1. *The Initial Capital Base (ICB)*

- *The submission is that DORC does not set a maximum for the ICB and that other valuation methods, as well as the reasonable expectations of the service provider under the prior regime, should also be taken into account whether or not they exceed an economically efficient valuation.*

- *It is correct that the Supreme Court of Western Australia – Court of Appeal EPIC Decision states (in para. 178) the following:-*

> *"…..s8.11 is to be accepted for what it says, rather than seeking by implication to read much more into it. The expert evidence indicates that when the nature of the DAC and DORC valuation methodologies is understood, it can be accepted that, normally, the value of an existing pipeline would fall within that range of values. In a case, however, where there has been an acquisition of a pipeline on the open market before the commencement of the Code, that circumstance may take the application of s8.10 outside of what is normal within the meaning of s8.11, because a sale at market value may well involve the capitalization of some monopoly returns."*

- *S8.11 states:-*

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

- *We would note that the EPIC Decision also stated in para.179 that:-*

> *"At least in cases where an investment in a pipeline before the Code applied is made in the course of an arm's-length commercial transaction, and is based on a sound commercial assessment of the value of the pipeline in the circumstances then prevailing and anticipated, it is not apparent from the terms of the Act and the Code that the intention is, automatically and necessarily, to preclude consideration of the investment, or the interests of the service provider in recovering it together with a reasonable return, or the **reasonable expectations** **(our emphasis)** under the preceding regulatory regime of such a service provider. The interests of such a service provider may well be in tension with other considerations, but it is not apparent that their exclusion is intended by the Act and the Code."*

- *However, it is emphasised that although the EPIC Decision refers to "reasonable return" and "reasonable expectations" that may "well involve the capitalisation of some monopoly returns" it is as well to note the Collins English Dictionary explanation of the word "reasonable":-*

> *"rational; just; fair; proper; moderate; not exorbitant".*

- *The preceding would suggest that excessive or <u>more</u> than "rational", "just", "fair", "proper", "moderate", and "exorbitant", returns or expectations are not envisaged within the ordinary understanding of the word "reasonable". An average transportation tariff (sought by EAPL in its original access arrangement application) considered to be about 40% above what is regarded as the economically-efficient price, based on consideration of s2.24 and s8.10 provisions by the ACCC (ACCC draft decision) would, we submit, not be regarded as "reasonable" as the embedded monopoly rents would be seen as "exorbitant". In this regard, the actual price paid for the MSP is relevant, as are the terms and conditions of the purchase under the previous regime. Moreover, it is unlikely that under that regime, valuation and pricing would be based on a <u>notional</u> asset valuation methodology that contains an indexation for inflation and seeks to replicate replacement costs moving forward! The correct asset valuation methodology used would be DAC.*

- *Moreover, in the EPIC Decision, para. 187 in part, states:-*

> *"It must be remembered, however, that once the basic issues of interpretation are clarified it is for the Regulator, not this Court, to consider and weigh those factors and objectives.* ***<u>It is for the Regulator to assess the relevance and weight of each of these factors and objectives and to exercise the discretions that are committed by the Code to him</u>*** *" **(our emphasis)**.*

2. *<u>Monopoly Returns</u>*

- *It has been submitted that the EPIC Decision states that monopoly returns should be considered and may be a legitimate business interest of the service provider.*

- *In our view para. 155 of the EPIC Decision is relevant:-*

> *"The reasons of the Regulator in the draft decision reveal that he was well alert to another relevant aspect of the operation of the first limb of s8.1(d). Future investment decisions in pipelines might well be distorted were it the case that any price paid by a service provider to acquire a pipeline, no matter how uncommercial, mistaken or reckless, should automatically be recognized as the Initial Capital Base or value of the pipeline for the purposes of the Code. This would encourage the payment of excessive and unrealistic prices to acquire a pipeline in the expectation that the purchase price would be recovered over the life of the pipeline under the Code. It follows that a price paid for a pipeline before the Code applied to it, will need to be carefully evaluated by the Regulator for the purposes of s8.1(d)."*

- *Paragraph 189 is also relevant:-*

> *"The mere fact that it was a price paid at public tender is not necessarily determinative of any of these issues. Quite obviously, Epic may have erred in its assessment of value or had unreasonable expectations. It may have had reason to pay higher that true market value. Despite what has been urged on us, these are not matters of this Court to attempt to evaluate or to decide. It is for Epic to seek to justify to the Regulator that the price it paid represented market value at the relevant time and to establish its reasonable expectations*

under the previous regulatory regime. In this regard it is fair to say that the manner in which Epic sought to demonstrate that it paid market value for the DBNGP has shown itself, in the course of these proceedings, and in the Regulator's draft decision, to be well capable of being misunderstood in more than on material respect, namely the financial provision for future expansion of the capacity of the pipeline, and the period over which it proposed it should recover its capital investment. That will be for Epic to seek to remedy, if it is so minded."

- *In this regard we would expect the Commission to carefully evaluate the purchase price, the sale processes, the information memorandum available, and the expectations regarding future tariffs in the context of para. 155, above.*

- *It is also relevant that the EPIC Decision points to the last words of s8.1 which expressly recognise that it may be necessary in a particular case for the Regulator to determine that one or more of those objectives should prevail over others. Moreover, as stated in para. 136:-*

  "…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 (g)".

- *S2.24 states:-*

  "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 and 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 Pipelines;*
  d. ***the economically efficient operation of the Covered Pipelines; (our emphasis)***
  e. ***the public interest, including the public interest in having competition in markets (whether or not in Australia); (our emphasis)***
  f. ***the interest of Users and Prospective Users; (our emphasis)***
  g. *any other matters that the Relevant Regulator considers are relevant."*

3. *The Alleged ACCC's Fairness Test*

- *It is alleged that the ACCC had applied a "fairness" test in its draft decision and is therefore, inconsistent with the EPIC Decision which sets out in detail the manner in which sections 2.24, 2.25, 3 and 8 should be interpreted and applied.*

- *We do not consider that the ACCC has applied a "fairness" test as alleged. All the ACCC appears to have done is to do no more than expected under Code provisions as the regulator of the MSP. In particular, the ACCC has weighed all the factors under the relevant provisions of the Code and has then exercised discretion as permitted under the Code. Again, para. 187 of the EPIC Decision is relevant:-*

> *"The submissions of the parties have provided reason for some more extensive observations than might otherwise have been relevant with respect to the interpretation of the factors in s2.24, s8.10 and s8.11, and the objectives in s8.1. It must be remembered, however, that once the basic issues of interpretation are clarified it is for the Regulator, not this Court, to consider and weigh those factors and objectives. It is for the Regulator to assess the relevance and weight of each of these factors and objectives and to exercise the discretions that are committed by the Code to him."*

4. *Legitimate Business Interests*

- *It has been submitted that if competing section 8 requirements are unable to be reconciled, or in deciding which should prevail, the Regulator should have regard to the broader considerations of section 2.24 and give weight to the legitimate business interests of the service provider under section 2.24.*

- *Section 2.24, in including the legitimate business interests of service providers as a factor which the regulator must take into account also includes other factors, viz:-*

> *"d. the economically efficient operation of the Covered Pipelines;*
> *e. the public interest, including the public interest in having competition in markets (whether in Australia or not in Australia);*
> *f. the interests of Users and Prospective Users:*
> *g. any other matters that the Relevant Regulator considers and relevant."*

- *Again, we note that para. 187 of the EPIC Decision reiterates the discretion given to the regulator under the Code.*