NEWMONT AUSTRALIA

SUBMISSION TO THE

ECONOMIC REGULATION AUTHORITY

REGARDING THE DRAFT ACCESS ARRANGEMENT

FOR THE GOLDFIELDS GAS PIPELINE

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Executive Summary

1. This submission is made on behalf of Newmont Australia which has a significant interest in the Goldfields Gas Pipeline arising from its interest in the Parkeston Power Station and various mines along the route of the GGP.
2. Newmont is generally supportive of the draft Access Arrangement dated 29 July 2004 issued by the Economic Regulation Authority.
3. However, Newmont submits that the draft Access Arrangement:
   a. Incorrectly concludes that recognition of profits earned under the State Agreement regime creates a perception of sovereign risk in dealing with the State of Western Australia;
   b. Incorrectly exercises its discretion, and acts contrary to the Code, in not taking into account profits earned under the State Agreement regime;
   c. Attaches undue significance to the expectations of the GGP owners arising from the operation of the State Agreement regime; and
   d. Incorrectly exercises its discretion, and acts in a manner not permitted by the Code, in arriving at a value for the Initial Capital Base of the GGP.

Sovereign Risk

4. The draft Access Arrangement dated 29 July 2004 ('AA') contains several references to sovereign risk (paragraphs 122, 129, 179, 219, 231-2). In essence, the ERA appears to rely on sovereign risk to justify disregarding the profits earned by the GGP owners under the State Agreement regime in calculating a reasonable return on the GGP owners investment in the GGP (see particularly paragraphs 179 and 219). It is submitted that the ERA's use of sovereign risk in this way is erroneous, for the following reasons.
5. If the ERA's assessment of sovereign risk were correct, particularly the risk that consideration of profits earned by the GGP owners under the State Agreement regime would create a perception of sovereign risk in dealings with the Government of Western Australia, then it would be reasonable to expect that the sovereign risk rating of Western Australia, and Australia, would have been adversely affected by the draft Access Arrangement issued by the Office of Gas Regulation in April 2001, but that is not the case. International ratings agency Fitch have rated the sovereign risk of Australia at AA since January 1996 and in fact improved that rating to AA+ in February 2003 (ratings of other well known agencies Moody's are Aaa and Standard & Poors are AAA.

over the same period). Ratings for Western Australia (specifically the Western Australian Treasury Corporation) have been at the highest, or second highest rating over the same period. This information suggests that the impact of this perception on sovereign risk is nil, or negligible.

6. The ERA's use of the phrase 'sovereign risk' in context in the AA is not entirely consistent with the manner in which that phrase is used in international credit analysis, where it relates to the credit risk associated with operations involving credit for sovereign states. Where the phrase 'sovereign risk' is used by the ERA in the AA it appears to contain a connotation that the relevant risk is that the action of a regulator may take account of past profits earned by the pipeline owner. If this is the meaning intended by the ERA, then it is submitted that what is required is a comparative analysis of this risk in other regulatory regimes. Newmont submits that if such a comparative analysis is undertaken it can be seen that precisely this risk exists in most jurisdictions in which gas pipelines are regulated therefore:
    a. The pipeline owners are exposed to no greater risk in Western Australia than they would be exposed elsewhere in which they were investing in a regulated pipeline; and
    b. The perception of this risk in Western Australia does not differ from the perception of this risk anywhere else.
7. Gas pipelines have been regulated in the USA for many years by the Federal Energy Regulatory Commission (FERC) and its predecessors. There are many examples of the FERC reviewing charges levied by a pipeline owner in a given period and ruling that such charges were excessive and therefore required adjustment or warranted reductions in tariffs or charges to users. See, for example, Big West Oil Company v Frontier Pipeline Company and Express Pipeline Partnership 106 FERC 61,171 (18 February 2004). In this, the FERC is even handed in that it may also retrospectively increase charges to users. See for example, Pacific Gas and Electric Company 100 FERC 61,156 (5 August 2002).
8. In Europe the position regarding Gas Regulation is more complex. The European Union Second Gas Directive dated 26 June 2003 appears, by its terms (particularly article 25), to permit the Regulatory authority to consider past profits in assessing the reasonableness of tariffs; certainly there appears no express prohibition on doing so (though due to language difficulties it has

not been possible to determine how the Second Gas Directive has been applied by Regulators).

9. Newmont's submission that this 'sovereign risk' is not unique to Western Australia is supported by other studies which indicate that regulatory activity has not affected investment in utilities in Australia. In submissions to the Productivity Commission by the Energy Markets Reform Forum dated September 2003 and the ACCC dated 17 March 2004, it is concluded that:
   a. "No substantive evidence has been provided to attest to the assertions of pipeline owners and their consultants that investments (in pipelines) have been deterred because of access regulation";
   b. "There is no evidence tendered to show that the Australian economy has been adversely affected because of access regulation of gas pipelines. On the contrary, the benefits to the national economy, have been clearly achieved" (EMRF submission of September 2003 p.18);
   c. "There is clear evidence to suggest that the current regime is delivering substantial net benefits to the industry and the economy...This view is supported by a significant reduction in access prices, examples of third party access to pipeline systems, a high level of investment in the industry and related markets, emerging upstream and downstream competition and increased consumption of gas" (ACCC submission 17 March 2004 p.43).

Past Profits

10. Further the ERA's methodology indicates that it has determined that the past profits earned under the State Agreement regime cannot be taken into account in a manner adverse to the interests of the GGP owners (for the reasons set out in paragraph 232). Yet clause 8.10(f) of the Code specifically states that the historical returns to the Service Provider from the Covered Pipeline should be considered in establishing the ICB. In Newmont's submission it is erroneous for the ERA to refuse to take into account a factor specifically stated in the Code and the ERA's methodology is not permitted by the Code.

Initial Capital Base

11. In considering the Initial Capital Base (ICB) the ERA has attached significant weight to sovereign risk (paragraphs 232-3). If Newmont's submissions above regarding sovereign risk are accepted, then it follows that the ERA's exercise

of its discretion in attributing a value to the ICB needs to be reconsidered without regard to the factors referred to as 'sovereign risk'.

12. Further, the ERA has attached significant weight to the expectation held by the owners of the GGP that the high rate of return would continue (paragraph 232), a rate of return which is substantially in excess of a reasonable estimate of the cost of capital for the GGP (paragraph 215). The GGP owners do not point to any express promise or warranty that the high rate of return would continue. In truth, this 'expectation' is no more than a hope that the super profits would continue, being a hope founded on the mere fact that the Government had not changed anything. This hope is not a reasonable expectation for the purposes of clause 8.10(g) of the Code; and the ERA has erred in attaching undue significance to it.
13. Since sovereign risk and the GGP owners' expectation that the high rate of return would continue are the main justification for the ERA's decision to attribute an ICB of $480M, then it follows that the ERA's exercise of its discretion in setting the ICB must be reviewed. In Newmont's submission there are no unique or distinguishing reasons which would justify an ICB for the GGP outside of the range of values determined by clauses 8.10(a) and (b) of the Code, and the ICB set by the ERA in the AA is erroneous and not permitted by the Code.

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