear to have been taken into consideration in the Draft Decision. Furthermore the proposal of amendments without such consideration, of itself contributes adversely to the commercial certainty otherwise afforded all parties under the established regime.

3.2 General Concepts of Risk

GGT considers that the Regulator has failed to properly consider the specific risks faced by the GGP in determining the allowed return for the project. One of the reasons for this is because of the Regulator's assumption that tariffs under an Access Arrangement should be less than the tariffs prior to the submission of the Access Arrangement. GGT considers that by adopting this stance, the Regulator has failed to properly balance the requisite interests and considerations when assessing an Access Arrangement.

In the preamble to Section 1 of the Code, it is stated that the Code "provides a high degree of certainty for the Pipelines covered" [by the Code]. In practice it appears the only certainty is that Users of Covered Pipelines will receive reductions in tariffs regardless of the point in the prevailing tariff path from which the Code applies.

In the GGP Draft Decision, the Regulator responds inadequately to its obligations under Section 8.10(g) of the Code, only making the assertion that in the Regulator's opinion, it would be the reasonable expectation of persons under the pre-existing regulatory regime, that following enactment, the Code would apply. This provides no guidance as to what outcomes the application of the Code should reasonably be expected to have. However, insight into the Regulator's expectation of the effect of the implementation of the Code is provided in previous decisions by it.

In the Draft Decision for the Tubridgi Pipeline System, the Regulator declared that, "For the most part, the criteria for a balance of interests has been that regulated tariffs should not exceed existing tariffs" (Part B, page 81). Further, in the Draft Decision for the Parmelia Pipeline, the Regulator asserts that its ruling "is consistent with the reasonable expectations of Users that regulation will provide for an overall reduction in tariffs" (part A, page 19). In the same document, the Regulator goes on to cite some principles developed by the Victorian Office of the Regulator General (ORG) by which the Regulator states it is guided in the ongoing implementation of the Code, which state "The default position is that Reference Tariffs will fall at the commencement of the next Access Arrangement Period..." (Part B, page 132).

It should be noted that the Code makes no such stipulation that tariffs must be reduced, in fact its provisions permit quite the contrary if such outcomes reflect efficient economic and competitive realities. This has been recognised by both the Australian Competition Tribunal[5] and the ACCC.[6]

In regard to the Final Decision, GGT requests the Regulator to give specific

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[5] Matter No. 3 of 2000, Application under section 38(1) of the Gas Pipelines Access Law for review of the Decision by the Minister for Industry, Science and Resources published on 16 October 2000 to cover the Eastern Gas Pipeline pursuant to the provisions of the National Third Party Access Code For Natural Gas Pipeline Systems and the Gas Pipelines Access Law, Australian Competition Tribunal, 4 May 2001, page 33.

[6] Draft Decision: Access Arrangement by East Australian Pipeline Limited for the Moomba to Sydney Pipeline System, ACCC, 19 December 2000, Section 2.8.4.

consideration to the matter of this divergence from the objectivity of the Code.

It is also noteworthy that the ORG is an agency tasked with regulating distribution networks (ie. which almost exclusively service an urban consumer base having an implicit guarantee of organic load growth linked to population growth) and specifically not the regulation of gas transmission pipelines to which the Regulator was applying this principle. With reference to the Parmelia Decision, the Regulator failed to appreciate the fact that the Parmelia Pipeline services an exclusively industrial market. This is a further example of the general inability of Regulators in Australia to distinguish between the nature of the risks faced by a distribution network and a transmission pipeline, and between transmission pipelines which service large, diversified population centres from those which service just a few, sometimes speculative, resource projects.

This lack of regulatory appreciation of investment risk is reflected in the small spread in permissible rates of return, with mandated real pre-tax returns on capital in Western Australia only having a spread of a fraction of one percent, regardless of the nature of the asset or its service function. Across the nation, the spread in permissible rates of return is only slightly larger. More perplexing though is that the relativity between the rates allowed on various types of assets is, when compared around the country, nonsensical with, in some cases, transmission pipelines having lower permissible returns than demonstrably lower risk distribution networks.[7]

This inability to distinguish the divergent nature of the risks involved between differing asset types and market circumstances is not mandated by the Code itself. In fact the Code specifically and separately lists distribution networks and transmission pipelines in its Schedule A.

Accordingly, GGT requests the Regulator to give specific consideration in the Final Decision to the matter of this differentiation as indicated in the Code itself.

This error in the Regulator's approach is a symptom of the emphasis of academic economic expertise rather than experienced commercial analysis brought to bear on the application of the Code. This is a major shortcoming which seems likely to cost Australia dearly once the inevitable commercial ramifications manifest themselves. With its dependence upon development investment, this will be felt particularly hard in Western Australia.

Evidence of such lack of appreciation of commercial reality can be found in the GGP Draft Decision at page B142, where the Regulator makes the academic assertion to the effect that regulation itself insures asset owners against loss. This is because the Regulator considers that "repair costs" can eventually be rolled into future capital recovery (implying that the Regulator will automatically deem them to be economically efficient, although this is in fact far from guaranteed) and "so the only loss to the firm is the financing cost in the meantime".

Clearly issues relating to a commercial appreciation of the time value of money or the requirement for the generation of positive cashflow in order to stay in business (and the duty under the Corporations Law to only trade whilst solvent) are matters that the Regulator feels are not relevant to its considerations. However GGT would direct the Regulator to Section 8.35 of the Code.

Further evidence of the apparently simplistic consideration of economic risk can be found in the statement the Regulator makes on page B136 of the Draft Decision dealing with

[7] The specific risks faced by the GGP are identified in the discussion of beta value and risk in the part of the previous section of this submission which addresses Amendment 34.

the determination of a tariffs specific to the GGP. In the section relating to beta values the Regulator makes the following statement.

> "For example, a number of the potential events that give rise to these risks [*that is risks associated with GGT having a small number of customers, all of whom are engaged in resource projects*] would only affect a small geographical area. These risks could be largely eliminated by investors in the GGP also holding shares in other Australian States."

It is a matter of considerable concern that the Regulator should make such a statement in regard to the evaluation of the risks faced by a specific, fixed and capital intensive piece of infrastructure. It is possible that this is merely symptomatic of the esoteric and highly academic application of the Capital Asset Pricing Model (CAPM) methodology as it has been applied to regulatory valuation in Australia. However this neither excuses the Regulator's statement nor provides any reduction in the real impact of sovereign risk on infrastructure investors.

In fact, throughout the Draft Decision, the Regulator fails to recognise the significant sovereign risk arising through the Regulator's approach to the implementation of a new regulatory regime having the apparently predetermined objective of reducing tariffs. Nor does the Regulator consider the consequences for investment certainty of solely focussing on such "consumer" biased objectives, and attempting to over-ride a pre-existing regulatory regime which had its own quite different objective of facilitating infrastructure and resource development.

It is also pertinent to note that the consumers who are the beneficiaries of this policy in this case would not be the unrepresented householders usually claimed to be the focus of decisions made by regulatory authorities. In fact the effect of a tariff reduction on GGP will simply be to transfer revenue from one corporate entity (the Service Provider) to other corporate entities (the pipeline Users). Hence the application of the traditional regulatory doctrine of "consumer advocacy" is, in regard to the GGP, misplaced.

3.3 Load and Uncertainty

In the Draft Decision, the Regulator appears to be seeking to apply its discretion to the determination of the load forecast for the purpose of setting tariffs in a manner which is inconsistent with the tariff setting principles under the State Agreement. The original owner-builders of the GGP and the Western Australian State Government were unable to foresee a commercially realistic asset life for the pipeline beyond 40 years. For the original owners this was despite a longer life arguably serving their own best interests as being the very customers which the pipeline would serve over this time.

However the Regulator has, without substantiation, deemed the life of the asset to now be as long as 70 years.

In asserting that the GGP has an economic life of 70 years, the Regulator in effect is expressing a view of 100% certainty in the GGP being utilised at substantial levels of throughput for that entire duration.

Even the most optimistic of the public comments the Regulator cites in the Draft Decision for justification of this, refers to "potential life-spans of up to 50 years" (page B 86).

GGT contends that the asset life adopted to establish real tariffs today (that is tariffs which have 100% chance of materialising), should at the very least be matched to an economic life with a similarly high chance of being realised. This was obviously a consideration in establishing the original GGP asset life.

It is worthy to note that, even though it is not a figure accepted by infrastructure investors, the ATO review of pipeline asset life has recently considered whether the effective life of pipelines should be extended from the current 20 years to 50 years for taxation purposes. However GGT contends that given the specific circumstances of the GGP, this would still be too long. In fact, there is evidence that the ATO is reconsidering its preliminary conclusion. Notwithstanding this view, the Regulator has in any event, failed to take into consideration all such indications of asset life. Such an arbitrary approach on the part of the Regulator, besides having an immediate direct and adverse impact upon tariff calculation, also substantially changes the owners' risk horizon.

Relative to the original 42 year term sanctioned by the State Government under the State Agreement, extending the time frame for returning owner's capital beyond that which is commensurate with the nature of the market being serviced, adds significant investment uncertainty. This is particularly onerous given the view taken by the Regulator of permissible rates of return.

GGT wishes to re-state its objection to the Regulator's dismissal of the asset life sanctioned by previous regulatory determinations.

Somewhat confusingly, and at odds with its own determination of asset life, the Regulator has alluded to the acceptability of the load forecast that GGT submitted in the proposed Access Arrangement. The forecast submitted by GGT was that accepted by the State for recent regulatory purposes (under Tariff Setting Principle 2 of the State Agreement), and is consistent with that upon which the original owners (now the main customer base) of the GGP based their decision for the project to proceed. It should also be noted that while GGT has the right to extend its pipeline licence at the end of the first 21 year period, it holds no right of renewal after 42 years.

Furthermore, GGT has no certainty as to what load will be mandated by the Regulator in the Final Decision.

The Draft Decision does not commit the Regulator to using the same load forecast for determining tariffs in the Final Decision; it merely states, on page B88, "additional advice on the throughput forecast is likely to be required before the Regulator issues the Final Decision".

The Draft Decision also quotes from the Offer Document issued by Australian Pipeline Limited for the Australian Pipeline Trust, and replicates a graph of GGP load forecast contained in that document. However the Regulator fails to also represent in either the graphical version of the data or the commentary, the distinction made in the Offer Document between contracted volumes and potential increases, nor does the Draft Decision consider the qualification which explains that the medium term forecast is "Subject to a positive mining industry outlook...". The document also states that, "In the short term, the Directors expect that there will be little growth over the existing contracted customer base" (page 37).

While the Regulator has accurately indicated that the forecast which the Draft Decision replicates on page B88 only extends for ten years, no connection or reference is made to the significance of this fact. This short horizon is indicative of the difficulties in making meaningful forecasts of market demand when the market in question is not a population centre having the characteristics of relatively predictable, naturally exponential organic growth. GGT faces a vastly different market exposure, having been built by a group of mine-site owners with the primary purpose of servicing the power needs of their own mines.

This determined the physical location of the pipeline as it exists today, and in consequence, load growth for the GGP largely depends upon the coincidental occurrence of developable resources in reasonably close proximity to it. Demonstrably, the farther from the existing pipeline a project is, the larger the gas demand and the longer the contracted life needs to be to simply recover the cost of an interconnecting lateral pipeline.

In addition to these matters, there are other aspects of uncertainty affecting the market the GGP services in the short to medium term. GGT requests that the Regulator, in the Final Decision, give consideration to at least the following aspects of this.

(1) The fact that any additional projects located close enough to be serviced by the GGP may also be otherwise supplied by electricity from existing power generation facilities which may or may not themselves be fuelled by gas,
(2) Uncertainty associated with the publicised current liquidity problems faced by Anaconda Nickel Limited,
(3) Consequences of receivership for Centaur Mining Limited,
(4) Ability to predict loads and technical consequences for load distribution associated with announcements regarding the proposed water and possibly gas pipeline to Esperance, taking regard of the effect of alternate competing water supply proposals (e.g. from the Officer Basin), and
(5) Announcements by the pipeline licence holder to the effect that economics of the proposed Geraldton to Mount Margaret (GEMM) pipeline, with which GGP will be competing directly, are unaffected by even substantial reductions in the tariff on GGP.

Furthermore, recent commercial initiatives via the offering of an Economic Development Tariff (EDT), representing a marginally priced, incremental-load-dependent, tariff discount on the part of GGT, confirm the assumptions for short term prospects for gas transportation growth on the GGP.

Under this scheme, the more new load committed to by Users, the greater the resulting base to spread the recovery of the largely fixed increment of necessary investment in capacity, and hence the lower the marginal price of transportation that could be offered.

Such an initiative is sanctioned under Tariff Setting Principle 13 of the existing State regulatory regime, although there is no equivalent concept defined under the national Code. (The closest concept being one of "Prudent Discounts" which involve cross-subsidisation between different classes of User).

It should be emphasised that as the EDT was based on marginal pricing, it was entirely dependent upon the volume and duration of additional load evidenced, and as such, can not be considered to have any wider or more sustainable application than in the context it was offered. In the event, GGT was disappointed that a credible load increase of only a matter of a few percent of the previously contracted base load was committed to.

Information regarding the progress and success of the EDT was made available to the Regulator during the time since the proposed Access Arrangement was submitted. Despite this, the Regulator in the Draft Decision reaches the conclusion that the outcome of the EDT did not demonstrate the inelasticity of resource projects in the East Pilbara and Goldfields to gas transportation costs (page B 189).

GGT finds that the analysis in the Draft Decision is entirely superficial and misleading. The fact is that Goldfields projects have indeed proceeded, they have merely done so without using gas transported via the GGP (ie. they have used diesel instead). Examples are provided in the following list of recently committed developments.

Project	Resource	Approx. Distance from GGP	Approx. Load	When
Bulong	Nickel	30 km	1.5 TJ/day	1999
Tarmoola	Gold	20 km	2.0 TJ/day	99/00
Carusoe Dam	Gold	90 km	2.0 TJ/day	2001
Sons of Gwalia	Gold	20 km	2.5 TJ/day	2000
Granny Smith	Gold	150 km	4.5 TJ/day	01/02
Sunrise Dam	Gold	150 km	3.5 TJ/day	01/02

This effectively demonstrates the nature of the competition which GGT faces. That is, GGT is competing directly with an alternative and non-capital intensive fuel and that delivered gas pricing is not the critical determinant in whether a project proceeds or not, but simply which fuel it will utilise.

GGT is happy to discuss with the Regulator or any other interested party, an example of how small a fraction of total annual end-user cashflow is represented by gas transportation costs, based on publicly available information regarding a representative resource project.

GGT wishes to also emphasise that the cost base for GGP as submitted in the proposed Access Arrangement does not currently include provision for any of the additional capacity investment which would be required to accommodate any additional load if it should eventuate.