AUSTRALIAN COMPETITION TRIBUNAL

WA Gas Networks Pty Ltd (No 1) [2011] ACompT 14

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| Citation: | WA Gas Networks Pty Ltd (No 1) [2011] ACompT 14 |
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| Parties: | **WA GAS NETWORKS PTY LTD (ACN 089 531 975)** |
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| File number: |  |
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| Tribunal: | **JUSTICE MANSFIELD (President)****PROFESSOR D ROUND****MR R DAVEY**  |
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| Date of decision: | 28 October 2011 |
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| Date of hearing: | Heard on the papers |
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| Date of last submissions: | 13 September 2011 |
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| Place: | Adelaide |
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| Category: | No catchwords  |
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| Solicitor for WA Gas Networks Pty Ltd: | Jackson McDonald |
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| Solicitor for Economic Regulation Authority: | Talbot Olivier |
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| IN THE AUSTRALIAN COMPETITION TRIBUNAL |  |
|  | ACT 3 of 2011 |

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| RE: | APPLICATION UNDER S 245 OF THE NATIONAL GAS LAW FOR A REVIEW OF A FULL ACCESS ARRANGEMENT DECISION MADE BY THE ECONOMIC REGULATION AUTHORITY OF WESTERN AUSTRALIA IN RELATION TO WA GAS NETWORKS PTY LTD PURSUANT TO RULE 64 OF THE NATIONAL GAS RULESWA GAS NETWORKS PTY LTD (ACN 089 531 975)Applicant |

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| tribunal: | JUSTICE MANSFIELD (PRESIDENT)PROFESSOR D ROUNDMR R DAVEY |
| DATE OF ORDER: | 28 OCTOBER 2011 |
| WHERE MADE: | ADELAIDE |

THE TRIBUNAL ORDERS THAT:

1. The applicant be given leave to apply for review of the decision of the Economic Regulation Authority of Western Australia published on 28 April 2011 in relation to the access arrangement in respect of the Mid-West and South-West Gas Distribution Network of the applicant.
2. The application is stood over for further directions.

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| IN THE AUSTRALIAN COMPETITION TRIBUNAL |  |
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| re: | ApplICATION UNDER SECTION 245 OF THE NATIONAL GAS LAW FOR A REVIEW OF A FULL ACCESS ARRANGEMENT DECISION MADE BY THE ECONOMIC REGULATION AUTHORITY OF WESTERN AUSTRALIA IN RELATION TO WA GAS NETWORKS PTY LTD PURSUANT TO RULE 64 OF THE NATIONAL GAS RULES.WA GAS NETWORKS PTY LTD (ACN 089 531 975)Applicant |

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| tribunal: | justice MANSFIELD (president)PROFESSOR D ROUNDMR R DAVEY |
| DATE: |  |
| PLACE: |  |

**REASONS FOR DECISION**

# APPLICATION

1. The Applicant owns and operates the Mid-West and South-West Gas Distribution System (GDS). It comprises various connected and non-interconnected sub-networks covering the Perth metropolitan area and country centres from Geraldton in the north to Busselton in the south. It excludes the Kalgoorlie and Albany networks.
2. The Applicant has applied for leave pursuant to s 245(1) of the National Gas Law (NGL) to apply to the Tribunal for a review of the decision of the Economic Regulation Authority of Western Australia (ERA) published on 28 April 2011 (the Reviewable Decision). That decision was made pursuant to Rule 64 of the National Gas Rules (NGR) in respect of the access arrangement for the GDS. It is a “reviewable regulatory decision” as defined in s 244 because it is an “applicable access arrangement decision” and a “full access arrangement decision” as defined in s 2. It made revisions to an access arrangement in place of revisions to an access arrangement submitted by the Applicant to the ERA under s 132 of the NGL which the ERA did not approve.
3. The pipeline services provided by the Applicant via the GDS comprise Reference Services and Non-Reference Services. The Reference Services are five gas Haulage Services designated A1, A2, B1, B2 and B3 and differentiated by the user’s load and type of delivery facilities, together with five Ancillary Services being Deregistering a Delivery Point, Applying or Removing a Meter Lock, and Disconnecting or Reconnecting a Delivery Point.
4. The predecessor of the ERA on 18 July 2000 approved an access arrangement in respect of the GDS in accordance with the *Gas Pipelines Access (Western Australia) Act* 1998 (WA Act). On 10 August 2005, the ERA approved revisions to the access arrangement to apply from 25 August 2005. That arrangement was revised with the approval of the ERA to apply from 25 August 2005. The Applicant was given to 31 January 2010 to lodge proposed revisions to that arrangement.
5. This application arises from the process of revisions. On 29 January 2010, the Applicant submitted proposed revisions to that arrangement in accordance with Rule 52 of the NGR. A draft decision on that application was published by the ERA on 17 August 2010 pursuant to Rule 59, and a revised proposal was submitted by the Applicant pursuant to Rule 60 of the NGR on 8 October 2010 (Applicant’s Proposed Revised Access Arrangement). The ERA did not accept the Applicant’s Proposed Revised Access Arrangement. One issue which attracted particular discussion was the appropriate means for measuring Debt Risk Premium (DRP).
6. On 28 February 2011, pursuant to Rule 62 of the NGR, the ERA published a Final Decision on the Applicant’s Proposed Revised Access Arrangement for the GDS. The ERA did not accept the Applicant’s Proposed Revised Access Arrangement.
7. The Applicant has separately applied in ACT 1 of 2011 to review the Final Decision of the ERA. An issue has arisen in that proceeding as to whether the Final Decision is a reviewable regulatory decision. The Tribunal has separately addressed that application, although its substantive grounds are effectively the same as the substantive grounds of this application: see *WA Gas Networks Pty Ltd (No 2)* [2011] ACompT 15. In this matter, there is no such issue.
8. Following the Final Decision, and further communications between the applicant and the ERA, on 28 April 2011, the ERA published the Reviewable Decision. Under the Reviewable Decision, the revised access arrangement commenced on 12 May 2011.
9. The reasons for the Reviewable Decision are discerned in the Reviewable Decision, and to an extent from the Final Decision.

# CONSIDERATION

1. The “National Gas Access (Western Australian) Law text” as defined in s 7 of the WA Act applies as the law of Western Australia. It comprises the National Gas Law (NGL), which is a Schedule to the *National Gas (South Australia) Act 2008* (SA). By s 7 of the WA Act, the NGL has the force of law in Western Australia, as adapted to Western Australia by the implications of ss 7(3) and (4), and modified by the amendments in Schedule 1 to the WA Act. It is convenient to refer to the NGL as so modified as the NGL in these reasons.
2. Section 245 of the NGL entitles “an affected or interested person or body”, with the leave of the Tribunal to apply to the Tribunal for a review of a reviewable regulatory decision. This application satisfies the formal requirements in s 245(2). It is also made within the time imposed by s 247 of the NGL.
3. There are particular matters the Tribunal must address before granting leave for the review.
4. First, it must be satisfied under s 248 that there is a serious issue to be heard and determined as to whether a ground of review set out in s 246(1) exists. Section 246(1) specifies the available grounds. The application is in terms consistent with those grounds in all respects. Nevertheless, the Tribunal must be satisfied that there is a serious issue to be heard and determined by the application.
5. Secondly, s 249 of the NGL imposes as a threshold that the amount that is specified in or derived from the Reviewable Decision must exceed either the lesser of $5m or 2% of the average annual regulated revenue of the covered pipeline service provider.
6. Section 250 precludes the Tribunal from granting leave if submissions to the ERA were not made within the time prescribed under the NGL, the NGR, or as required by the ERA. That does not arise in relation to this matter.
7. The Tribunal is also given power to refuse to grant leave in the event that it is satisfied that the Applicant has misconducted itself in certain specified ways: s 251. Again, that does not arise in the present circumstances.
8. There is no dispute that the Reviewable Decision is one which is reviewable under s 245.
9. The topics or matters specified in grounds of review in the application are:
10. Method of Calculating Rate of Return under Rule 87 of the NGR;
11. CPI methodology;
12. Cost of Bridging Finance;
13. Working Capital
14. Regulatory Capital Expenditure under reference Tariff Variation Mechanism; and
15. Template Haulage Contract.
16. Each of these matters has been the subject of detailed submissions, and to a small extent is explained by the affidavit evidence as to background filed in support of the application.
17. The ERA makes no submissions that the requirement of s 248 of the NGL, namely that there is a serious issue to be heard and determined, is not made out.
18. The Applicant has submitted that the first issue, namely the method of calculating rate of return on capital, involves two separate propositions.
19. The first is that the general approach taken by the ERA to determining the rate of return on capital as required by Rule 87 of the NGR failed to satisfy Rule 87(1) as the ERA did not make its determination as one commensurate with prevailing conditions in the market for funds and the risks in providing reference services. Instead, the Applicant contends, the ERA directly used a weighted average cost of capital (WACC) as modelled, when it should have adjusted that modelled output consistent with evidence that established that the prevailing conditions and risks required an upward adjustment of the modelled output.
20. The second is that the ERA made a number of specific errors in the decision about the components used to calculate the rate of return on capital. They include the assessment of the market risk premium, the assessment of the value of gamma so that it was overstated, and the assessment of the cost of debt.
21. The Tribunal is satisfied from the uncontroverted submissions of the Applicant that with respect to those matters, there is a serious question to be tried. The Applicant presented evidence to the ERA to show that the financial model used by the ERA included elements or assumptions which did not reliably produce an output to accord with the terms of Rule 87(1). It further contended to the ERA that, when properly applying Rule 87(1), the appropriate real pre-tax WACC was 9.6% rather than the WACC of 7.4% adopted by the ERA in the Reviewable Decision. Again, its submissions identify evidentiary material to support its claim.
22. The Applicant’s submissions further address the conventional formula used to calculate the nominal pre-tax WACC, and its adjustment to a real pre-tax rate of return. It explains why and how certain elements of the formula, or the assumptions underlying its elements, were not in all respects applicable having regard to the terms of Rule 87(1), and it identifies the material it relies (and relied) upon to support those contentions. It argues that the ERA came to its conclusion on the appropriate WACC in error by failing to consider the evidence and its contentions, including in particular the contentions and material presented by the Applicant following the Final Decision. It refers to the decision of the Tribunal in Application by *Energex Limited (Gamma) (No 5)* [2011] ACompT 9 as reaching a different conclusion from that of the AER in relation to the value of gamma in that formula. The submissions explain why the Applicant, in this general context, says that the market risk premium used by the ERA was erroneous, having regard to evidence about the state of the financial market at the material time. Reference was made above to the particular focus on the Debt Risk Premium in the period between the Final Decision and the Reviewable Decision. The Debt Risk Premium fixed by the ERA was based upon the Bond Yield Approach, despite the Applicant’s contentions that such an approach failed to properly have regard to the prevailing conditions in the market for funds and despite the material it provided to support the proposition. Finally, in this stream of contentions, the Applicant complains that no allowance was made for pre-financing costs despite its claim for their inclusion and that each of those costs should have been allowed.
23. The Tribunal is not, of course, in a position to assess the ultimate merits of any of those contentions. Its task at this point is to determine whether they each give rise to a serious issue to be determined. It is not entirely clear whether such an assessment must be made in relation to each of the separate but related matters referred to above, or whether the assessment is to be made on the more general topic of either the proper application of Rule 87(1) or the discrete topics under the heading of “WACC/Rate of Return” (as it appears in the Applicant’s submissions) which encompass several matters. Section 248 of the NGL refers to a “serious issue” as to whether a ground for review set out in s 246(1) exists. The grounds for review in s 246(1) are general in their terms, encompassing a material error or errors of fact which collectively are material, or that the discretion of the ERA was “incorrect” or that its decision was “unreasonable” having regard to all the circumstances. The latter grounds may encompass a number of particular matters which support or give rise to an assessment of incorrectness or unreasonableness.
24. As the Tribunal noted above, the ERA has made no submission on whether the Tribunal should be satisfied that the Applicant’s grounds for review constitute serious issues to be tried. In the Tribunal’s view, having considered the Applicant’s submission on the matters referred to under the heading “WACC/Rate of Return”, the Applicant has so satisfied the Tribunal. The brief recital of the particular contentions, and the material referred to in support of them, in this matter has enabled the Tribunal to reach that view in relation to the individual matters specified, and consequently as to the more general question of the proper application of Rule 87(1).
25. The second block of contentions is headed “CPI Methodology”.
26. In essence, the Applicant contends that the ERA erred in its approach to the escalation of cost to take account of inflation because it:
27. understated the starting capital base of the relevant assets by escalating the previous opening capital base to take account of inflation using the national CPI instead of the Western Australia CPI figures; and
28. understated the value of capital expenditure incurred in the period of the previous access arrangement firstly by using the national CPI rather than the Western Australia CPI figures, and secondly by making the inflation adjustment from the end of each year rather than from the mid-point of each year (which the Applicant contends more properly reflects that capital expenditure occurs through the course of a year);

so that the starting capital basis for the access arrangement under the Reviewable Decision was also understated.

1. It is clear those matters were put to the ERA, and that they concern grounds for review under s 46.
2. On the basis of the Applicant’s contentions, the Tribunal considers that there is a serious issue to be determined on each of those two contentions.
3. The historical and forecast expenditure was incurred or to be incurred in Western Australia, at least predominantly, and some material showed that, for the relevant periods, the Western Australia CPI had exceeded and was expected to exceed the national CPI rate and that the two CPI forecasts could have different uses. There is also, as the submissions acknowledge, material to support the ERA’s approach consistent with the “national gas objective”. The issue as to whether the ERA’s discretion in selecting the national CPI measure was unreasonable is a serious one to be determined. The second of the matters raises a clear issue upon which different views might be held. The ERA, in the Reviewable Decision appears to have taken the view that the issue over the long term was a relatively minor one, and that the objective of modelling consistency supported its approach, as well as consistency with other regulators. Again, those issues satisfy the test in s 248.
4. The third block of contentions is headed “Cost of Bridging Finance”.
5. The ERA excluded a claim for bridging finance costs incurred by the Applicant said to be a result of delayed implementation of the NGL/NGR as they were not costs appropriately classified as operating expenditure, incurred by a prudent service provider acting efficiently, in accordance with good industry practice, to achieve the lowest sustainable costs of delivering pipeline services.
6. The Applicant contends that that decision, concerning an issue put to the ERA, reflects error on the application of Rule 91(1) and is an unreasonable exercise of the discretion prescribed by Rule 40. Those matters fall within the grounds specified in s 246 of the NGL.
7. In its detailed submission, the Applicant referred to the chronology of events leading up to the introduction of the *National Gas Access (WA) Act 2009* (WA), assented to on 1 September 2009, whilst the proposed new access arrangement was being advanced. It asserts that it had to secure bridging finance for the period of January 2010 to June 2010 and incurred very significant costs in establishing that bridging finance facility. While the ERA did not dispute that the bridging finance costs were operating expenditure, it was considered that they did not meet the criteria in Rule 91(1). The Applicant disputes that finding. That is a matter which is a serious one: there are reasonable competing viewpoints.
8. The fourth block of contentions is headed “Working Capital”.
9. The ERA made no allowances for the Applicant to recover the costs of a Working Capital facility in determining the total revenue earned over the regulatory period.
10. This was despite the claims of the Applicant that by reason of a three monthly meter reading cycle, which is a term of the reference service provided for the majority of the delivery points on the GDS, and the conduct of invoicing, receipts and payments, resulted in a requirement for working capital. It was also said that the costs of reducing the billing cycle are greater than the costs of obtaining the working capital facility. The failure of the ERA to allow that claim is expressed in terms of the grounds for review available under s 246 of the NGL.
11. Rule 76 prescribes how the total revenue for each year of the access arrangement is determined. It does not refer to the cost of working capital, but the Applicant contends ss 23 and 24 of the NGL supports its claim. The ERA apparently took the view that the end of year modelling approach it applied removed the need for a separate specific allowance for working capital, and had regard to the nature of the Applicant’s business as an “inventory intensive business”, so that it was not satisfied that the claim should be allowed.
12. In the view of the Tribunal to state the competing views contained in the submissions in this instance is sufficient to lead to the conclusion that there is, on the identified topic, a serious question to be heard and determined. It has reached that view.
13. The fifth block of contentions is headed “Regulatory Capital Expenditure Under Reference Tariff Variation Mechanism”.
14. The Applicant claimed an allowance for capital expenditure during the access arrangement period as a result of unforeseen regulatory requirements, because it could not vary the reference tariff to recover a return on that expenditure or to recover depreciation during the access arrangement period. It argues that including such capital expenditure in the opening capital base is a “partial and delayed” recompense, in effect mandated by Rule 92(2).
15. There is, in relation to this topic, a different view between the Applicant and ERA as to whether “regulatory capital expenditure” in the reference tariff variation mechanism is consistent with the requirements of the NGL and the NGR. That is a matter upon which minds may reasonably differ. In the Tribunal’s view, it gives rise to a serious issue to be heard and determined.
16. The sixth and final block of contentions of the Applicant is headed “Template Haulage Contract”.
17. This complaint arises from the ERA refusing to include certain significant terms and conditions into the template haulage contract on the basis that the terms and conditions concerned “commercial matters” which should be left open to the parties to negotiate.
18. The Applicant argues that Rule 48(1)(d)(ii) of the NGR directs that the access arrangement must specify the terms and conditions on which the reference service will be supplied, so that it includes “commercial matters”, and that there is in fact no clear line between those terms and conditions required by Rule 48(1)(d)(ii) on the one hand and “commercial matters” on the other, including the specification of a cost plus GST tariff. The terms which the ERA declined to include dealt with matters such as whether the reference service is GST exclusive or inclusive and liability for other costs and taxes, security that may be required for performance by a prospective user, the ownership of intellectual property, and standard representations and warranties by the parties.
19. In addition to the dispute about what is required or permitted by the relevant provisions of the NGR, the Applicant argues that the ERA decision on this topic arose from particular errors, so that the terms of the template haulage contract also involved grounds for review which fall within the scope of s 146. It is clear that these matters were presented to the ERA for consideration prior to the Reviewable Decision.
20. In the Tribunal’s view, the contentions of the Applicant on this matter also indicate that there is a serious issue to be heard and determined.
21. There is a reasonable viewpoint as to what is required or permitted under Rule 48(1)(d)(ii) of the NGR for the template haulage agreement in relation to the terms and conditions which the ERA declined to include, and whether on the other hand the ERA would be exceeding its function by addressing terms and conditions which it considered involved a form of tax regulation.
22. There are a number of clauses in the revised proposed template haulage contract referred to by the Applicant where that dispute can be seen to arise: clauses 10.1, 10.2, 16 and 20.1; and the reference to “upstream persons” in the context of clauses 5.10(c)(ii) and 16.4 relating to indemnities; clause 8.3 concerning user access; and clause 10(c) concerning *force majeure.* It is clear that the competing views of the Applicant and the ERA have a reasonable foundation, so that s 248 is satisfied.
23. It is apparent from the above that the analysis of the matters sought to be raised by the Applicant has descended to detail only to the limited extent necessary for the Tribunal to form its views on the pre-requisite for leave to review specified in ss 248 of the NGL. The Tribunal’s reasons for this decision have been reached after consideration of the considerably more detailed submissions of the Applicant. The details of those submissions have, in effect, enabled the Tribunal to reach its conclusions particularly about the existence of the several serious issues to be heard and determined.
24. The ERA accepts that the revenue threshold is satisfied with respect to the matters raised by the Applicant that relate to the amount of revenue that may be earned by the Applicant if it were successful in its application.
25. The topics or matters referred to in (1), (2), (3) and (4) of [18] above relate to the amount of revenue that may be earned by the Applicant derived from the Reviewable Decision. That refers to the amount of revenue forgone over the regulatory control period if the amounts the subject of the review application are excluded from the regulatory asset base, and are or may be calculated by the aggregate value of the grounds of review which meet the serious issue threshold: *Application by ElectraNet Pty Ltd* [2008] ACompT 1 at [59]; *Application by Jemena Gas Networks (NSW) Ltd (No 2)* [2011] ACompT 5 at [4]. The Tribunal has considered the affidavits of Deborah Mary Evans of 4 July 2011 and Allan Ross Hudson of 13 September 2011 which addresses particular matters referred to in the affidavit of Wayne Trevor Blakiston of 19 August 2011, an analyst of the ERA. The Tribunal is satisfied that the aggregate value of the amounts derived from the Reviewable Decision which are the subject of the Application, over the whole of the regulatory period, are well in excess of the prescribed threshold of 2% of the average annual regulated revenue of the Applicant. That is so, irrespective of the approach adopted to estimating the rate of return on capital, and the additional modelled scenarios which exhibit a range of variations of outcomes on particular topics. Those matters would not bring the cumulative amounts in issue below the threshold. As that evidence is not disputed on this Application, it is not necessary to refer to it in detail.
26. As the Tribunal is satisfied that each of the topics or matters in the Application gives rise to a serious issue to be heard and determined, it is not necessary to address the revenue impact of each of those topics or matters separately.
27. For those reasons, the Tribunal gives leave to the Applicant to apply to the Tribunal for a review of the Reviewable Decision. It notes that the reasons for the Reviewable Decision are, to a degree, informed by the reasons of the ERA for the Final Decision.

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| I certify that the preceding fifty-six (56) numbered paragraphs are a true copy of the Reasons for Decision herein of the Honourable Justice Mansfield (President); Professor D Round and Mr R Davey. |

Associate:

Dated: 28 October 2011