

AUSTRALIAN COMPETITION TRIBUNAL

Application by GasNet Australia (Operations) Pty Ltd

[2003] ACompT 6

ADDENDUM

APPLICATION BY GASNET AUSTRALIA (OPERATIONS) PTY LTD
File No 1 OF 2003

COOPER J, MR RC DAVEY, PROFESSOR DK ROUND
BRISBANE (HEARD IN MELBOURNE)
23 DECEMBER 2003

IN THE AUSTRALIAN COMPETITION TRIBUNAL

File No 1 of 2003

**RE: APPLICATION FOR REVIEW OF THE DECISION BY THE
AUSTRALIAN COMPETITION AND CONSUMER
COMMISSION PUBLISHED ON 17 JANUARY 2003 IN
CONNECTION WITH REVISIONS TO THE ACCESS
ARRANGEMENT FOR THE GAS TRANSMISSION SYSTEM
OWNED BY GASNET AUSTRALIA (OPERATIONS) PTY
LTD**

**BY: GASNET AUSTRALIA (OPERATIONS) PTY LTD
APPLICANT**

**TRIBUNAL: COOPER J (DEPUTY PRESIDENT)
MR RC DAVEY
PROFESSOR DK ROUND**

DATE OF ORDER: 23 DECEMBER 2003

WHERE MADE: BRISBANE (HEARD IN MELBOURNE)

ADDENDUM TO REASONS FOR JUDGMENT

In the orders, insert final order, as follows:

‘6. That there be no order as to costs.’

I certify that this is a true copy of the addendum to the Reasons for Judgment herein of the Honourable Justice Cooper, Mr RC Davey and Professor DK Round.

Associate:

Dated: 23 December 2003

Counsel for the Applicant:
Solicitor for the Applicant:

AC Archibald QC with P Fox
Mallesons Stephen Jacques

Counsel for the ACCC:
Solicitor for the ACCC:

J Beach QC with PRD Gray
ACCC Legal Group

Counsel for Energy Action Group:

CM Maxwell QC with S Hibble

Dates of Hearing:
Date of Judgment:

13 - 15, 18 - 21 August 2003
23 December 2003

AUSTRALIAN COMPETITION TRIBUNAL

Application by GasNet Australia (Operations) Pty Ltd

[2003] ACompT 6

TRADE PRACTICES - access to pipelines - review of decision of Australian Competition and Consumer Commission to draft access arrangement - *Gas Pipelines Access (Victoria) Act 1998 (Vic)*

Gas Pipelines Access (Victoria) Act 1998 (Vic)

Gas Pipelines Access (South Australia) Act 1997 (SA)

Application by Epic Energy South Australia Pty Ltd [2003] ACompT 5

Re Michael Ex parte Epic Energy (WA) Nominees Pty Ltd (2002) 25 WAR 511

Application by Epic Energy South Australia Pty Ltd [2002] ACompT 4

APPLICATION BY GASNET AUSTRALIA (OPERATIONS) PTY LTD
File No 1 OF 2003

COOPER J, MR RC DAVEY, PROFESSOR DK ROUND
BRISBANE (HEARD IN MELBOURNE)
23 DECEMBER 2003

IN THE AUSTRALIAN COMPETITION TRIBUNAL

File No 1 of 2003

RE: APPLICATION FOR REVIEW OF THE DECISION BY THE AUSTRALIAN COMPETITION AND CONSUMER COMMISSION PUBLISHED ON 17 JANUARY 2003 IN CONNECTION WITH REVISIONS TO THE ACCESS ARRANGEMENT FOR THE GAS TRANSMISSION SYSTEM OWNED BY GASNET AUSTRALIA (OPERATIONS) PTY LTD

BY: GASNET AUSTRALIA (OPERATIONS) PTY LTD APPLICANT

**TRIBUNAL: COOPER J (DEPUTY PRESIDENT)
MR RC DAVEY
PROFESSOR DK ROUND**

DATE OF ORDER: 23 DECEMBER 2003

WHERE MADE: BRISBANE (HEARD IN MELBOURNE)

THE TRIBUNAL ORDERS THAT:

1. The decision of the Australian Competition and Consumer Commission ('the ACCC') under s 2.42 of the National Third Party Access Code for Natural Gas Pipeline Systems ('the Code'), whereby the ACCC decided to draft and approve its own amended revisions to the Access Arrangement ('the Decision') for the gas transmission system owned by the applicant ('GasNet'), be varied.
2. The Decision be varied with effect from 1 January 2004 (in addition to the alteration approved by the ACCC on 10 December 2003 pursuant to Schedule 3 of the Access Arrangement) as follows:
 - (a) an allowance of 25 basis points per annum for debt raising costs above the debt margin be used in determining Total Revenue;
 - (b) the following allowances (in 2003 dollars) for the asymmetric risks referred to below be used in determining Non Capital Costs:
 - (i) for uplift liability risk, \$65 000 per annum;
 - (ii) for key person risk, \$72 000 per annum; and
 - (iii) for employment practices risk, \$35 000 per annum;

- (c) the asymmetric risks referred to in pars (b)(i) to (iii) above to be self-insured by the applicant;
 - (d) the eventuation of the following risks be included as Pass Through Events in the Access Arrangement:
 - (i) counterparty default (in place of the current allowance of \$10,000 per annum); and
 - (ii) terrorist risk;
3. A real risk free rate of 3.33 per cent (based on ten year Commonwealth Government bonds) be used for determining the Rate of Return;
 4. All necessary and consequential amendments be made to give effect to such variations in terms of the amendments contained in Attachments 1 and 2 to these orders.
 5. All necessary and consequential amendments to the Access Arrangement Information be made in accordance with the Code within twenty-eight days.

**Attachment 1:
Relevant clauses showing amendments**

Cover Page

Drafted and approved by the Australian Competition and Consumer Commission under section 2.42 of the National Third Party Access Code for Natural Gas Pipeline Systems for the Second Access Arrangement Period commencing 1 February 2003.

Publication Date: 17 January 2003
Commencement Date: 1 February 2003

Varied by order of the Australian Competition Tribunal under sections 38 and 39 of Schedule 1 to the Gas Pipelines Access (South Australia) Act 1997 (SA).

Date of Order: 23 December 2003

Date for Commencement
of Revised Version: 1 January 2004

Page 1

Commencement Date 1 February 2003

**Date for Commencement
of Revised Version** 1 January 2004

1.1 Purpose

This Access Arrangement is established for the GNS.

~~This Access Arrangement (as revised) has been drafted and approved by the Commission under section 2.42 of the Code.~~

The Commission drafted and approved, under section 2.42 of the Code, a revised Access Arrangement for the Second Access Arrangement Period commencing 1 February 2003.

On 23 December 2003, the Australian Competition Tribunal varied that Access Arrangement with effect from 1 January 2004.

2.1 Commencement

This Access Arrangement (as revised by the Australian Competition Tribunal) commences on 1 ~~February 2003~~ January 2004.

4.2 Initial Transmission Tariffs

The initial Transmission Tariffs (excluding GST) are set out in Schedule 1 (Part A of clauses 1.2 and 1.3).

Notwithstanding clause 4.3 of this Access Arrangement, the Transmission Tariffs that apply for the Regulatory Year commencing 1 January 2004 (excluding GST) are set out in Schedule 1 (Part B of clauses 1.2 and 1.3). These Transmission Tariffs replace the statement approved by the Commission on 10 December 2003 under Schedule 3.

4.12 Self-insurance

- (a) GasNet will self insure in respect of the following risks for the Second Access Arrangement Period:
- (i) ~~extortion and bomb threats; and~~
 - (ii) ~~counter party and insurer credit risk;~~
 - (iii) uplift liability;
 - (iv) key person risk; and
 - (v) employment practices risk.

Any losses incurred by GasNet in respect of the risks identified in paragraph (a) will not be included in calculating Reference Tariffs.

6.3 Factors the Commission must take into account

- (a) In deciding the Pass Through Amount and the basis on which the Pass Through Amount is to apply under clause 6.2, the Commission must ensure that the financial effect on GasNet in the Second Access Arrangement Period and subsequent Access Arrangement Periods associated with the Pass Through Event concerned is economically neutral taking into account:
- (i)-(iii) ...
 - (iv) in relation to a Counterparty Default Event, the recovery of any outstanding amounts;
 - (v) any other factors the Commission considers relevant.

9 Transitional provisions

Although the revisions made by the Commission comprising this Access Arrangement came into effect on 1 February 2003, it is intended that GasNet and Users should be no worse off than if the revisions had commenced on 1 January 2003. To facilitate this, the following transitional provisions apply

10.1 Definitions

Commencement Date means 1 ~~February 2003~~ January 2004.

Counterparty Default Event means the default by a Shipper in respect of an amount or amounts payable by the Shipper to GasNet under the relevant Gas Transportation Deed.

Pass Through Event means:

- (a) a Change in Taxes Event;
- (b) a Regulatory Event; ~~or~~
- (c) an Insurance Event; ~~or~~
- (d) a Counterparty Default Event; or
- (e) a Terrorism Event.

Second Access Arrangement Period means the Access Arrangement Period commencing on 1 February 2003 ~~The date this Access Arrangement (as revised) takes effect~~ and ending on 31 December 2007.

Terrorism Event means an act, including but not limited to the use of force or violence and/or the threat thereof, of any person or group(s) of persons, whether acting alone or on behalf of or in connection with any organisation(s) or government(s), which from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons, including the intention to influence any government and/or to put the public, or any section of the public, in fear.

**Attachment 2:
Amendments to Schedule 4 (Price Control Formula)**

1. Clause 4.4 (AAT)
Delete the table set out in clause 4.4 and substitute the following table:

| For regulatory year "t" | ATTt |
|-------------------------|---|
| 2004 | = <u>0.353196</u> .CPI ₍₂₀₀₄₎ .(1 - PPT) |
| 2005 | = <u>0.347617</u> .CPI ₍₂₀₀₄₎ .CPI ₍₂₀₀₅₎ .(1 - PPT) ² |
| 2006 | = <u>0.357148</u> .CPI ₍₂₀₀₄₎ .CPI ₍₂₀₀₅₎ .CPI ₍₂₀₀₆₎ .(1 - PPT) ³ |
| 2007 | = <u>0.366662</u> .CPI ₍₂₀₀₄₎ .CPI ₍₂₀₀₅₎ .CPI ₍₂₀₀₆₎ .CPI ₍₂₀₀₇₎ .(1 - PPT) ⁴ |

Amendments to Schedule 1 (Initial Transmission Tariffs)

1. Heading
Amend the heading to Schedule 1 as follows:
Schedule 1 - Initial Transmission Tariffs and 2004 Transmission Tariffs
2. Clause 1.2 (Injection Tariffs)
 - 2.1 Heading
Insert a heading between the second paragraph and the heading to the first table as follows:

The principles for determining the applicable Injection Zone and Matched Withdrawal Zone are discussed in clauses 1.4 and 1.5 of this Schedule.

Part A: Initial Transmission Tariffs (Injection Tariffs)

- (a) *Injection at Longford Injection Zone*
- 2.2 New Part B
Insert the following after the table set out under the heading '(e) *Injection at Dandenong Injection Zone*':

Part B: 2004 Transmission Tariffs (Injection Tariffs)

(a) *Injection at Longford Injection Zone*

| Matched Withdrawal Zone | Injection Tariff (\$/GJ, for 10 day Injection MDQ) | X-factor |
|--|---|-----------------|
| All Withdrawal Zones except LaTrobe, Tyers, West Gippsland and Lurgi | <u>1.9270</u> | 0.03 |
| LaTrobe | <u>0.4501</u> | 0.03 |
| Tyers & Lurgi | <u>0.4572</u> | 0.03 |
| West Gippsland | <u>1.1418</u> | 0.03 |

(b) *Injection at Culcairn Injection Zone*

| Matched Withdrawal Zone | Injection Tariff (\$/GJ, for 10 day Injection MDQ) | X-factor |
|--|---|-----------------|
| All Withdrawal Zones except Interconnect | <u>0.9912</u> | 0.03 |
| Interconnect | <u>0.2258</u> | 0.03 |

(c) *Injection at Port Campbell Injection Zone*

| Matched Withdrawal Zone | Injection Tariff (\$/GJ, for 10 day Injection MDQ) | X-factor |
|---|---|-----------------|
| All Withdrawal Zones except Western and South West and Port Campbell to Adelaide Pipeline | <u>2.1197</u> | 0.03 |
| Western and Port Campbell to Adelaide Pipeline | 0.0000 | 0.0 |
| South West | <u>1.4590</u> | 0.03 |

(d) *Injection at Pakenham Injection Zone*

| Matched Withdrawal Zone | Injection Tariff (\$/GJ, for 10 day Injection MDQ) | X-factor |
|--------------------------------|---|-----------------|
| All Zones | <u>0.3849</u> | 0.03 |

(e) *Injection at Dandenong Injection Zone*

| Matched Withdrawal Zone | Injection Tariff (\$/GJ, for 10 day Injection MDQ) | X-factor |
|--------------------------------|---|-----------------|
| All Zones | 0.0000 | 0.0 |

3. Clause 1.3 (Withdrawal Tariffs)

3.1 Heading

Insert a heading between the second paragraph and the heading to the first table as follows:

The principles for determining the applicable Zone in which a Connection Point is located and the nature of a Withdrawal are discussed in clauses 1.4 and 1.6 of this Schedule.

Part A: Initial Transmission Tariffs (Withdrawal Tariffs)

(a) *Transmission Delivery Tariff*

3.2 New Part B

Insert the following after the table set out under the heading '(h) *Murray Valley Tariffs*':

Part B: 2004 Transmission Tariffs (Withdrawal Tariffs)

(a) *Transmission Delivery Tariff*

Subject to the exceptions in clauses 1.3(b), (c), (d), (e), (f) and (g) of this Schedule, the Withdrawal Tariffs are as follows:

| Withdrawal Zone Number | Withdrawal Zone Name | Transmission delivery tariff D (\$/GJ) | Transmission delivery tariff V (\$/GJ) | X-factor |
|-------------------------------|-----------------------------|---|---|-----------------|
| 1 | LaTrobe | <u>0.0455</u> | <u>0.0610</u> | 0.03 |
| 2 | West Gippsland | <u>0.0859</u> | <u>0.0859</u> | 0.03 |
| 3 | Lurgi | <u>0.1312</u> | <u>0.1541</u> | 0.03 |
| 4 | Metro North West | <u>0.2185</u> | <u>0.2503</u> | 0.03 |
| 5 | Calder | <u>0.6892</u> | <u>0.8187</u> | 0.03 |
| 6 | South Hume | <u>0.3013</u> | <u>0.3073</u> | 0.03 |
| 7 | Echuca | <u>0.4885</u> | <u>0.6971</u> | 0.03 |
| 8 | North Hume | <u>0.6782</u> | <u>0.9359</u> | 0.03 |
| 9 | Western | <u>0.4363</u> | <u>0.5833</u> | 0.03 |
| 10 | Murray Valley | <u>1.1455</u> | <u>1.9868</u> | 0.0 |
| 11 | Interconnect | <u>0.6968</u> | <u>0.9036</u> | 0.03 |
| 13 | South West | <u>0.0821</u> | <u>0.0822</u> | 0.03 |
| 17 | Wodonga | <u>0.7616</u> | <u>0.9774</u> | 0.03 |
| 18 | Tyers | <u>0.1247</u> | <u>0.1276</u> | 0.03 |
| 19 | Culcairn | <u>0.5312</u> | NA | 0.03 |
| 20 | Metro South East | <u>0.2185</u> | <u>0.2503</u> | 0.03 |

(b) *System Export Tariff*

Where a Connection Point in an Injection Zone services an export of gas from the GNS to a Connected Transmission Pipeline, gas Injected at that Injection Zone and Withdrawn through that Connection Point is subject to the System Export Tariff specified below, instead of the Withdrawal Tariff specified in clause 1.3(a) of this Schedule.

| Connected Transmission Pipeline Number | Connected Transmission Pipeline Name | System Export Tariff (\$/GJ) | X-factor |
|---|---|-------------------------------------|-----------------|
| 1 | VicHub | 0.0000 | 0.0 |
| 2 | Port Campbell to Adelaide Pipeline | <u>0.0202</u> | 0.0 |

(c) *Transmission Refill Tariff*

Where a Connection Point services a Storage Facility, all gas Withdrawn through that Connection Point is subject to the Transmission Refill Tariff specified below, instead of the Withdrawal Tariff specified in clause 1.3(a) of this Schedule.

| Storage Facility Number | Storage Facility Name | Transmission Refill Tariff (\$/GJ) | X-factor |
|--------------------------------|------------------------------|---|-----------------|
| 1 | LNG | <u>0.1167</u> | 0.0 |
| 2 | WUGS | <u>0.1250</u> | 0.0 |

(d) *Cross System Withdrawal Tariff*

If:

- (i) gas is Withdrawn at a Connection Point, other than a Connection Point servicing a Storage Facility, located on an Injection Pipeline other than the Interconnect Pipeline; and
- (ii) that Withdrawal is a Matched Withdrawal with respect to an Injection Zone other than the Injection Zone for that Injection Pipeline,

then the Withdrawal is subject to the following Cross System Withdrawal Tariff in addition to the applicable Injection Tariff and Withdrawal Tariff.

| Injection Pipeline | Cross System Withdrawal Tariff D (\$/GJ) | Cross System Withdrawal Tariff V (\$/GJ) | X-factor |
|---------------------------|---|---|-----------------|
| All | <u>0.1322</u> | <u>0.1632</u> | 0.03 |

(e) *Matched Withdrawals - Culcairn*

If a Withdrawal in one of the following Zones is a Matched Withdrawal relating to Injections in the Culcairn Zone, then the following Matched Withdrawal Tariffs apply instead of the tariffs described in clause 1.3(a) of this Schedule:

| Withdrawal Zone Number | Withdrawal Zone Name | Transmission delivery tariff D (\$/GJ) | Transmission delivery tariff V (\$/GJ) | X-factor |
|-------------------------------|-----------------------------|---|---|-----------------|
| 8 | North Hume | <u>0.3143</u> | <u>0.4263</u> | 0.03 |
| 10 | Murray Valley | <u>0.9277</u> | <u>1.6519</u> | 0.0 |
| 11 | Interconnect | <u>0.0876</u> | <u>0.0875</u> | 0.03 |
| 17 | Wodonga | <u>0.1032</u> | <u>0.1337</u> | 0.0 |

(f) *Matched Withdrawals - Metro (Pakenham)*

If a Withdrawal in the Metro South East Zone is a Matched Withdrawal relating to Injections in the Pakenham Zone, then the following Matched Withdrawal Tariffs apply instead of the tariffs described in clause 1.3(a) of this Schedule:

| Withdrawal Zone Number | Withdrawal Zone Name | Transmission delivery tariff D (\$/GJ) | Transmission delivery tariff V (\$/GJ) | X-factor |
|-------------------------------|-----------------------------|---|---|-----------------|
| 20 | Metro South East | <u>0.0136</u> | <u>0.0136</u> | 0.0 |

(g) *Prudent Discounts - Warrnambool and Koroit*

If:

- (i) a Withdrawal is made in the Western Zone at a Connection Point designated by MIRN 30000089PC or MIRN 30000091PC; and
- (ii) at the time the Withdrawal is made, the SEAGas Pipeline has been commissioned,

then, subject to clause 4.10, that Withdrawal is subject to the Withdrawal Tariff specified below instead of the Withdrawal Tariff specified in clause 1.3(a) of this Schedule.

| Withdrawal Zone Number | Withdrawal Zone Name | Transmission delivery tariff D (\$/GJ) | Transmission delivery tariff V (\$/GJ) | X-factor |
|-------------------------------|--|---|---|-----------------|
| 9A | Western, MIRN 30000089PC (Warrnambool) | <u>0.0539</u> | <u>0.0860</u> | 0.0 |
| 9B | Western, MIRN 30000091PC (Koroit) | <u>0.1137</u> | <u>0.1538</u> | 0.0 |

(h) *Murray Valley Tariffs*

The Murray Valley tariffs in clauses 1.3(a) and (e) of this Schedule are comprised of two elements which are treated differently in the price control formula contained in Schedule 4 of this Access Arrangement. To enable Schedule 4 to operate, these elements are shown here for both sets of tariffs.

| Withdrawal Zone Number | Withdrawal Zone Name | Transmission delivery tariff D (\$/GJ) | Transmission delivery tariff V (\$/GJ) | X-factor |
|-------------------------------|---|---|---|-----------------|
| 10 | Murray Valley (Chiltern Valley) | <u>0.3464</u> | <u>0.4843</u> | 0.0 |
| 10 | Murray Valley (Chiltern Valley) (Matched to Culcairn) | <u>0.1286</u> | <u>0.1494</u> | 0.0 |
| 10 | Murray Valley (Incremental) | <u>0.7991</u> | <u>1.5025</u> | 0.0 |

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File No 1 of 2003

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BY: GASNET AUSTRALIA (OPERATIONS) PTY LTD APPLICANT

**TRIBUNAL: COOPER J (DEPUTY PRESIDENT)
MR RC DAVEY
PROFESSOR DK ROUND**

DATE: 23 DECEMBER 2003

PLACE: BRISBANE (HEARD IN MELBOURNE)

THE TRIBUNAL

BACKGROUND

1 GasNet Australia (Operations) Pty Ltd ('GasNet') owns and maintains natural gas transmission networks (the Principal Transmission System and the Western Transmission System) in Victoria and Southern New South Wales which are known as the GasNet System ('the GNS'). The GNS, by virtue of the *Gas Pipelines Access (Victoria) Act 1998* (Vic) ('the Act'), is a 'Covered Pipeline' under the National Third Party Access Code for Natural Gas Pipeline Systems ('the Code'). The Code is applied as a law of Victoria, it being part of the Gas Pipelines Access (Victoria) Law ('the Law'): s 7 of the Act. The Law is as contained in Schedules 1 and 2 to the *Gas Pipelines Access (South Australia) Act 1997* (SA), the Code forming Schedule 2. GasNet is a 'Service Provider' as defined in the Code.

2 Section 2.2 of the Code obliges GasNet to submit to the Relevant Regulator, in this case the Australian Competition and Consumer Commission ('the ACCC'), a proposed Access Arrangement ('AA'), together with applicable Access Arrangement Information ('AAI') for the GNS.

3 Section 3 of the Code requires that the AA must include a Reference Tariff and a
Reference Tariff Policy which comply with the Reference Tariff Principles described in s 8 of
the Code: s 3.3 and s 3.5 of the Code.

4 The ACCC, as the Relevant Regulator, is obliged to consider the AA and either
approve it as submitted, or as amended in accordance with the requirements of the ACCC, or
not approve it. In the event that it does not approve the AA, the ACCC is obliged to itself
draft and approve an AA instead of the AA as submitted by the Service Provider: s 2.42 of
the Code.

5 In December 1998, the ACCC approved separate initial AAs for GasNet's two
pipelines. The AAs came into effect on 15 March 1999 and provided that GasNet would, by
31 March 2002, submit revisions of the AAs for approval by the ACCC, such approved
revisions to commence on 1 January 2003. On 28 March 2002, GasNet submitted its
proposed revisions of the AA. Those revisions included merging GasNet's two AAs and a
revised Reference Tariff which would apply during the period 1 January 2003 to and
including 31 December 2007.

6 On 14 August 2002, the ACCC issued a Draft Decision which proposed not to
approve GasNet's proposed revised AA in its then current form. The Draft Decision set out
the amendments (or nature of the amendments) which would have to be made to the revisions
for the ACCC to approve them. Written submissions on the Draft Decision were requested
by 13 September 2002.

7 GasNet's response to the ACCC's Draft Decision was dated 20 September 2002.

8 On 13 November 2002, the ACCC issued its Final Decision ('the FD') wherein it
determined:

- (a) not to approve GasNet's proposed revised AA in the form as submitted;
- (b) the amendments (or nature of amendments, as appropriate) it required to be made to
the proposed revised AA in order to obtain its approval; and
- (c) that GasNet must submit its amended revisions that comply with the FD by
2 December 2002 in order for the ACCC to approve the revisions.

9 On 6 December 2002, following an extension of time granted by the ACCC, GasNet submitted to the ACCC:

- (a) amended revisions to the AA;
- (b) amended revisions to the AAI;
- (c) a Supplementary AAI; and
- (d) a Supplementary Submission.

The amended revisions were said by GasNet to incorporate some, but not all, of the specific amendments identified in the FD and were expressed to commence on 1 January 2003 as envisaged in the initial AAs approved by the ACCC in December 1998.

10 An exchange of correspondence followed the submission of the amended revisions on 6 December 2002. That exchange included:

- (a) GasNet expressing concern that the ACCC may not be in a position to finalise the revisions prior to 1 January 2003 and stating that *'In the event that GasNet and the Commission cannot come to a satisfactory arrangement, GasNet may be left with no alternative but to seek an injunction compelling the Commission to make its determination in a timely fashion'*; and
- (b) the ACCC, pursuant to s 2.44 of the Code, extending the time for its consideration of the revisions to 28 January 2003 and proposing alternatives to minimise harm to GasNet consequential upon the revisions commencing post 1 January 2003.

11 On 6 January 2003, GasNet requested from the ACCC an extension of time (from 6 December 2002 to 6 January 2003) to submit amended revisions which would:

- (a) replace those submitted on 6 December 2002;
- (b) clarify the treatment of tariffs for the period between 1 January 2003 and the date the AA commenced; and
- (c) include what GasNet described as *'... a number of other minor amendments to its revised Access Arrangement and Access Arrangement Information to deal with some issues raised by the Commission since the documents were submitted on 6 December 2002.'*

12 On 8 January 2003, the ACCC informed GasNet that:

'The Code (section 7.19) provides that the regulator may grant a time extension "provided that an application for that extension has been received

by it before the expiration of the time period in question". There is no provision to further extend the period for lodgement of amended revisions. In this case, the time period expired on 6 December 2002.

Nonetheless, the Commission considers that it may subsequently accept changes to amended revisions where those changes correct errors or are otherwise in response to issues identified by the Commission during the approval process. However, it would not be appropriate to accept changes that, at the required lodgement date, were not identified as an area of departure from the Final Decision.

On this basis, the Commission accepts the access arrangement and access arrangement information lodged on 6 January 2003.

However, I note that clause 3.4 of the access arrangement information provided on 6 January 2003 describes a method for estimating inflation for 2003 which is said to be "consistent with the short term forecast incorporated in the Victorian Treasury election review of the Victorian economy".

As the reference tariffs in GasNet's amended revisions of 6 December 2002 were derived using this approach, the Commission is prepared to accept the change. However, this approach was not included in the access arrangement information of 6 December 2002 or earlier documents. Nor was it identified in GasNet's supplementary submission of that date as an area of departure from the Final Decision. No information has been provided at any stage to the Commission (or interested parties) to indicate how an inflation adjustment determined on this basis would be consistent with relevant Code provisions or the amendments specified in the Final Decision. The Commission will take these factors into account when considering GasNet's proposals.'

THE FINAL DETERMINATION AND THE APPLICATION FOR REVIEW

13 On 15 January 2003, the ACCC, pursuant to s 2.42 of the Code, determined that it was not satisfied that the amended revisions submitted by GasNet incorporated the amendments that it required in its FD. Accordingly, it did not approve the amended revisions and, as it was required to do by s 2.42 of the Code, drafted and approved its own revisions to the AA instead of the revisions proposed by GasNet. The revised AA approved by the ACCC was published on 17 January 2003, together with its revised AAI, Supplementary AAI and a Final Approval ('FA'). The FA stated that subject to the Code and the Law, the revised AA drafted and approved by the ACCC was to commence on 1 February 2003.

14 On 31 January 2003, Gasnet applied, pursuant to s 39(1) of the Law and s 2.48 of the Code, for review of the decisions made on 15 January 2003 pursuant to s 2.41 and s 2.42 of the Code whereby the ACCC decided not to approve the AA and approved its own revisions to the AA, and all decisions relating thereto.

15 On 14 August 2003, GasNet was granted leave to amend its application to reflect the ultimate issues for determination on the hearing as summarised in pars [19] to [24] below.

16 Section 39 of the Law, so far as is presently relevant, provides:

'39. ...

(2) *An application under subsection (1) -*

(a) *may be made only on the grounds, to be established by the applicant -*

(i) *of an error in the relevant Regulator's finding of facts; or*

(ii) *that the exercise of the relevant Regulator's discretion was incorrect or was unreasonable having regard to all the circumstances; or*

(iii) *that the occasion for exercising the discretion did not arise; and*

(b) *may not raise any matter that was not raised in submissions to the relevant Regulator before the decision was made.*

(3) *An application under subsection (1) must give details of the grounds for making the application.*

...

(5) *The relevant appeals body, in reviewing a decision under this section must not consider any matter other than -*

(a) *the application under subsection (1) and submissions in support of it (other than any matter not raised in submissions before the decision was made) and any written submissions made to the relevant Regulator before the decision was made;*

(b) *the access arrangement and the access arrangement information prepared by the service provider in accordance with the Code;*

(c) *any reports relied on by the relevant Regulator before the decision was made;*

(d) *any draft decision, and submissions on any draft decision made to the relevant Regulator;*

(e) *the decision of the relevant Regulator and the written record of it and any written reasons for it;*

(f) *the transcript (if any) of any hearing conducted by the relevant Regulator.*

...'

17 The construction of s 39 of the Law in terms of the rights which it gives, the nature of the review available and the meaning to be ascribed to the phrase ‘*unreasonable having regard to all the circumstances*’ (in s 39(2)(a)(ii)), was recently considered in *Application by Epic Energy South Australia Pty Ltd* [2003] ACompT 5; it is not proposed to repeat what was said by the Tribunal on that occasion. However, it does bear repeating that the review available is not one at large; it is a review on the documents and material that was before the Relevant Regulator at the time the decision under review was made. It is a review limited to the matters specified in s 39(5) and matters which do not fall within s 39(5) must not be considered by the Tribunal. It is a review limited to those matters which were before the Relevant Regulator which the Service Provider contends were erroneously decided by it and which the Service Provider wishes reviewed. Ultimately those matters are constrained by the grounds of error pleaded and particularised in the Service Provider’s application to the Tribunal as required by s 39(2) and s 39(3), and the operation of s 39(5) on the deliberations of the Tribunal.

THE ISSUES FOR DETERMINATION

18 The errors which GasNet relies upon to ground its right to have the decision reviewed and set aside or varied, all relate to the proper determination of the Reference Tariff applicable to GasNet’s revised AA, having regard to the objectives of, and requirements contained in, the Code. The errors alleged against the ACCC raise for consideration four separate issues.

19 The first issue relates to the estimation of the various parameters of the Capital Asset Pricing Model (‘the CAPM’) utilised for calculating the Rate of Return on the capital assets which form the GNS for the purpose of determining the Reference Tariff. GasNet contends that the relevant requirements of the Code necessitate that the risk-free rate utilised in the CAPM be based upon an interest rate of Commonwealth bonds having preferably a maturity that matches the length of life of the relevant asset or, as no such long-dated bonds currently exist in Australia, bonds with a maturity of ten years; not one of five years as determined by the ACCC in its FA. Further, GasNet contended that the relevant requirements of the Code dictated the use of an equity beta of 1.16 in the CAPM for calculating the Rate of Return rather than the 0.97 as determined by the ACCC in its FA.

20 However, GasNet did not pursue its claims that the equity beta utilised by the ACCC was in error. Accordingly, the only matter arising for determination on the first issue was the ACCC's entitlement to use a five year bond rate or the correctness or reasonableness of its use.

21 The second issue concerns the choice of the inflation rate to calculate the annual revenue requirements for the Reference Tariff over the five years of the AA. GasNet contends that the Code requires the use of a rate of 2.52 per cent per annum for 2003 and, in consequence, 2.07 per cent per annum for each of the following four years, resulting in an annual average inflation rate of 2.16 per cent over the entire period 2003 - 2007, rather than the rate of 2.16 per cent per annum for each of the years 2003 to 2007 as determined by the ACCC in its FA.

22 The third issue concerns five of the parameters used in the calculation of the appropriate allowance for non-capital costs for the purpose of determining the Reference Tariff. GasNet's parameters and claimed values and the ACCC's determinations of those values on those parameters are set out below:

| Parameter | GasNet | ACCC |
|---------------------------|---------------|-------------|
| Counterparty default | \$250 000 pa | \$10 000 pa |
| Terrorist risk | \$65 000 pa | 0 |
| Uplift liability | \$65 000 pa | 0 |
| Key person risk | \$72 000 pa | 0 |
| Employment practices risk | \$35 000 pa | 0 |

23 During the hearing the third issue was resolved in GasNet's favour by the ACCC conceding that the decision ought to be varied by:

- (a) the counterparty default and terrorist risk being included in the AA as Pass Through Events and self insured; and
- (b) substituting the values contended by GasNet for uplift liability risk, key person risk and employment practices risk, those risks to be self-insured.

24 The fourth issue concerns the proper approach to be taken by the ACCC in determining whether or not the proposed revised AA, as submitted by GasNet to the ACCC

on 28 March 2002, complied with the Reference Tariff Principles described in s 8 of the Code. Specifically, whether the Code dictates that the ACCC determine a range of outcomes permitted by the Code, and determine whether GasNet's proposed revisions fell within that range or, alternatively, whether GasNet's proposals complied with the relevant requirements contained in the Code, rather than whether or not GasNet's proposal was, in the view of the ACCC, the most appropriate proposal.

THE ROLE OF THE REGULATOR

25 The task which confronted the ACCC, as the Relevant Regulator under the Code, was to determine whether, in its opinion, the Revised AA (and the Reference Tariff and the Reference Tariff Policy included in it) proposed by GasNet complied with the Reference Tariff Principles described in s 8 of the Code: s 3.4 and s 3.5 of the Code. The task identified the questions which the ACCC was required to address and answer in the discharge of its statutory function under the Code.

26 Section 8.1 of the Code contains the General Principles applicable to a Reference Tariff and a Reference Tariff Policy. It provides:

'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;*
- (b) replicating the outcome of a competitive market;*
- (c) ensuring the safe and reliable operation of the Pipeline;*
- (d) not distorting investment decisions in Pipeline transportation systems or in upstream and downstream industries;*
- (e) efficiency in the level and structure of the Reference Tariff; and*
- (f) providing an incentive to the Service Provider to reduce costs and to develop the market for Reference and other Services.*

To the extent that any of these objectives conflict in their application to a particular Reference Tariff determination, the Relevant Regulator may determine the manner in which they can best be reconciled or which of them should prevail.'

27 Section 8.2 of the Code specifies five factors about which the ACCC as the Relevant Regulator must be satisfied in determining to approve a Reference Tariff and Reference Tariff Policy. Section 8.2 provides:

'8.2 The factors about which the Relevant Regulator must be satisfied in determining to approve a Reference Tariff and Reference Tariff Policy are that:

- (a) the revenue to be generated from the sales (or forecast sales) of all Services over the Access Arrangement Period (the **Total Revenue**) should be established consistently with the principles and according to one of the methodologies contained in this section 8;*
- (b) to the extent that the Covered Pipeline is used to provide a number of Services, that portion of Total Revenue that a Reference Tariff is designed to recover (which may be based upon forecasts) is calculated consistently with the principles contained in this section 8;*
- (c) a Reference Tariff (which may be based upon forecasts) is designed so that the portion of Total Revenue to be recovered from a Reference Service (referred to in paragraph (b)) is recovered from the Users of that Reference Service consistently with the principles contained in this section 8;*
- (d) Incentive Mechanisms are incorporated into the Reference Tariff Policy wherever the Relevant Regulator considers appropriate and such Incentive Mechanisms are consistent with the principles contained in this section 8; and*
- (e) any forecasts required in setting the Reference Tariff represent best estimates arrived at on a reasonable basis.'*

28 The role of the Relevant Regulator was considered by a Full Court of the Supreme Court of Western Australia in *Re Michael Ex parte Epic Energy (WA) Nominees Pty Ltd* (2002) 25 WAR 511. Parker J, with whom the other members of the Court agreed, had occasion to consider s 8 of the Code. So far as is presently relevant, his Honour said:

'[64] It is as at this point that the submissions of Epic and the Regulator diverge. The Regulator contends that s3.4, and also s3.5, do not call for the exercise of discretion by the Regulator. Hence, there is no scope for the application to them of the s2.24(a) to s2.24(g) factors. In the Regulator's submission, the only issue posed by s3.4 is whether a proposed Reference Tariff "complies with the Reference Tariff Principles described in s8". The same issue is posed by s3.5 with respect to the Reference Tariff Policy included in the proposed Access Arrangement.

[65] *The Regulator submits that the s8 Principles produce a single Total Revenue figure from which is derived a single dollar value for each reference tariff. There is no range of possible outcomes and no discretionary element in respect of which the Regulator could apply the s2.24(a) to s2.24(g) factors. All that s3.4 requires, it is submitted, is a 'yes' or 'no' answer.*

[66] *There are difficulties in the way of accepting this submission. First, there appears to be a misconception, implicit in elements of the Regulator's submission, which, in effect, involves a barrier being drawn between s3.4 and s3.5, as being within the reach of the first sentence of s2.24, and s8, as beyond its reach. The "Reference Tariff Principles described in s8" are expressly the subject of both s3.4 and s3.5. By express reference those principles are incorporated into s3.4 and s3.5. While drafting convenience has led to those principles being described in s8, the effect of s3.4 and s3.5 is as though the s8 principles were set out fully in each of those subsections.*

[67] *Secondly, a consideration of s3.3, s3.4 and s3.5 reveals that they involve much scope for discretion in the assessment of interrelated matters which may well bear directly on a proposed reference tariff, even one expressed as a single dollar value. As an example, from s3.3 there must be a determination by the Regulator of which services warrant a reference tariff. In this case the proposed Access Arrangement designated transport from Dampier to Perth as one service. Transport from Dampier to the industrial area of Kwinana, which is a little south of Perth, was proposed to be the subject of a different service. The Regulator's draft decision proposed that transport from Dampier to Kwinana (which would include Dampier to Perth) would be one service. Such a decision, pursuant to s3.3, both involves and gives rise to a number of interrelated issues under the s8 Principles. These are likely to affect directly the single dollar value (if it is so expressed) for that service. The Regulator must form an opinion as to these for the purposes of s3.4. Further, s3.4 requires the Regulator to form an opinion as to the compliance of the whole of proposed Access Arrangement, as well as each proposed reference tariff, with the s8 Principles. Likewise, s3.5 requires the Regulator to form an opinion as to the compliance of the proposed reference tariff policy with the s8 Principles.*

[68] *Thirdly, while a reference tariff for a particular service may be expressed as a single dollar value, that is not necessarily the case pursuant to the s8 Principles. S8.3 provides an indication of the way in which the reference tariff policy may lead to variations in the actual dollar value of a reference tariff during an Access Arrangement period. It also reveals that a tariff may be adjusted during the Access Arrangement period, either according to predetermined events, or having regard to actual progressive outcomes, or a combination of these approaches. In many cases the decision to express a tariff in a single dollar value will involve the discretionary rejection of such possibilities. It is also the case that those aspects of a reference tariff and a reference tariff policy that are concerned with the allocation of Total Revenue between a number of services, or between a number of users of a reference service, provide examples of the range and*

potential complexity of issues the Regulator may be required to consider to form an opinion as to compliance with the s8 Principles, even though he is assessing an Access Arrangement, such as the present one, which proposes a number of reference tariffs each expressed as a single dollar value. There are many more examples of this nature.

[69] These considerations tell powerfully, in my view, against acceptance of the Regulator's submission that there is no scope for the application of the s2.24(a) to s2.24(g) factors to the Regulator's task as he considers the principles set out in s3.4, ie compliance with the s8 Principles, for the purposes of the first sentence of s2.24.

...
[136] In s8.1 it is to be noted that para (a) to para (f) are not stated as finite or absolute criteria. They are objectives which a reference tariff and a reference tariff policy should be "designed with a view to achieving". Further, and importantly, s8.1, in its concluding paragraph, expressly recognises that those objectives may be in conflict in their application to a particular reference tariff determination. The provision expressly recognises, what analysis of the objectives reveals, that the different objectives may well be in tension in a particular case. The process of reconciliation by the Regulator for which the concluding paragraph provides, necessarily accepts that the achievement of one objective may be impaired to satisfy another. Further, as the last words of s8.1 expressly recognise, it may be necessary in a particular case for the Regulator to determine that one or more of those objectives should prevail over others. In other words, in a particular case, not all of the objectives may be achievable even in a moderated form. The necessarily discretionary power of the Regulator to determine how best to reconcile conflicting objectives, or which of them should prevail, is critical, in my view, to an understanding of the intended operation of s8.1 with its potentially disparate objectives. As has been mentioned briefly earlier in these reasons it is not possible for the Regulator, in exercising these significant discretionary powers, to be guided only by s8.1 itself. Of necessity, guidance in the exercise of discretion to resolve conflict within s8.1 must be provided from outside that provision. As indicated earlier in these reasons the intended operation and interpretation of the Code appears to require that in the exercise of the discretionary powers provided by the concluding paragraph of s8.1, the Regulator should be guided by the factors in s2.24(a) to s2.24(g).'

29 It is clear in the reasoning in *Michael* that there is no single correct figure involved in determining the values of the parameters to be applied in developing an applicable Reference Tariff. The application of the Reference Tariff Principles involves issues of judgment and degree. Different minds, acting reasonably, can be expected to make different choices within a range of possible choices which nonetheless remain consistent with the Reference Tariff Principles. Where the Reference Tariff Principles produce tension, the Relevant Regulator has an overriding discretion to resolve the tensions in a way which best reflects the statutory objectives of the Law. However, where there are no conflicts or tensions in the application of

the Reference Tariff Principles, and where the AA proposed by the Service Provider falls within the range of choice reasonably open and consistent with Reference Tariff Principles, it is beyond the power of the Relevant Regulator not to approve the proposed AA simply because it prefers a different AA which it believes would better achieve the Relevant Regulator's understanding of the statutory objectives of the Law.

30 This follows because the power of the Relevant Regulator to require amendments, or to itself draft and approve its own AA, does not arise until it is of the opinion that the AA proposed by the Service Provider does not comply with the Code, and in determining the question of compliance, it must act in accordance with s 2.24 of the Code. Section 2.24 provides:

'2.24 The Relevant Regulator may approve a proposed Access Arrangement only if it is satisfied the proposed Access Arrangement contains the elements and satisfies the principles set out in sections 3.1 to 3.20. The Relevant Regulator must not refuse to approve a proposed Access Arrangement solely for the reason that the proposed Access Arrangement does not address a matter that sections 3.1 to 3.20 do not require an Access Arrangement to address. In assessing a proposed Access Arrangement, the Relevant Regulator must take the following into account:

- (a) the Service Provider's legitimate business interests and investment in the Covered Pipeline;*
- (b) firm and binding contractual obligations of the Service Provider or other persons (or both) already using the Covered Pipeline;*
- (c) the operational and technical requirements necessary for the safe and reliable operation of the Covered Pipeline;*
- (d) the economically efficient operation of the Covered Pipeline;*
- (e) the public interest, including the public interest in having competition in markets (whether or not in Australia);*
- (f) the interests of Users and Prospective Users;*
- (g) any other matters that the Relevant Regulator considers are relevant.'*

THE INTERVENER

31 Leave to intervene was given to the Energy Action Group ('the EAG'), a Victorian not-for-profit incorporated association which represents the interests of domestic utility

consumers in Victoria. The EAG contended, contrary to the view expressed by the Tribunal in *Application by Epic Energy South Australia Pty Ltd* [2002] ACompT 4, that it is not necessary that GasNet make out reviewable error in respect of one or more of the grounds specified in its application in order to obtain the relief sought and that the filing of the application itself was sufficient to open up each and every aspect of the FA for merits review. Such a review, it contended, was to have regard to the totality of the materials that were available to the ACCC at the time of making its decision, with the Tribunal substituting, if it thought appropriate, its own view of the most appropriate revised AA. Consequently, the EAG sought to revisit the determination of the values for the Return on Equity, the Weighted Average Cost of Capital ('the WACC'), the Market Risk Premium ('the MRP') and the equity beta used by the ACCC in its application of the CAPM. The EAG sought to contend that each of these values as determined by the ACCC was too high.

32 The Tribunal ruled that the EAG was constrained to such of the grounds as were relied upon by GasNet and which it sought to agitate to a final resolution. The reason for so ruling was, in general, as reflected in the observations contained in par [17] above dealing with the statutory operation of s 39 of the Law. The Tribunal also limited the leave to intervene previously granted to EAG. In its final form, leave was limited to making submissions in accordance with the following ruling:

'3. The EAG may advance the contention that if all or any of the grounds of reviewable error relied upon by GasNet in its amended application are made out to the satisfaction of the Tribunal, then, the Tribunal should in those particular circumstances:

- (a) itself determine and approve revisions of the access arrangements determining the values of the equity Beta and MRP parameters; and*
- (b) for that purpose ought to determine those values as contended for by EAG in its written submissions.'*

33 The EAG was also given leave to make such submissions as it wished in respect of the matters ultimately relied upon by GasNet to obtain the relief sought.

RESOLUTION OF THE ISSUES

34 There is no dispute between GasNet and the ACCC as to the procedures to be followed in calculating the Reference Tariff for the revised AA. The disagreement lies in the

choice of the risk-free rate used to calculate the WACC and in the choice of the inflation rate to be used to estimate the annual revenue requirements.

Choice of the risk-free rate

35 GasNet submits that the ACCC erred in deciding that GasNet's proposed risk-free rate, based on ten year Commonwealth bonds, was inconsistent with the Code. It further submits that the ACCC erred in concluding that the Code required that the risk-free rate be set by reference to five year Commonwealth bonds, corresponding to the period covered by the AA. Specifically, GasNet contends that the ACCC acted incorrectly or unreasonably, having regard to all the circumstances because:

- (a) The conventional view of economists as a matter of theory and practical application, is that the term of the bond should follow the life of the assets. This meant that in the absence of a well established market for longer-dated bonds in Australia, the appropriate rate was the rate for ten year Commonwealth bonds because it better reflected the life of the GasNet assets estimated by it to be thirty to fifty years. (GasNet also submits that the decision to choose the shorter period bond rate was not one that the ACCC was entitled to make and was, in any event, an error of fact).
- (b) The ACCC adopted a five year bond rate in lieu of the ten year bond rate adopted by the majority of Australian regulators.
- (c) The ACCC, having adopted a risk-free rate based on ten year bonds to calculate the MRP, in order to utilise the CAPM, should have used ten year bond rates for the base risk-free rate, which it did not do. This follows because the CAPM is defined by the following formula:

$$r_e = r_f + (r_m - r_f) \beta$$

where:

| | | |
|---------|---|--|
| r_e | = | expected return on equity |
| r_f | = | risk free rate |
| r_m | = | expected return to the market as a whole |
| β | = | equity beta |

The r_f appears twice in the formula. The MRP is that part of the formula represented by $(r_m - r_f)$. The risk-free rate must be consistent if the result is to represent the proper utilisation of the CAPM. To calculate different risk-free rates by reference to different bond rate periods, GasNet contends, was to misapply the CAPM, and was an incorrect use of the model that produces an incorrect and inutile result.

(d) The conventional view of economists is that the maturity of the risk-free investment used for the cost of debt should align with the term of the investment. That conventional view required the use of a ten year bond rate for the purpose of calculating the cost of debt. The ACCC, by matching the risk-free rate to the regulatory period, did not allow GasNet a return for the refinancing risk that it faces.

36 It is important to recall that the preparation of a proposed AA together with proposed AAI, begins with the Service Provider of a Covered Pipeline. It is the obligation of the Service Provider to design a proposed AA with AAI which is consistent with the provisions of the Code and to lodge it with the Relevant Regulator: s 2.2.

37 The proposed AA may include any relevant matter but must include the elements in s 3.1 to s 3.20: s 2.5. The proposed AAI must contain such information as would enable Users and Prospective Users to understand the derivation of the elements in the proposed AA and to form an opinion as to compliance of the AA with the provisions of the Code: s 2.6. The AAI may include any relevant information, but must include the categories of information described in Attachment A to the Code. The choices available under the Code are for the Service Provider to make, subject only to the limitation that the implementation of the choice must be consistent with the principles contained in s 8 of the Code.

38 One of the choices available to GasNet was the choice of methodology used to establish the revenue to be generated from sales of all services over the AA period: s 8.2(a). It chose the 'Cost of Service' approach as provided in s 8.4. In doing so, it was both obliged and entitled to design a Reference Tariff and Reference Tariff Policy applicable to that choice with a view to achieving the objectives contained in s 8.1 of the Code. Relevantly, that section included as an objective:

'(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.'

39 The choice of the 'Cost of Service' approach requires that a Rate of Return on the value of the capital assets that form the Covered Pipeline be established: s 8.4. This in itself requires that a further choice be made of a methodology to establish the rate.

40 The Code deals with Rate of Return in s 8.30 and s 8.31, which provide:

'Rate of Return

8.30 *The Rate of Return used in determining a Reference Tariff should provide a return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service (as reflected in the terms and conditions on which the Reference Service is offered and any other risk associated with delivering the Reference Service).*

8.31 *By way of example, the Rate of Return may be set on the basis of a weighted average of the return applicable to each source of funds (equity, debt and any other relevant source of funds). Such returns may be determined on the basis of a well accepted financial model, such as the Capital Asset Pricing Model. In general, the weighted average of the return on funds should be calculated by reference to a financing structure that reflects standard industry structures for a going concern and best practice. However, other approaches may be adopted where the Relevant Regulator is satisfied that to do so would be consistent with the objectives contained in section 8.1.'*

41 The complaint of GasNet as to what has occurred in the ACCC's treatment of the Rate of Return was summarised by its counsel as follows:

'We as the provider have the right to chose[sic] the model. We've chosen the model. The regulator must stay faithful to it and we say they clearly haven't stayed faithful to it. That itself demonstrates error but the error is really compounded by the excuse proffered, "Don't worry about the inconsistency because we" - the commission - "assert that the difference is insignificant." There's nothing in the code permitting departure from CAPM at all, whether or not it produces a difference of moment. Nothing in the code gives the regulator the capability of employing any other model. There's no choice within the code. Once the model is selected by the provider that's the one to be applied. It's got to be a well-accepted model but the regulator can't employ some other model, even if they were to contend it was some other well-accepted model. There's no choice provided for the regulator. We would say in any event as the tribunal knows we say that when the commission does this they're not employing CAPM at all. Even if they were employing some other model, (a) they're not entitled to, but (b) it's not a well-accepted model. It's aberrational.'

42 Contrary to the submission of the ACCC, it is not the task of the Relevant Regulator under s 8.30 and s 8.31 of the Code to determine a 'return which is commensurate with prevailing conditions in the market for funds and the risk involved in delivering the Reference Service'. The task of the ACCC is to determine whether the proposed AA in its treatment of Rate of Return is consistent with the provisions of s 8.30 and s 8.31 and that the rate

determined falls within the range of rates commensurate with the prevailing market conditions and the relevant risk.

43 As a matter of construction s 8.30 involves issues of judgment and degree as stated in par [29] above as to whether the Rate of Return is commensurate with the prevailing conditions in the market for funds and the risk involved in delivering the Reference Service. Nevertheless, it involves making decisions as to the existence or otherwise of the underlying facts which are relevant to the statutory task and to the choice of a method of utilising those facts to produce a Rate of Return. The right to choose a methodology is found in s 8.31.

44 GasNet chose to use the CAPM. Having done so, there was no occasion for the ACCC to be satisfied that the approach adopted by the choice of the model was not consistent with the objectives contained in s 8.1.

45 When the proposed AA was delivered by GasNet to the ACCC, insofar as it contained a Rate of Return which was used to determine the Reference Tariff established by the use of the CAPM, the only issue for the ACCC to determine in respect of the Rate of Return was whether GasNet had used the model correctly. That is, whether it had used the CAPM to produce a Rate of Return which was consistent with the conventional use of the model. If GasNet had done so, then there was no occasion to refuse to approve the proposed AA on the basis that the Rate of Return had not been determined on a basis which was consistent with the objectives contained in s 8.1. Importantly, it was not open to the ACCC to choose some model other than the CAPM because the ACCC believed that another model would produce a better outcome in terms of the objectives in s 8.1 than the application of the CAPM in the conventional way would produce.

46 The position of the ACCC was that it was required to make an evaluative judgment for the purposes of s 8.30 as to what the appropriate Rate of Return should be. Its position was that although consistency was desirable, best estimates have to be used when perfect information is not available, and that at various stages of the CAPM, approximations and estimates are required. The ACCC contends that such a use of estimates and approximations does not invalidate the use of the CAPM. While it is no doubt true that the CAPM permits some flexibility in the choice of the inputs required by the model, it nevertheless requires that one remain true to the mathematical logic underlying the CAPM formula. In the present

case, that requires a consistent use of the value of r_f in both parts of the CAPM equation where it occurs so that the choice was either a five year bond rate or a ten year bond rate in both situations.

47 The ACCC erred in concluding that it was open to it to apply the CAPM in other than the conventional way to produce an outcome which it believed better achieved the objectives of s 8.1. In truth and reality, the use of different values for a risk free rate in the working out of a Rate of Return by the CAPM formula is neither true to the formula nor a conventional use of the CAPM. It is the use of another model based on the CAPM with adjustments made on a pragmatic basis to achieve an outcome which reflects an attempt to modify the model to one which operates by reference to the regulatory period of five years. The CAPM is not a model which is intended to operate in this way. The timescales are dictated by the relevant underlying facts in each case and for present purposes those include the life of the assets and the term of the investment.

48 The Tribunal is satisfied that the use by GasNet of a ten year Commonwealth bond rate to determine a Rate of Return on equity under s 8.30 of the Code was a correct use of the CAPM and was in accordance with the conventional use of a ten year bond rate by economists and regulators where the life of the assets and length of the investment approximated thirty years in the MRP calculation and the risk-free rate. The use of the CAPM with these inputs in the Tribunal's view, produces a Rate of Return on equity which s 8.31 treats as one commensurate with the relevant market conditions and risk for the purposes of s 8.30.

49 Having regard to the view which the Tribunal takes as to the resolution of this issue, it is not necessary to consider in detail the submissions made by GasNet that the decision of the ACCC was incorrect or unreasonable having regard to the circumstances set forth in par [35] (a), (b) and (d) above.

Choice of inflation rate

50 GasNet contends that its 'sculpted' forecast of inflation at 2.52 per cent for 2003, and 2.07 per cent for each of the years 2004 - 2007 in the AA Period, resulting in an inflation rate of 2.16 per cent as the overall average for 2003 - 2007, was the best estimate arrived at on a reasonable basis and, in terms of s 8.2(e) of the Code, was required to be used in preference

to any other estimate of inflation in setting the Reference Tariff. It contends that it was the best estimate because it was based on a Victorian Treasury inflation forecast published on 15 November 2002 for the year ended 30 June 2003 and on an implied inflation forecast derived from the difference between the yields on index-linked and nominal Commonwealth bonds, a method known as the Fisher equation. The ACCC's estimate (which was determined solely by reference to the Fisher equation, not the Victorian Treasury forecast) GasNet contends, was not the best available estimate of inflation for 2003 and therefore should not have been used to calculate the Reference Tariff for that year.

51 GasNet also contends that for the ACCC to adopt a single forecast of 2.16 per cent per annum for each year of AA Period rather than considering it on a year by year basis, was in error having regard to the requirement of s 8.2(e) of the Code. The error, GasNet contends, produces a loss of revenue in 2003 of approximately \$275,000.

52 GasNet further contends that at no time did the ACCC ask the question whether it was satisfied in determining to approve or not approve the Reference Tariff that GasNet's inflation forecast complied with the Code and in particular s 8.2(e).

53 The ACCC's submissions in support of its rejection of GasNet's use of sculpted inflation rates may be summarised as follows:

- (a) the ACCC did not become seized of the issue until 6 January 2003, not 6 December 2002 as asserted by GasNet;
- (b) it became seized of the issue in the context of a prior threat by GasNet of legal action aimed at compelling the ACCC to make its determination in a timely manner which threat resulted in the ACCC scheduling its determination for Wednesday 15 January 2003 and publication of that determination for Friday 17 January 2003;
- (c) when it did become seized of the issue and sought clarification of it, the ACCC was not only informed five days before it was scheduled to make its determination that GasNet did not apply the sculpted interest rates to O&M costs because it was '*... too time consuming to go back to the detailed estimates and unscramble all of the CPI and non CPI escalators*' but also late in the afternoon on the day before it was scheduled to make its determination the following exchange of e-mails occurred:

GasNet to the ACCC:

'Sent: Tuesday, 14 January 2003 3:41 PM

...

As discussed with ..., GasNet has identified a typographical error in both the "complying" and "non complying" versions of the Access Arrangement. The definition of Injection Pipeline in Schedule 1 refers to the "Western Injection Zone" which should be the "Port Campbell Injection Zone"

In Schedule 1.8 the definition of Injection Pipeline (b) should read as follows:

"(b) in relation to the Port Campbell Injection Zone, any or all of the pipeline from Iona to Lara; and"

GasNet requests that this error be corrected.

Regards, ...'

ACCC to GasNet:

'Sent: Tuesday, 14 January 2003 4:13 PM

...

Thank you. We will incorporate this.

Further to our discussion the other day about the inflation adjustment, could you advise which approach (2.16% each year or 2.52%/2.07%) is used for linepack and spare parts?

...'

GasNet to the ACCC:

'Sent: Tuesday, 14 January 2003 4:53PM

...

Given the low amounts, the linepack and spare parts calculations were not re-done with the variable CPI. They are at 2.16% each year.

Regards ...'

GasNet to the ACCC:

'Sent: Tuesday, 14 January 2003 5:00PM

...

Further to the phone message I left for you, please ignore the reply below [ie the reply sent on 14 January 2003 at 4:53PM]. I had the wrong model open. The Linepack and Spare Parts calculations were re-done at with 2.52%/2.07% CPI.

My apologies for the confusion.

Regards ...'

- (d) GasNet's use of sculpted inflation rates raised issues which should be the subject of consultation with interested parties, but the time between the date when the ACCC became seized of the issue and the date it was scheduled to make its determination did not allow for such consultation, particularly in circumstances summarised in paragraph (c) above;

- (e) in the context in which inflation is being applied, the best estimate in terms of s 8.2(e) of the Code is one rate for each of the five years of the AA which will provide a proper average (ie: a single figure of 2.16 per cent derived by use of the objectively assessed Fisher equation or the difference between nominal and index-linked bond yields) not, as GasNet would have it, two rates (2.52 per cent for the first year and 2.07 per cent for the remaining four) derived from a possibly subjective Victorian Treasury estimate;
- (f) in applying s 8.2(e) of the Code to this issue, the question is not ‘*What is the best inflation forecast for 2003?*’, but rather ‘*What is the best inflation forecast that may be used consistently in the context of a five year AA?*’.
- (g) GasNet’s inflation figure for 2003 is a hybrid of a number of different figures (the Victorian Treasury forecast adjusted for the CPI of the previous September and an assumed December 2002 quarter CPI increase to produce a figure for the March and June quarters of 2003 plus figures for the September and December 2003 quarters based on the ACCC’s average inflation forecast) and is not a forecast representing a best estimate in terms of s 8.2(e) of the Code;
- (h) GasNet’s apparent use of an annual inflation rate of:
 - (i) 2.16 per cent for each year of the AA to calculate both the real Rate of Return and the nominal non-capital costs (forecast O&M expenditure) and to adjust the tariffs each year under the price path approach, on the one hand; and
 - (ii) 2.52 per cent for 2003 and 2.07 per cent for 2004 to 2007 to calculate depreciation and the capital base (including forecast capital expenditure), on the other,is inconsistent and contrary to s 8.5A of the Code;
- (i) GasNet’s failure to sculpt the risk free rate and the real WACC in line with its sculpting of the inflation rate for the first year is inconsistent and contrary to s 8.5A of the Code and would result in it delivering to itself about \$108,000 a year excess real revenue; and
- (j) GasNet’s use of sculpted interest rates would result in it being:
 - (i) over compensated (by in excess of \$1.4m in nominal terms over the five years of the AA) in a way which is inconsistent with the Code; or
 - (ii) if there were a spike in the inflation rate in the final year, under compensated, whereas the ACCC’s approach of using an average inflation rate would achieve a result of allowing forecasting errors in any one year to be compensated in other years

because of the annual reset process.

54 GasNet used the sculpted inflation rates based on the Victorian Treasury forecasts (rather than the Fisher equation) for the first time in the revisions to its AA submitted to the ACCC on 6 December 2002 in response to the ACCC's Draft Decision. While there is some suggestion in argument before the Tribunal that there may have been discussions of the issue between representatives of GasNet and the ACCC between 6 December 2002 and 6 January 2003 (when GasNet requested from the ACCC an extension of time to submit amended revisions which would replace those it had submitted on 6 December 2002), GasNet did not provide evidence of such discussions. In responding to the request, the ACCC noted that:

- (a) the sculpted inflation rate approach was not included in GasNet's AAI of 6 December 2002 or earlier documents;
- (b) it was not identified in GasNet's supplementary submission of that date as an area of departure from the FD;
- (c) no information had been provided at any stage to the ACCC (or interested parties) to indicate how an inflation adjustment determined on this basis would be consistent with relevant Code provisions or the amendments specified in the FD; and
- (d) it would take these factors into account when considering GasNet's use of sculpted inflation rates.

55 In its FA (published on 17 January 2003) the ACCC concluded:

'If GasNet provided further information and the Commission was able to conduct public consultation, it is possible that the Commission may be satisfied that GasNet's use of the Victorian Treasury forecasts meets the Code requirements and therefore addresses Amendment 12. However, on the basis of the current information supplied by GasNet, the Commission cannot reach such a conclusion. This is not altered by the argument made by GasNet in its supplementary submission of 6 December 2002, that its amended revisions should be approved as the difference in total revenue is only 5.8 per cent which disproportionately affects GasNet as opposed to users. (This submission is discussed in relation to Amendment 13 in this section 2.1.4 of the Final Approval).

Accordingly, the Commission is not satisfied that GasNet's amended revisions incorporate or otherwise address Amendment 12. This also affects Amendments 29 (forecast capital expenditure) and 30 (depreciation). This is reflected in the amended revisions drafted and approved by the Commission (see chapter 3 of this Final Approval).'

56 Contrary to the submissions of GasNet set out in par [52] above, this statement of the ACCC in its FA demonstrates that the ACCC did ask the question whether the use of the sculpted inflation rates was consistent with the provisions of the Code. It also shows that the ACCC determined it could not be satisfied that it was consistent on the basis of the information then available to the ACCC.

57 Having regard to the ACCC's submissions in support of its rejection of GasNet's use of sculpted inflation rates summarised in par [53] (a) to (d) above, the Tribunal does not accept GasNet's contention to the effect that the issue raised but a conceptual point capable of being addressed by the ACCC in a short time without public consultation. Nor does the Tribunal accept GasNet's contention to the effect that the ACCC may have dealt with the issue by way of a determination subject to a condition which might allow or compel a reset or a claw back if GasNet were over compensated. A determination to that effect would give rise to such uncertainties as to be an incorrect and unreasonable exercise of the ACCC's discretion. In the event, the ACCC's conclusion on the issue in its FA as quoted above was a correct exercise of the ACCC's discretion and was, having regard to all the circumstances, reasonable.

58 The ACCC rejected the sculpted inflation forecasts as an unacceptable hybrid and applied the Fisher equation which, until 6 December 2002, had been accepted by GasNet as the best method of estimating annual inflation rates for the period of the AA as required by s 8.2(e) of the Code.

59 However, there is no one correct method of estimating inflation. A whole range of indicators can be used in practice to derive estimates of future inflation rates. This would normally involve taking a number of these estimates and determining an average value. Like the Fisher equation, this procedure is market based. It is no more or no less objective than the Fisher equation. Inflation forecasting is an inexact science. The Fisher equation has no inherent superiority over other methods.

CONCLUSION

60 GasNet has established to the satisfaction of the Tribunal reviewable error in relation to:

- (a) the estimation of the various parameters of the CAPM used for calculating the Rate of Return on the capital assets which form the GNS (see par [19]);
- (b) the ACCC's determinations of the values of five non-capital cost parameters (see pars [22] - [23]); and
- (c) the ACCC determining for itself a Rate of Return for the purposes of s 8.30 in circumstances where GasNet's proposed Rate of Return using the CAPM was consistent with the objectives of s 8.1 of the Code (see par [24]).

Accordingly, the Tribunal must determine whether such errors require that it set aside or vary the decision under review pursuant to s 38(9) of the Law: s 39(6).

61 The Tribunal sought from the parties submissions as to the appropriate orders to give effect to a decision of the Tribunal under different scenarios. Having regard to those scenarios and the decision of the Tribunal, GasNet and the ACCC are agreed on the appropriate orders which would be necessary to vary the decision under review to take account of the Tribunal's findings.

62 EAG previously submitted that the Tribunal should determine whether the proposed AA lodged by GasNet was consistent with the Code in all of its aspects (which EAG submitted it was not) and if it were not, the Tribunal should itself draft and approve a new AA and AAI. Alternatively, in place of the ACCC's AA the Tribunal should draft and approve its own AA and AAI pursuant to s 2.42 of the Code. If the Tribunal were not persuaded to draft and approve its own AA, EAG submitted that the impact of any error on the part of the ACCC was more than adequately compensated by the ACCC over-estimating the equity beta and the MRP in determining its Reference Tariff, thus indicating that no change to the Reference Tariff was necessary in all the circumstances.

63 The Tribunal has considered all of the submissions and has noted the impact on GasNet's revenue caused by the rejection by the ACCC of GasNet's estimations of the CAPM parameters and of the non-capital costs. Bearing in mind s 2.24 and the principles contained in s 8.1 and s 8.2, the Tribunal is of the view that the decision under review requires variation. This follows because the interests of Users and Prospective Users, and the public interest (which must be given substantial effect to in keeping down the cost of the service) nevertheless must be weighed against the Service Provider's legitimate business interests and investment in the Covered Pipeline, and the Code objective that it be given a

stream of revenue to recover the efficient costs of delivering the Reference Service. In the present case the errors impact upon revenues to cover actual costs incurred, or to be incurred, and thus require variations to the determination under review to allow for such recovery.

64 The Tribunal is satisfied that the agreed form of orders proposed by the ACCC and GasNet to give effect to the Tribunal's findings do so fairly and consistently with s 8 of the Code and ought to be made by the Tribunal.

I certify that the preceding sixty-four (64) numbered paragraphs are a true copy of the Reasons for Judgment herein of the Honourable Justice Cooper, Mr RC Davey and Professor DK Round.

Associate:

Dated: 23 December 2003

Counsel for the Applicant: AC Archibald QC with P Fox
Solicitor for the Applicant: Mallesons Stephen Jacques

Counsel for the ACCC: J Beach QC with PRD Gray
Solicitor for the ACCC: ACCC Legal Group

Counsel for Energy Action Group: CM Maxwell QC with S Hibble

Dates of Hearing: 13 - 15, 18 - 21 August 2003
Date of Judgment: 23 December 2003