

APA Group

Regulatory accounting treatment of Pipeline Management Agreement termination payment Further information

May 2012

This report contains 37 pages

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1 Introduction

APT Petroleum Pipelines Limited (APTPPL) is a member of the APA Group (APA), an Australian infrastructure owner and operator, involved principally in the delivery of gas transmission and distribution services. As part of its operations, APTPPL formerly outsourced pipeline construction, maintenance and operations services under a Pipeline Management Agreement (PMA) that APTPPL (formerly AGL Pipelines Limited) made with Agility Management Pty Ltd (Agility) (formerly AGL Infrastructure Management Pty Limited) in April 2000.

During the period to 2007, the APA Group grew through the acquisition of various businesses, which included the acquisition of a number of businesses with substantial in house operating functions. The business model changed from a relatively small staff base to a much larger one with the resources to undertake operational and maintenance activities cost effectively. APTPPL took the view that the advantages it gained from its increased scale of operations exceeded the benefits that accrued to it from the PMA. In October 2007, APTPPL terminated the PMA and acquired the Agility asset management business.

APTPPL considered that the termination of the PMA and the associated consideration it paid (the PMA premium), would deliver efficiency benefits to its operations over a prolonged period, including efficiencies to the Roma to Brisbane Pipeline (RBP), which was formerly subject to the PMA.

The APA Group has proposed to include an allocation of the premium in the capital base of the RBP in its revised access arrangement for the RBP for the period 2012-13 to 2016-17.

The APA Group engaged KPMG to provide independent evidence that may assist the Australian Energy Regulator (AER) consider this aspect of the proposed revisions to the RBP access arrangement. That evidence was set out in a KPMG Report *"Regulatory accounting treatment of Pipeline Management Agreement termination payment"*, October 2011, prepared in compliance with the Federal Court's Practice Note CM 7 *"Expert Witnesses in proceedings in the Federal Court of Australia"* (1 August 2011) (the KPMG Report).

The AER published its Draft Decision on APTPPL's proposed revisions to the RBP Access Arrangement, in April 2012 (the Draft Decision). Among the other matters considered by the Draft Decision, the AER did not approve the inclusion of the proposed capital expenditure (capex) associated with the PMA contract buyout in APTPPL's opening capital base. The AER stated that this was because:

*"The AER is not satisfied that the PMA expenditure meets the definition of capex in r. 69 of the NGR because APTPPL has not substantiated that the expenditure was incurred to provide or in providing pipeline services. The AER also considers that the proposed expenditure is not conforming capex for the purposes of r. 79 of the NGR."*¹

¹ AER, Draft decision Roma to Brisbane Pipeline 2012-13 to 2016-17, Appendix D, p 347

1.1 The purpose of this report

The sole purpose of this report is to provide independent evidence that supplements that set out in the KPMG Report of October 2011, to further assist the AER or any relevant appellate body, to consider the APA Group's proposed revisions to the access arrangement for the RBP for the period 2012 to 2017, in accordance with terms of reference provided to KPMG by the APA Group on 26 September 2011. Those terms of reference are appended to this report at Appendix A. This report has been written to comply with the Federal Court's "*Practice Note CM 7 "Expert Witnesses in proceedings in the Federal Court of Australia"*" (1 August 2011).

1.2 Compliance with the Federal Court's Practice Note CM 7

1.2.1 The Expert

The author of this report is:

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1.2.2 Acknowledgement

I have read, understood and complied with the Federal Court's "*Practice Note CM 7 "Expert Witnesses in proceedings in the Federal Court of Australia"*" (1 August 2011).

1.2.3 Training and experience

My qualifications and relevant experience are set out in my CV attached at Appendix B.

1.2.4 The questions the Expert has been asked to consider

The KPMG Report of October 2011 addressed the following questions set out in the terms of reference dated 26 September 2011 (See Appendix A):

1. Taking into consideration any relevant financial accounting standards, is it reasonable that the premium (or part thereof) paid by APTPL to Agility be treated as capital expenditure for the purposes of establishing the opening capital base for the next regulatory period for which the revised access arrangement is to apply (2012-2017)?
2. Assuming it is reasonable that the premium (or part thereof) paid by APTPL to Agility be treated as capital expenditure for the purposes of establishing the projected capital base for the next regulatory period for which the revised access arrangement is to apply (2012-2017), is the value of \$30.1m allocated by the APA Group to the RBP at October 2007, a reasonable valuation for these purposes?

This report provides additional information to assist addressing the following questions that arise from the AER's Draft Decision.

- Does the PMA premium comprise capital expenditure consistent with National Gas Rules (NGR) r69?
- Can an intangible asset be included in the capital base of a covered pipeline?
- Is expenditure on the PMA premium asset properly attributable to a service provider and the RBP in particular?
- Is the approach to valuing the PMA premium asset attributable to a service provider and the RBP in particular, reasonable?

1.2.5 The documents and material the Expert has been asked to consider

- AER Draft Decision, Roma to Brisbane Pipeline 2012-13 to 2016-17, April 2012 (the Draft Decision);
- KPMG, Regulatory accounting treatment of Pipeline Management Agreement termination payment, October 2011 (the KPMG Report);
- RSM Bird Cameron, Review of capital expenditure for the Roma to Brisbane Pipeline access arrangement (the Bird Cameron Report);
- Frontier Economics, Review of capital expenditure on the Roma to Brisbane Pipeline access arrangement, April 2012 (the Frontier Economics Report); and
- Australian Pipeline Limited, Item for Approval No 6, Board Meeting, 26/02/07, Acquisition of Alinta's Pipeline Operation Agreements for APG's Assets and Associated Assets (All States)

1.2.6 Source materials referenced in this report

Appendix C sets these out.

1.2.7 Factual Findings

To complete this task, I have:

- considered the documents set out at Section 1.2.5 above; and
- undertaken a reasoned analysis that I have set out in this report.

1.2.8 The Expert's opinions and reasons

These are summarised below. Further explanation of the opinions and reasons are set out in the sections of this report referred to by the summary below.

Does the PMA premium comprise capital expenditure consistent with NGR r69?

The PMA premium is expenditure of a capital nature consistent with NGR r69, because consistent with the statutory definition of an asset provided by the Corporations Act and Australian Government Accounting Standards, the expenditure

delivers future economic benefits. These benefits comprise savings in expenditure on the provision of pipeline services, of a kind that is recoverable by a reference tariff.

Section 2 of this report considers this question in more detail.

Can an intangible asset be included in the capital base of a covered pipeline?

Whether an asset is tangible or intangible is not relevant to the question of whether an asset can be included in the capital base of a covered pipeline because:

- no requirement of the National Gas Rules is predicated on whether an asset is tangible;
- whether an asset is tangible or intangible, has no bearing on its consistency with the statutory definition of an asset;
- whether capital expenditure is capitalised as a tangible or intangible asset is not relevant to a consideration of whether the economic benefits that the asset provides are properly attributable to a pipeline service; and
- regulatory precedents for whether assets are capitalised are concerned with the underlying economic substance of the asset, not its form as either tangible or intangible:
 - there are precedents for the inclusion of intangible assets in regulatory asset bases. Easements provide examples; and
 - regulatory accounting precedents that exclude goodwill from regulatory asset and capital bases are predicated on the underlying substance of the economic benefits the asset provides, not the asset's form as goodwill. The economic substance of the PMA premium asset and its benefits do not accord with the rationale that led to those exclusions.

Section 3 of this report considers this question in more detail.

Is expenditure on the PMA premium asset properly attributable to a service provider and the RBP in particular?

Expenditure on the PMA premium asset is properly attributable to a service provider and to the RBP in particular. The AER refers to reasons for the buyout of the PMA set out in an APA Board paper dated 26 February 2007 and reproduced in a confidential appendix to the Draft Decision²:

- the regulatory value of the PMA premium asset attributed to the RBP is solely predicated on economic benefits resulting from savings in costs of operating and maintaining the RBP of a kind that are recoverable by a reference tariff;
- the principal objective of the APA Group entering into the PMA, was the procurement of operational and maintenance services necessary to enable APA to

² AER, Draft Decision, Confidential Appendices, Appendix H, p 12

deliver pipeline services. Accordingly, to the extent that the PMA related to the provision of pipeline services, the termination of the PMA and the associated costs and benefits, also relate to the provision of pipeline services;

- absent the APA Group conducting a business of providing gas pipeline services including transmission services provided by the RBP, there would have been no imperative or reason to terminate the PMA. Accordingly, the termination of the PMA and the associated premium, relate to the provision of pipeline services, regardless of whether other reasons or benefits may have existed; and
- the actual or hypothetical existence of any additional reasons not connected with the provision of pipeline services neither invalidates nor changes the valuation of the PMA premium asset and the expenditure attributable to the RBP.

Section 4 of this report considers this question in more detail.

Is the approach to valuing the PMA premium asset attributable to a service provider and the RBP in particular, reasonable?

The relative value of the savings that accrue to the RBP and each other pipeline (both covered and non-covered) that benefits from the cessation of the PMA provides a reasonable basis for allocation under the NGR that is consistent with well established regulatory precedent.

Section 5 of this report considers this question in more detail.

2 Does the PMA premium comprise capital expenditure consistent with NGR r69?

2.1 Economic and accounting principles

The NGR r79(3) criteria for “conforming capital expenditure” provide a key test of whether the expenditure on the PMA premium is in the nature of capital expenditure, namely whether:

- the expenditure delivers future positive economic value.

This criterion is also consistent with the statutory definition of an asset cited in the KPMG Report, namely that an asset is:

“A resource:

- a) controlled by an entity as a result of past events; and*
- b) from which future economic benefits are expected to flow.”³*

The KPMG Report evidences that the PMA premium is an asset. Also, the AER on page 360 of its Draft Decision:

“agrees that these precedents, and the submissions by APTPPL, support the view that the PMA expenditure is capital in nature.”

Nonetheless, certain parts of the AER’s Draft Decision appear to be inconsistent with this finding and do not recognise the economic substance of the PMA premium asset. For example:

“The AER is of the view that goodwill is not an asset that is purchased to provide, or in providing, regulated services. Rather it is a premium that is paid by a purchaser to derive some additional benefit above the identified assets of a business.”⁴

However, the AER’s statement does not appear to recognise that the goodwill is by definition, an asset of the APA Group.

Also on p 360 of the Draft Decision, the AER states:

“It was a payment for unidentified benefits associated with the purchase of the Agility business.”

³ KPMG, Regulatory Accounting Treatment of Pipeline Management Agreement termination payment, October 2011, p 17 and Australian Government Accounting Standards Board, Glossary of defined terms, May 2011, p. 3

⁴ AER, Draft Decision, Appendix D.3, p. 351

The AER also appears to have mistaken:

- the fact that the goodwill is not separably identifiable from other parts of the purchased Agility business, with
- the question of whether the goodwill delivers identifiable benefits.

The delivery of identifiable benefits sufficient to sustain a valuation of the APA premium asset is supported by:

- the KPMG Report;
- the Frontier Economics Report
- the Bird Cameron Report; and
- the unqualified audit opinions on the APA's Group's statutory financial statements⁵.

The definition of goodwill for statutory purposes is provided by Appendix A of Australian Government Accounting Standard AASB3 "Business Combinations" (set out in the Bird Cameron Report) for example:⁶

"an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised."

AASB3 further states:

"An asset is identifiable if it either:

- (a) is separable, i.e. capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or*
- (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations."*⁷

In plain terms, the goodwill asset only exists in conjunction with the acquired Agility business and cannot be sold or otherwise transacted separately from that business. These characteristics provide no reason to conclude or suggest that goodwill and in this case the PMA premium, is not a business asset. On the contrary, the inseparability of the goodwill asset binds it to the purpose of the business to which it relates, in this case the operations and maintenance of gas pipelines, formerly conducted by Agility.

The question of separability is one of asset classification, not existence or valuation. For example, Australian Government Accounting Standard AASB3 provides examples

⁵ Also referred to by Bird Cameron, p 12.

⁶ Bird Cameron, p. 6

⁷ AASB3, Appendix A, p 33

to provide guidance on whether certain assets should be accounted for as goodwill or as another form of intangible asset⁸.

The AER's concerns about the PMA premium asset's classification as goodwill as opposed to any other form of intangible or tangible asset, is not relevant to the question of whether the expenditure meets the definition of capital expenditure under NGR r69. This is because, as explained above, the asset's classification has no bearing on:

- whether it delivers future economic benefits and hence the asset's existence and valuation; and
- the business or services to which those benefits relate.

Additionally, this section of this report goes on to consider the nature of capital expenditure. It firstly considers the question of whether the PMA expenditure delivers future economic benefits. Whether the economic benefits are positive is a question of valuation that has already been considered by the KPMG Report. Rather, the following analysis is concerned with the principal criterion of whether the expenditure is capital expenditure.

2.2 Does the PMA expenditure deliver future economic benefits to the users of pipeline services?

The following reasoning leads to a conclusion that the PMA expenditure delivers future economic benefits to the users of pipeline services:

- the PMA expenditure avoids expenditure that the APA Group would otherwise be contractually obliged to pay to Agility;
- the expenditure payable to Agility under the PMA was for the delivery of services set out in the PMA;
- those services were for the operations and maintenance of APA's pipelines;
- the expenditure on those services was accepted by the ACCC as recoverable by reference tariffs to the extent that they were provided to covered pipelines and excluded the payment of management fees not recoverable by a reference tariff;
- therefore it must follow that because:
 - the PMA premium was expended wholly and exclusively on an agreement to terminate the PMA; and
 - the PMA was wholly and exclusively concerned with the provision of pipeline services

the PMA premium expenditure was wholly and exclusively applied to APA's pipeline business. (This matter is further addressed in Section 4 of this paper).

⁸ See AASB3, Appendix B, p 42 to p 45.

The extent to which the premium expenditure was associated with the RBP in particular, is a matter of allocation of expenditure in accordance with well established regulatory principles and precedents, which are addressed in Section 5 of this report;

- the PMA premium expenditure delivers future economic benefits to the users of pipeline services because:
 - it is the consideration over and above the valuation of separable net assets previously accounted for by Agility and transferred to APA, necessary to terminate the PMA and hence necessary to enable APA to reduce the amounts of future expenditure recoverable by reference tariff, to operate and maintain the covered pipelines subject to the PMA;
 - the KPMG report demonstrates that the capitalised PMA premium that APA has proposed be included in the RBP capital base, amounts to less than the present value of the economic benefits, arising wholly and exclusively from the premium, accruing to the services provided by the RBP;
- the AER's experts Bird Cameron⁹ and Frontier Economics¹⁰ also conclude that the PMA premium is in the nature of capital. While the Frontier Economics Report takes a different view to KPMG on the value of the PMA premium asset that could be included in the RBP capital base in order to deliver a positive economic value to the users of pipeline services, that difference is not relevant to a conclusion that the PMA premium is in the nature of capital;
- among its other findings, the Bird Cameron Report stated that in relation to whether the PMA premium asset (referred to as goodwill below) qualified as "conforming capital expenditure" under the NGR:

"AER provided us with preliminary calculations on the comparison of what the assumed tariff would be when including the goodwill and then compared this to the tariff if the old arrangement was still in place. The financial data used to conduct this analysis by AER was based on APTPL's proposed models and assumptions made in the KPMG report.

The results of this analysis indicate that the tariff would be higher under the inclusion of the goodwill in the opening capital base, as opposed to the previous arrangement of outsourcing.

On discussions with AER, it was concluded that, as this analysis resulted in a negative conclusion, the condition under clause (a) (which referred to NGR r79(3)) could not be met for the costs incurred on goodwill to be identified as "conforming capital expenditure".

In a teleconference held between the AER, APA and KPMG on 11 May, 2012, the AER agreed that the comparative analysis it provided to Bird Cameron, which it also provided to APA on 3 May 2012, only considered the access period

⁹ E.g. Bird Cameron, p 1

¹⁰ E.g. Frontier Economics, p 7

2013-2017. On this basis, it seems reasonable to conclude that this analysis did not form a sufficient basis for Bird Cameron's conclusion, because it did not consider the full period over which the PMA premium will deliver benefits to users of pipeline services.

However, the AER also emphasised in the teleconference, that it had not relied on this finding of Bird Cameron in its Draft Decision. Therefore, it seems reasonable to disregard this particular finding of the Bird Cameron Report;

- APA's statutory financial statements prepared in accordance with the statutory requirements of the Corporations Act 2001 and Australian Government Accounting Standards mandated by that Act, record the PMA premium as a non-current (capital) asset.

2.3 Conclusion

The reasoning set out above demonstrates that the PMA premium is expenditure of a capital nature consistent with NGR r69. This is because it delivers future economic benefits to the provision of APA's pipeline services.

3 Can an intangible asset be included in the capital base of a covered pipeline?

3.1 Whether an asset is tangible is not relevant

Whether an asset is tangible or intangible is neither relevant to, nor a consideration of, either:

- the statutory definition of an asset (referred to in Section 2.1 above); or
- the National Gas Rules.

On this basis, the status of the PMA premium as an intangible asset is not a relevant consideration to whether the expenditure on that asset qualifies as conforming expenditure under rules 60 and 79 of the NGR.

Nevertheless, the AER expressed concern in a teleconference with APA and KPMG on 11 May 2012 that because the PMA premium asset is not a tangible asset and may provide benefits with different characteristics to those provided by plant or equipment used to deliver pipeline services, the asset may not deliver pipeline services and hence that the capital expenditure may not be conforming capital expenditure.

3.2 The PMA premium asset valuation is wholly predicated on savings in pipeline operational and maintenance costs

The rationale for such a concern is not clear. As explained in Section 2.2 above and Section 4 below:

- the PMA premium expenditure is wholly and exclusively associated with benefits to APA's pipeline business that accrue from the termination of the PMA; and
- the value of the PMA premium asset that APA has proposed to include in its capital base is fully supported (and exceeded) by the present value of the future savings secured exclusively by the PMA premium, in the costs of operating and maintaining gas pipelines. The PMA premium asset value therefore wholly and exclusively comprises benefits directly connected with pipeline operations and maintenance.

The KPMG Report's valuation of the PMA premium asset is predicated entirely on future savings in expenditure on the operation and maintenance of APA's pipelines.

In the event that the AER is concerned that the PMA premium asset may not deliver savings in the direct costs of pipeline services, the following observations consider circumstances where the PMA premium asset valuation might in some way be partly

founded on non-production expenditure benefits¹¹, or increased beyond its current value by the attribution of non-production expenditure benefits:

- the criteria for recoverability in the NGR do not distinguish between production and non-production expenditure or indeed any other categories of expenditure beyond capital and operating expenditure;
- there is ample precedent for recovering indirect expenditure on pipeline services by reference tariffs. The AER invariably permits the recovery of efficient non-production operating expenditure such as corporate overheads that meet the criteria of the NGR; and
- the distinction between operating and capital expenditure is one of timing. The former provides benefits in a single accounting period, whereas the latter also provides benefits in future periods. This distinction is relevant to the question of the timing of the recognition of the benefits of expenditure but is not relevant to the question of whether expenditure is incurred to deliver pipeline services.

Therefore the regulatory precedents and rationale for the recovery of non-production expenditure by reference tariffs are equally applicable to operating and capital expenditure. Should the AER consider that the PMA premium asset in any part, be valued on the basis of future non-production expenditure benefits, the fact that those costs would have been capitalised rather than expended as operating expenditure would not be relevant to the question of whether the PMA premium asset comprises conforming capital expenditure.

3.3 Regulatory precedents

The AER points to a range of precedents where regulators have prohibited goodwill from the regulatory asset or capital, base¹².

The Bird Cameron Report considers the regulatory precedents¹³ and comments that these are not applicable to the circumstances of the PMA premium. Referring to these precedents, Bird Cameron states:

*“...these reports were not detailed in respect to their reasoning as to why the goodwill should be excluded from a regulatory capital base as some claimed that goodwill costs did not relate to the regulatory business. **This is different when compared to APTPL’s case, as they only incurred the expenditure in relation to the regulatory business, being their pipeline, to reduce costs of providing the services.**”* (Emphasis added)

¹¹ For the purposes of illustration, expenditure either capital or operating, incurred directly on pipeline operations and maintenance might be termed “production expenditure”. Conversely, non-production expenditure can be considered to comprise expenditure that provides the environment or setting necessary for the provision of service. Corporate costs and indirect overheads are common examples.

¹² AER, Draft Decision, Appendix D3.

¹³ Bird Cameron, Table C, p 8 and p 9

Frontier Economics draws similar conclusions. For example, it refers to the Office of the Regulator-General's (ORG's) Electricity Industry Guideline No.3 which KPMG also referred to in its report¹⁴.

"Upon reviewing Guideline No 3, we are also inclined to the view that Guideline No 3 should not prevent the PMA buyout costs from being classed as a form of capital expenditure. The treatment of goodwill in clause 3.7.4 of Guideline No 3 is similar to the treatment of asset revaluations and adjustments in clause 3.7.2. In both cases, the prime objective appears to be to prevent a service provider using an acquisition to pass inflated asset purchase costs on to customers. 'Inflated asset purchase costs' in this context refers to costs in excess of book value. However, in the PMA buyout transaction, the premium amount known as goodwill was paid (at least in part) to compensate Agility for its loss of profits on the provision of services under the PMA.

*Further, the definition of capital expenditure in Guideline No 3 includes expenditure that 'will significantly reduce the ongoing maintenance of the assets'. If 'maintenance' is read as referring to maintenance costs rather than the actual activity of maintenance, **this definition would appear to allow expenditures made up front to reduce future maintenance costs to be classed as capital expenditures.**¹⁵ (Emphasis added)*

KPMG has been involved in drafting or critiquing the majority of the regulatory accounting guidelines referred to by the AER and on this basis, additionally observes that:

- in the example of the ORG's Electricity Industry Guideline No.3 referred to in the KPMG Report, the regulatory framework for the reformed Victorian electricity industry set prices based on asset values carefully set by the regulatory framework (DORC values and adjustments set out in the Tariff Order). The inclusion of goodwill would also have been inconsistent with the fact and intent of this framework, which was highly specific to the Victorian electricity industry and is simply not relevant to the NGR;
- as Bird Cameron mentions, several regulatory guidelines simply do not explain why goodwill is excluded. An unsupported precedent for exclusion cannot be fairly presented as a reason for setting aside a well reasoned and supported case for including the PMA premium;
- the AER expresses concerns that it may depart from accepted practice in other jurisdictions if it were to accept that a payment for the goodwill of a purchased business was properly recorded as expenditure that is incurred to provide, or in providing regulated services¹⁶. To address this concern, it is necessary to examine the underlying substance of the PMA premium asset and how this is distinguished from goodwill which may not be appropriate to include in a capital base. To exclude

¹⁴ KPMG, p 22

¹⁵ Frontier Economics p6 and p7

¹⁶ AER, Draft Decision, Appendix D, p 352

the PMA premium asset from a capital base merely on the basis of it being classified as “goodwill” would promote the form of the transaction over its substance, which in turn would be contrary to well accepted regulatory accounting requirements including the AER’s own guidelines;¹⁷

- a key distinguishing feature between the PMA premium asset and the goodwill contemplated by the regulatory guidelines cited by the AER is that:
 - the precedent regulatory guidelines contemplated goodwill arising on the acquisition of a network business. They sought to avoid the circularity that could arise where goodwill is valued on the basis that its value, if included in the capital or regulatory asset basis, would enable it to earn a return. This is not the case for the PMA premium asset; whereas
 - the PMA premium asset arises from a transaction conducted in the course of the pipeline service provider’s business in order to reduce the costs of operating and maintaining its pipelines. The value that has been attributed to the PMA premium asset for the RBP is constrained to below the present value of the operational cost savings wholly and exclusively attributable to the premium. Because of this, it does not present the risk of circularity outlined above.

In reviewing regulatory precedents, the AER has not referred to precedents where easements, which comprise intangible assets, have been included in the regulatory asset bases of network service providers.¹⁸ This evidence supports a conclusion that it is necessary to examine the underlying substance of an asset and its economic benefits rather than determine its regulatory treatment on the basis of its descriptive form or title.

3.4 Conclusions

The question of whether an intangible asset can be included in the capital base of a covered pipeline is not relevant since:

- no requirement of the National Gas Rules is predicated on the answer to this question;
- whether an asset is tangible or intangible has no bearing on its consistency with the statutory definition of an asset;
- whether capital expenditure is capitalised as a tangible or intangible asset is not relevant to a consideration of whether the economic benefits that the asset provides are properly attributable to a pipeline service; and

¹⁷ For example see: AER, Electricity Distribution Network Service Providers Cost Allocation Guidelines, June 2008, section 2.2.2 “Substance over legal form” and ACCC, Draft regulatory reporting guidelines for gas pipeline service providers, May 2004, p. 12

¹⁸ For example see: AER, Final decision, ElectraNet transmission determination 2008-09 to 2012-13, April 2008 and AER, Final decision, Queensland distribution determination 2010-11 to 2014-15, May 2010

- regulatory accounting precedents that exclude goodwill from regulatory asset and capital bases are predicated on the underlying substance of the economic benefits the goodwill asset provides, not the asset's form as either goodwill or an intangible asset. The PMA premium asset and its bounded and demonstrable economic benefits do not accord with the rationale that led to those exclusions.

4 Is expenditure on the PMA premium asset properly attributable to a service provider and the RBP in particular?

The AER refers to Appendix H of its Draft Decision and asserts:

“On the basis of information included in the 2007 Board Paper, it is clear that the purchase was motivated by many purposes and it was intended to address a number of factors other than the maintenance and operations for existing pipeline services that would be properly attributable to the RBP.”¹⁹

The key questions that arise from this statement are whether:

- the reasons and hence anticipated benefits set out in the 26 February 2007 Board paper (refer to Section 1.2.8) may in any part, not be related to the provision of pipeline services and the RBP; and
- to the extent that any reasons or anticipated benefits may not relate to the provision of pipeline services, would they cause:
 - any part of the PMA premium not to rank as an asset; and/or
 - the valuation of a PMA premium asset to change?

4.1 Are these reasons and anticipated benefits connected with the delivery of pipeline services?

The reasons set out in the 26 February 2007 Board paper include reasons directly associated with the physical operation and maintenance of a pipeline, for example:

- *“....allows APG to optimise the long term management of its key assets in an economic and operational manner”*

Whether the anticipated benefits set out in the 26 February 2007 Board paper are *all* related to the provision of pipeline services and the RBP is not a relevant consideration.

This is because the regulatory value of the PMA premium asset is solely predicated on economic benefits accruing to the direct costs of operations and maintenance of the RBP and other pipelines. The actual or hypothetical existence of any additional reasons not connected with the provision of pipeline services does not invalidate the reasons or change the benefits relating to the provision of pipeline services on which the PMA premium asset valuation is founded.

The principal objective of the APA Group entering into the PMA, was the procurement of operational and maintenance services necessary to enable APA to deliver pipeline services. Accordingly, to the extent that the PMA related to the provision of pipeline

¹⁹ AER Draft Decision Appendix D.5.1, p. 360

services, the termination of the PMA and the associated costs and benefits, also relate to the provision of pipeline services.

Absent the APA Group conducting a business of providing gas pipeline services including transmission services provided by the RBP, there would not have been an imperative or reason to terminate the PMA. Accordingly, the termination of the PMA and the associated premium relate to the provision of pipeline services, regardless of whether other reasons or benefits may have existed.

4.2 Is the valuation of the PMA premium asset contingent on whether all the reasons and anticipated benefits relate to the provision of pipeline services?

As Section 2.1 explains, assets are predicated on demonstrable future economic benefits, not the reasons for bringing about an asset. An asset may or may not deliver the benefits that were anticipated by those reasons, but the value and description of an asset (or indeed any other financial item such as expenditure, revenue, or a liability) is determined by reference to evidenced, not anticipated, benefits and costs. Otherwise historical financial statements would have little meaning as they would be based on hopes and intentions, not evidenced outcomes.

The PMA premium asset and its value is evidenced by its demonstrable economic benefits, not the motives or hopes for the PMA buyout. But for the purposes of the remainder of this discussion, it is assumed that benefits corresponding to the reasons set out in the 26 February 2007 Board paper, exist.

Benefits are not necessarily dependent on one another. It is not necessary for *all* benefits of the PMA buyout to be related to pipeline services in order:

- for *any* benefit to be related to pipeline services; and
- for that benefit related to pipeline services to be sufficient by itself to support a corresponding valuation of an asset related to pipeline services.

Rather, consistent with the basic economic principles set out in Section 2.1 above, it is necessary for:

- benefits related to the maintenance and operations of pipeline services to exist; and
- the value accruing to the pipeline services from those benefits to be fairly assessed.

The PMA premium asset fulfils these criteria, and hence the valuation of the PMA premium asset is not contingent on whether further benefits exist, regardless of whether they relate to the maintenance and operations of pipeline services. This is because:

- consistent with the principles outlined at Section 2.1 above, APA has proposed that the amount of the premium attributable to the RBP is valued at an amount less

than the future economic benefits accruing to the RBP that are exclusively associated with it, to provide a positive economic value consistent with NGR r79 (2)a;

- the valuation approach described in the KPMG Report is based solely on demonstrable cost savings that accrue to replacing pipeline operations and maintenance services formerly provided by Agility with services provided in house. These benefits and the associated PMA premium asset value relate wholly and exclusively to the delivery of pipeline services;
- the range of benefits anticipated by the Board paper of 26 February 2007 includes these benefits (for example “allows APG to optimise the long term management of its key assets in an economic and operational manner”) among other broader benefits; and
- as the KPMG, Bird Cameron and Frontier Economics Reports demonstrate, any broader benefits beyond the cost savings, have not been taken into account to arrive at a valuation of the PMA premium. If broader benefits were taken into account, the valuation of the PMA asset would be higher.

In a teleconference on 11 May 2012 with APA and KPMG, the AER indicated that it anticipates the asset would be allocated between the various reasons for the buyout of the PMA. A mistaken implication of this could be that to the extent that reasons may exist for the buyout that are arguably not related to the provision of pipeline services, the value attributed to the reasons that do not relate to the provision of pipeline services, would not be attributable to the regulatory value of the PMA premium.

To allocate part of this value derived from pipeline operational and maintenance expenditure savings to other, non-pipeline services would be problematic because:

- it would lead to an under-valuation of the pipeline services asset, which would be valued at less than the present value of future cost savings attributable to that asset and hence would be inconsistent with approaches to valuation adopted by KPMG, the AER’s Draft Decision, Frontier Economics and endorsed by Bird Cameron; and
- would produce arbitrary outcomes since there is no upper bound to the range of reasons than can be postulated for any action.

Such an approach would be mistaken. It is reasonable to allocate the asset value to the services that receive the economic benefits delivered by the asset. However, there is no basis or rationale for quantitatively or qualitatively allocating the PMA asset values to reasons since reasons are neither a basis of valuation nor a causal allocator of the PMA asset value.

The PMA premium asset is valued on the present value of future cost savings. Section 5 shows how this provides a causal basis of allocation that accords with well established regulatory precedent.

Additionally:

- the value of economic benefits provides the causal basis of the value of the PMA premium asset and hence of any allocation or attribution of that value; and
- the PMA premium asset has been valued on the basis of a single demonstrable economic benefit. That valuation is independent of the existence of other benefits. Should other benefits be taken into account, they would be added to the existing valuation. Because the PMA premium value is less than but directly proportional to corresponding economic benefits, an increase in the PMA asset value from the quantification of further benefits may increase, but could not diminish, the value attributed to the RBP or any other pipeline service.

4.3 Conclusions

Expenditure on the PMA premium asset is properly attributable to a service provider and the RBP in particular.

While there is no evidence to suggest that a broader range of benefits anticipated by the 26 February 2007 Board paper relate to anything other than the provision of pipeline services, the regulatory value of the PMA premium asset attributed to the RBP is predicated solely on economic benefits resulting from savings in costs of operating and maintaining the RBP that are recoverable by a reference tariff.

The actual or hypothetical existence of any additional reasons not connected with the provision of pipeline services neither invalidates nor changes the valuation of the PMA premium asset and the amount allocated to the RBP.

5 Is the approach to valuing the PMA premium asset attributable to a service provider and the RBP in particular, reasonable?

Well established regulatory precedent²⁰ indicates that expenditure being:

- directly attributed²¹ to an object to which it wholly and exclusively relates; or
- allocated on a causal basis to an object, where there is a cause and effect between the basis of allocation and cost being allocated such that the basis of allocation triggers the consumption or utilisation of the resources or services represented by the costs subject to allocation²²

comprises a reasonable basis for the purpose of allocating expenditure and other account items under the NGR.

In the instance of the PMA premium asset, the regulatory value of the premium is caused entirely and solely by the economic value of the savings in recoverable expenditure that is directly attributed to it.

Therefore the relative value of the savings that accrue to each pipeline that benefits from the cessation of the PMA (including both covered and non-covered pipelines) provides a reasonable basis for allocation.

²⁰ For example, see National Electricity Rules, Version 49, Chapter 6, Economic regulation of distribution services, clause 6.15.2, Cost Allocation Principles, p 608

²¹ "directly attributed" is also normally defined as meaning "wholly and exclusively attributed." For example see AER, Electricity transmission network service providers, Cost Allocation Guidelines, September 2007, p 14

²² For example, see Queensland Competition Authority, SEQ Interim Price Monitoring, Information Requirements for 2011/12, June 2011, p 19

6 Expert's statement

I have read the Federal Court's "Practice Note CM 7 "Expert Witnesses in proceedings in the Federal Court of Australia" (1 August 2011) and prepared this report in a form consistent with Practice Note CM 7.

I have prepared this report for the purpose set out in Section 1.1 of this report and it is not to be used for any other purpose without my prior written consent. Accordingly, KPMG accepts no responsibility in any way whatsoever for the use of this report for any purpose other than that for which it has been prepared.

I have made all inquiries that I believe are desirable and appropriate and no matters of significance which I regard as relevant have, to my knowledge, been withheld from the material set out in this report.

Nothing in this report should be taken to imply that I have verified any information supplied to me, or have in any way carried out an audit of any information supplied to me other than as expressly stated in this report.

My opinion is based solely on the information set out in this report. If I amend any conclusion on further information, I will amend the report.



Keith Lockey

A Terms of reference

May 2012

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APA Group

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ARSN 115 585 441

26 September 2011

Mr Keith Lockey
KPMG
147 Collins Street
Melbourne VIC 3000

By email: klockey@kpmg.com.au

Dear Mr Lockey

Roma to Brisbane Pipeline access arrangements 2012 – 2017: Regulatory treatment of Pipeline Management Agreement termination payment

Background

APT Petroleum Pipelines Ltd (**APTPL**) owns the Roma to Brisbane Pipeline (**RBP**) which transports natural gas from the gas hub near Roma to the markets of Brisbane and the regional centres along the pipeline route. The mainline was constructed in 1969, is 438km long and runs from Roma (Wallumbilla) to Brisbane. The Peat lateral was constructed in 2001, is 121km long and runs from the Peat and Scotia gas fields to Arubial.

Pursuant to the National Gas Rules (**Rules**), APTPL is required to submit an access arrangement revision proposal to the Australian Energy Regulator (**AER**) by 12 October 2011. The access arrangement revision proposal must, amongst other things, set out the amendments to the access arrangement that the service provider proposes for the following access arrangement period.

The reference service provided by the RBP is a non-interruptible service for the receipt, transportation and delivery of gas through any length of the pipeline in the direction from Wallumbilla or Peat to Brisbane.

Under the Rules, total revenue for a relevant service provider is determined for each regulatory year of the access arrangement using a "building blocks" methodology (rule 76). The building blocks include, amongst other things:

- a return on the projected capital base for the year (rule 76(a));
- depreciation on the projected capital base for the year (rule 76(b)); and

The return on the projected capital base for the year and the depreciation on the capital for the year are both a function of the projected capital base for a particular period (rule 78). The projected capital base for a particular period takes into account, amongst other things, the forecast conforming capital expenditure for the period (rule 78(b)) and the forecast depreciation for the period (rule 78(c)).

The criteria governing the inclusion of new capital expenditure in the projected capital base for a particular period is set out in rule 79. Rule 79 includes the following requirements:

"New capital expenditure criteria

- (1) Conforming capital expenditure is capital expenditure that conforms with the following criteria:
 - (a) the capital expenditure must be such as would be incurred by a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing services;

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- (b) the capital expenditure must be justifiable on a ground stated in subrule (2).
- (2) Capital expenditure is justifiable if:
 - (a) the overall economic value of the expenditure is positive; or
 - (b) the present value of the expected incremental revenue to be generated as a result of the expenditure exceeds the present value of the capital expenditure; or
 - (c) the capital expenditure is necessary:
 - (i) to maintain and improve the safety of services; or
 - (ii) to maintain the integrity of services; or
 - (iii) to comply with a regulatory obligation or requirement; or
 - (iv) to maintain the service provider's capacity to meet levels of demand for services existing at the time the capital expenditure is incurred (as distinct from projected demand that is dependent on an expansion of pipeline capacity); or
 - (d) the capital expenditure is an aggregate amount divisible into 2 parts, one referable to incremental services and the other referable to a purpose referred to in paragraph (c), and the former is justifiable under paragraph (b) and the latter under paragraph (c).
- (3) In deciding whether the overall economic value of capital expenditure is positive, consideration is to be given only to economic value directly accruing to the service provider, gas producers, users and end users.
- ...
- (6) The AER's discretion under this rule is limited."

Rule 74, which applies generally to forecasts and estimates (including those used in determining the return on capital), provides:

- "(1) Information in the nature of a forecast or estimate must be supported by a statement of the basis of the forecast or estimate.
- (2) A forecast or estimate:
 - (a) must be arrived at on a reasonable basis; and
 - (b) must represent the best forecast or estimate possible in the circumstances."

Pursuant to section 28 of the National Gas Law (Law), in making a decision on whether to approve an access arrangement proposal, the AER must have regard to the National Gas Objective (in section 23 of the National Gas Law), which is:

"...to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."

The AER must also take into account the revenue and pricing principles in section 24 of the Law when exercising a discretion in approving or making those parts of an access arrangement relating to a reference tariff. The AER may take into account the revenue and pricing principles when performing or exercising any other AER economic regulatory function or power (which is defined to include an applicable access arrangement decision), if the AER considers it appropriate to do so. The revenue and pricing principles in section 24 of the Law include the following:

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"(2) A service provider should be provided with a reasonable opportunity to recover at least the efficient costs the service provider incurs in—

- (a) providing reference services; and
- (b) complying with a regulatory obligation or requirement or making a regulatory payment.

...

- (5) A reference tariff should allow for a return commensurate with the regulatory and commercial risks involved in providing the reference service to which that tariff relates.
- (6) Regard should be had to the economic costs and risks of the potential for under and over investment by a service provider in a pipeline with which the service provider provides pipeline services."

Pipeline Management Agreement termination payment

APTPL formerly outsourced pipeline construction, maintenance and operations services under a Pipeline Management Agreement (**PMA**) with Agility Management Pty Ltd (**Agility**). In 2006, APTPL terminated that arrangement. To do so, it was necessary for APTPL to negotiate a premium to recompense Agility for the termination of the PMA.

APTPL considers that the termination of the PMA and the associated premium will deliver efficiency benefits to its operations over a prolonged period. That is, that the amount of the premium will be exceeded by the present value of the benefits (costs avoided).

In its access arrangement revision proposal APTPL proposes to include in the RBP capital base a portion of the premium that was paid to Agility. In this context, APTPL is seeking the opinion of a recognised independent expert on whether, by reference to relevant accounting standards, the premium paid to Agility (or part of it) is properly of a capital nature and, if so, the quantum of expenditure that would appropriately be included in the RBP capital base.

Scope of Work

You are briefed to provide an expert opinion report for use by APTPL in its access arrangement revision proposal that addresses the following questions:

- 1 Taking into consideration any relevant financial accounting standards, is it reasonable that the premium (or part thereof) paid by APTPL to Agility be treated as capital expenditure for the purposes of establishing the opening capital base for the next regulatory period for which the revised access arrangement is to apply (2012 – 2017)?
- 2 Assuming it is reasonable that the premium (or part thereof) paid by APTPL to Agility be treated as capital expenditure for the purposes of establishing the projected capital base for the next regulatory period for which the revised access arrangement is to apply (2012 – 2017), is the value of \$30.1m allocated by the AAP Group to the RBT at October 2007, a reasonable valuation for these purposes?

Information to be relied on

In providing your report, you are expected to draw upon the following information:

- the Law and the Rules in relation to the economic regulation of gas networks;
- relevant financial accounting standards;

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- relevant regulatory precedents on the use of financial accounting standards in regulatory decision making; and
- such information that, in expert's opinion, should be taken into account to address the questions outlined above.

Guidelines in preparing your report

The Guidelines for Expert Witness in the Federal Court of Australia are attached to this letter. Although this brief is not in the context of litigation, APTPPL is seeking a rigorously prepared independent view for use in the context of regulatory decision making and you are requested to follow the Guidelines to the extent reasonably possible in this context.

In particular, within your report you are requested to:

- (e) identify all persons contributing to the report, their relevant area of expertise and provide a curriculum vitae for each person setting out the details of their expertise (to be attached to your report);
- (f) only address matters that are within your expertise;
- (g) where you have used factual or data inputs please identify those inputs and the sources;
- (h) if you make assumptions, please identify them as such and confirm that they are in your opinion reasonable assumptions to make;
- (i) if you undertake empirical work, please identify and explain the methods used by you in a manner that is accessible to a person not expert in your field;
- (j) confirm that you have made all the inquiries that you believe are desirable and appropriate and that no matters of significance that you regard as relevant have, to your knowledge, been withheld from your report; and
- (k) please do not provide legal advocacy or argument and please do not use an argumentative tone.

All key source materials referenced by you in your report should be provided to APTPPL with your report.

Confidentiality

Please ensure that any confidential information provided to you by APTPPL for the purposes of drafting your report is kept confidential, and that any confidential information is not disclosed to any person without the consent of APTPPL.

Your report, and potentially all key source material, will be provided to the AER as part of APTPPL's revised proposal. All non-confidential material will be published by the AER on its website, including your report. As such, should your report contain any information which is confidential, this material must be clearly identified by you as confidential at the time your report is finalised.

Timing

APTPPL requires a final report no later than 3 October 2011 and a draft report no later than 28 September 2011. Please let us know if you anticipate that you may not be able to meet these deadlines.

May 2012

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Yours sincerely



Peter Bolding
General Manager Regulatory and Strategy

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ATTACHMENT: FEDERAL COURT GUIDELINES

**FEDERAL COURT OF AUSTRALIA
EXPERT WITNESSES IN PROCEEDINGS IN THE
FEDERAL COURT OF AUSTRALIA**

Guidelines

1. General Duty to the Court¹

- 1.1 An expert witness has an overriding duty to assist the Court on matters relevant to the expert's area of expertise.
- 1.2 An expert witness is not an advocate for a party even when giving testimony that is necessarily evaluative rather than inferential.
- 1.3 An expert witness's paramount duty is to the Court and not to the person retaining the expert.

2. The Form of the Expert's Report²

- 2.1 An expert's written report must comply with Rule 23.13 and therefore must
 - (a) be signed by the expert who prepared the report; and
 - (b) contain an acknowledgement at the beginning of the report that the expert has read, understood and complied with the Practice Note; and
 - (c) contain particulars of the training, study or experience by which the expert has acquired specialised knowledge; and
 - (d) identify the questions that the expert was asked to address; and
 - (e) set out separately each of the factual findings or assumptions on which the expert's opinion is based; and
 - (f) set out separately from the factual findings or assumptions each of the expert's opinions; and
 - (g) set out the reasons for each of the expert's opinions; and
 - (h) comply with the Practice Note.
- 2.2 The expert must also state that each of the expert's opinions is wholly or substantially based upon the expert's specialised knowledge³.
- 2.3 At the end of the report the expert should declare that "[the expert] has made all the inquiries that [the expert] believes are desirable and appropriate and that no matters of significance that [the expert] regards as relevant have, to [the expert's] knowledge, been withheld from the Court."

¹The "Ikarian Reefer" (1993) 20 FSR 563 at 565-566.

²Rule 23.13.

³Dasreef Pty Limited v Hawchar [2011] HCA 21.

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- 2.4 There should be included in or attached to the report the documents and other materials that the expert has been instructed to consider.
- 2.5 If, after exchange of reports or at any other stage, an expert witness changes the expert's opinion, having read another expert's report or for any other reason, the change should be communicated as soon as practicable (through the party's lawyers) to each party to whom the expert witness's report has been provided and, when appropriate, to the Court⁴.
- 2.6 If an expert's opinion is not fully researched because the expert considers that insufficient data are available, or for any other reason, this must be stated with an indication that the opinion is no more than a provisional one. Where an expert witness who has prepared a report believes that it may be incomplete or inaccurate without some qualification, that qualification must be stated in the report.
- 2.7 The expert should make it clear if a particular question or issue falls outside the relevant field of expertise.
- 2.8 Where an expert's report refers to photographs, plans, calculations, analyses, measurements, survey reports or other extrinsic matter, these must be provided to the opposite party at the same time as the exchange of reports⁵.
3. **Experts' Conference**
 - 3.1 If experts retained by the parties meet at the direction of the Court, it would be improper for an expert to be given, or to accept, instructions not to reach agreement. If, at a meeting directed by the Court, the experts cannot reach agreement about matters of expert opinion, they should specify their reasons for being unable to do so.

PA KEANE
Chief Justice
1 August 2011

⁴ The *"Ikarian Reefer"* [1993] 20 FSR 563 at 565.

⁵ The *"Ikarian Reefer"* [1993] 20 FSR 563 at 565-566. See also Ormrod *"Scientific Evidence in Court"* [1958] Crim LR 240.

B Keith Lockey's curriculum vitae



Keith Lockey

Executive Director

Economics, Infrastructure and Policy Group

Location	Melbourne
Education	BSc (Hons) (Environmental Sciences), University of Lancaster
Professional qualifications	Associate Chartered Accountant. Institute of Chartered Accountants in England and Wales
Country experience	Australia, 17 years UK, 11 years USA, Europe, Middle East, NZ, Asia - project based

Background

Keith co-leads KPMG's specialist group that advises governments and participants in utility and other economically regulated industries on matters of industry reform, economic regulation and pricing and funding arrangements.

He has worked exclusively in this area since the inception of National Competition Policy in Australia and has wide-ranging experience of advising on and managing utility reform and its consequences.

Keith has over 12 years experience and has advised regulators and businesses on regulatory accounting and cost allocation and efficiency issues in the utilities sector. He has a detailed knowledge of Australian regulatory accounting requirements for

utilities, including drafting many of the original principles which regulators have subsequently adopted and developed.

Experience

Regulatory reporting of cost allocations and efficiencies

Legal advisors to Envestra – Independent report on a management fee claimed as a recoverable cost under the Gas Code. Keith was engaged as an expert witness to report on the efficiency of the business's cost structures. This included benchmarking, examining and explaining how operational requirements for organisational structures led to costs, and benchmarking those costs to demonstrate their efficiency. An Appeal Tribunal accepted the report and agreed that the management fee was a recoverable cost.

Legal advisors to Multinet - Independent report on a management fee claimed as a recoverable cost under the Gas Code. Keith was engaged as an expert witness to report on the efficiency of the business's cost structures. Keith used benchmarks, cost modelling of staffing structures and referred to corporate legal and regulatory obligations to provide an independent assessment of the efficient non-capital costs of a distribution business where management and governance services are provided to the business by other entities. Following the submission of this report, the regulator's Final Decision substantially increased the amount of recoverable non-capital cost.

Electricity Transmission Network Owners Forum (ETNOF) - Transmission Cost Allocation Guidelines 2007 -Keith assisted ETNOF to critique and draft a submission on Cost Allocation Guidelines published by the Australian Energy Regulator.

Transend Networks Ltd - Keith led a KPMG team that drafted a "Cost Allocation Methodology" required by the Australian Energy Regulator, and for Transend, an accompanying cost allocation and regulatory reporting procedures and process manual.

Related party transactions. Keith advised a network business on the business risks and regulatory implications of regulatory requirements for related party disclosures, that were inconsistent with Accounting Standards.

Electricity industry regulatory accounting guidelines. Keith was engaged by industry to critique the *Queensland Competition Authority's Guidelines* (2005). He demonstrated its significant practical limitations and inconsistencies with Accounting Standards.

Electricity industry ring-fencing guidelines. Keith provided an electricity utility with a draft submission on the jurisdictional regulator's draft guideline. He demonstrated significant practical difficulties that also would not have assisted the regulator to achieve his objectives.

Independent Pricing and Regulatory Tribunal of NSW – Review of audit requirements for electricity industry price cap variables. Keith was engaged by IPART to provide an independent critique of criticism of the audit regime recommended changes to the audit regime to make it more light-handed and consistent with Auditing Standards.

Independent Competition and Regulatory Commission, ACT – Licensed electricity, gas, water and sewerage utilities Performance reports 2003-04, 2004-05 and 2006-07. Keith led small KPMG teams that provided the ICRC with substantial assistance to compile these comparative performance reports and commentaries.

Accounting Information for Office of the Regulator-General, Victoria. Keith surveyed the accounting and management information capabilities of regulated business to help the regulator to determine appropriate information requirements.

AER/Australian Competition and Consumer Commission – Accounting Ring Fencing Guidelines for Gas Transmission Businesses. Keith critiqued a jurisdictional regulator's guideline as a basis for accounting ring fencing for gas transmission pipeline service providers, and subsequently drafted a guideline for the Commission.

Major New Zealand gas distribution and transmission business – Advice on regulatory accounting requirements. Keith assisted a major gas network business to comply with the New Zealand Commerce Commission's Avoided Cost Accounting Method ("ACAM") for regulatory financial reporting.

Office of the Tasmanian Electricity Regulator – Electricity Industry Regulatory Accounting Guidelines. Keith developed regulatory accounting guidelines for distribution and transmission businesses.

Review of regulatory accounting submission. Keith has been engaged by different electricity networks to review regulatory accounts for compliance with regulatory requirements, prior to submission.

ACCC – Review of Airport Regulatory Accounts. Keith undertook a high level review of the first airport regulatory accounts submitted to the ACCC. The objective was to also assess airport operator compliance with the guidelines issued by the ACCC.

Australian Competition and Consumer Commission – Review of Electricity Transmission Business Co Regulatory Information Guidelines. Keith reviewed and provided advice to the ACCC on proposed regulatory information guidelines and subsequently drafted revised Guidelines that were published in 2001.

Office of Regulator-General, Victoria ("ORG"). Shortly after its establishment, Keith was seconded to the ORG for a 15 month period to manage and implement the process of acquiring and analysing regulatory accounts from electricity distribution businesses. He also provided the ORG with day-to-day advice on regulatory financial and accounting issues.

ACCC. Keith organised and participated as a key speaker at a one-day workshop held with the ACCC on regulatory accounting, that explored both issues of principle and practice.

Office of the Regulator-General, Victoria. Keith initiated the first practical steps to obtain regulatory accounting information from electricity distribution businesses in Victoria.

Electricity

Transpower New Zealand – Network operating cost benchmarking. Keith advised on the robustness of its approach to benchmarking network operating costs for regulatory purposes.

Electricity industry disaggregation and reform in Korea Keith led KPMG teams that:

- reviewed the draft pool rules for the Korean electricity market and advised the vertically integrated Korea Electric Power Corporation (KEPCO) on the practical implications for the disaggregation of distribution and retail businesses;
- developed demand side management strategies for the disaggregated businesses; and
- assisted with development of a pool price risk management strategy ("vesting contracts") for KEPCO.

Network revenue submission. Keith advised the Northern Territory's Power and Water Corporation on its submission.

Assessment of potential for cross-subsidies in a vertically integrated energy utility. Keith reviewed the potential for economic cross-subsidies both within the utility and with other parties.

NEM Entry Costs. Keith advised a utility on how the capital and operating costs associated with NEM entry might be recovered through regulatory pricing mechanisms.

Independent Pricing and Regulatory Tribunal of NSW – Review of electricity industry regulatory model. Keith led a team that provided an independent review of the robustness of its electricity network pricing model.

Business Analysis Modelling in the Electricity Industry. Keith was involved in designing a financial model of the Victorian electricity distribution businesses.

Department of Treasury and Finance Victoria – Review of Distribution Business ("DB") Submissions to the 2001 Electricity Price Review. Keith advised on the implications of the DB submissions.

Electricity Industry Enquiry Panel – New Zealand Regulatory Information Requirements. Keith compared regulatory information and reporting requirements between regimes in Australia and the UK, in the context of the New Zealand regulatory environment.

Energy retailing

Electricity retailer gross margin benchmarking. Keith has undertaken a range of benchmarking studies for retailers (and network businesses) to establish benchmarks of operating costs and margins. This involved both empirical and analytical comparisons, the latter building up cost models based on benchmarked inputs.

Assessment of a gross retail margin for franchise electricity retailers. Keith led a KPMG team that was engaged by Queensland Treasury to assess a benchmark efficient gross margin.

Assessment of cost allocations and the bases of CSO payments for electricity supply. Keith advised the NT Power and Water Authority on appropriate responses to government guidelines on and a regulator's review of, these issues.

Gas

Gas industry licensing and code regime in South Australia. Keith worked with the Essential Services Commission of South Australia to develop the industry licensing and code regime and associated regulatory requirements.

Cost allocation in the gas industry. Keith has worked with gas pipeline operators in Australia and New Zealand to develop and explain regulatory models to attribute costs to pipeline businesses.

Development of a cost allocation model for gas businesses. To assist a gas business gain regulatory approval for access arrangements, Keith led a KPMG team that developed a cost allocation model.

Gas Access Arrangements - Independent Pricing and Regulatory Tribunal New South Wales ("IPART"). Keith helped to analyse pricing proposals included in a major pipeline operator's Access Arrangement proposals. This work included the development of a financial model and options for cost allocation. Keith has also reviewed for IPART pricing and cost allocation models.

Gas & Fuel Corp. Keith conducted a benchmarking review.

Water

Utility – Assessment of efficient overhead and indirect costs for regulatory purposes. Keith advised a major utility on the potential for efficiency improvements in indirect and overhead costs. This included reviewing cost accounting and allocation processes, and staffing structures.

Other

Financial Modelling – Forecasting. Keith has completed numerous assignments which required the production of cost forecasting models to help analyse the financial implications of proposed transactions. Financial modelling assignments include assessing significant transactions for Crown Casino, Wool International, Gold Mines of Kalgoorlie, Bell Resources and ACI.

Benchmarking training – University of Melbourne and Council of Capital City Lord Mayors. In these engagements, Keith provided both benchmarking training and advice on its practical implementation.

Legal advisors to BHP Billiton (BHPB) - Options for providing access to the Mt Newman railway. Keith provided an independent report on the commercial and regulatory options for providing access, in connection with an access dispute.

C Sources of information

- ACCC, Draft Regulatory reporting guidelines for gas pipeline service providers, May 2004
- AER Draft Decision, Roma to Brisbane Pipeline 2012-13 to 2016-17, April 2012
- AER, Electricity Distribution Network Service Providers Cost Allocation Guidelines, June 2008, Section 2.2.2, p 9
- AER, Electricity Transmission Network Service Providers, Cost Allocation Guidelines, September 2007
- AER, Final decision, ElectraNet transmission determination 2008-09 to 2012-13, April 2008
- AER, Final decision, Queensland distribution determination 2010-11 to 2014-15, May 2010
- Australian Government, Australian Accounting Standards Board, AASB3, Business Combinations
- Australian Pipeline Limited, Item for Approval No 6, Board Meeting, 26/02/07, Acquisition of Alinta's Pipeline Operation Agreements for APG's Assets and Associated Assets (All States)
- Frontier Economics, Review of capital expenditure on the Roma to Brisbane Pipeline access arrangement, April 2012
- KPMG, Regulatory accounting treatment of Pipeline Management Agreement termination payment, October 2011
- National Electricity Rules, Version 49, Chapter 6, Economic regulation of distribution services
- National Gas Rules, Version 12
- Queensland Competition Authority, Interim Price Monitoring, Information Requirements for 2011/12, June 2011
- RSM Bird Cameron, Review of capital expenditure for the Roma to Brisbane Pipeline access arrangement