



**MINISTERIAL COUNCIL ON ENERGY – PROPOSED
INDUSTRY LEVY**

**SUBMISSION IN RESPONSE TO STANDING
COMMITTEE OF OFFICIALS’ DISCUSSION PAPER**

APRIL 2004

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1. Introduction

Epic Energy welcomes the opportunity to comment on the Ministerial Council on Energy (“MCE”) Standing Committee of Officials’ Discussion Paper entitled “*Application of the Industry Levy to fund the AER and AEMC*”, dated March 2004 (“Paper”).

Epic Energy has made submissions on the issue of the funding of regulators in various forums (including most recently, to the Productivity Commission for the purposes of the Gas Access Regime review). In addition, it has been involved in the preparation of the submission made by the Australian Pipeline Industry Association (“APIA”) in response to the Paper.

It therefore endorses the entirety of that APIA submission. In particular, it reiterates the submissions made by APIA that:

- The costs of regulation should be borne from consolidated revenue in order to realise the objectives of national competition policy reform.
- Whatever the regime that is implemented by the Ministerial Council on Energy, the regime must exhibit at least the following minimum attributes:
 - Only those who benefit from the regime should pay the costs. This means service providers should not bear any costs.
 - Not all of the costs incurred by Regulators in carrying out all powers and functions are to be recovered from service providers and users; where Regulators exercise enquiry functions or planning functions, the costs must be recovered from government.
 - If service providers are to be the collection agency, there must be a guaranteed “pass through” of all costs and the costs that service providers incur in acting as the collection agency.
 - There must exist sufficient levels of transparency and accountability to ensure costs are efficiently and appropriately incurred by Regulators. This includes at least the following measures:
 - The setting of budgets by an independent body such as parliament;
 - The ability for stakeholders to comment on budgets of regulators before they are approved;
 - The disclosure of sufficient information by Regulators to enable scrutiny of costs actually incurred by Regulators;
 - The ability for stakeholders to challenge the validity of costs imposed on stakeholders, including the reasonableness of these costs;
 - Incentives for Regulators to ensure costs do not exceed the current levels of expenditure and that costs are kept to a minimum.
 - Most importantly however, only reasonable costs can be passed on – as per the Supreme Court case for Epic Energy.
 - Establishment costs should not be borne by industry - particularly with the number of consultants that have already been engaged by the MCE and each jurisdiction as part of this process.
 - The users of gas pipelines must not bear an unfair proportion of the costs of the super regulator.

- It is neither fair nor reasonable for industry to be required to pay the legal costs of actions in which the Regulator is shown to have erred, or the costs of preparation of a flawed decision.

As stated in the APIA submission, Epic Energy and other regulated pipeline service providers in Western Australia, are subjected to the most draconian and unfair cost recovery regime in Australia – being the regime as set out in the Gas Pipelines Access (Funding) Regulations 1999 and the Economic Regulation Authority (Transitional) Regulations 2003 (“WA Funding Regime”). This regime does not exhibit any of the minimum attributes that Epic Energy considers must exist in a cost recovery regime. It has led to Epic Energy being billed for in excess of \$3 million in charges representing costs incurred by the Regulator over a 4 year period.

The issue of what costs the WA Gas Pipelines Regulator could recover has been the subject of a judicial determination by the Western Australian Supreme Court. Notwithstanding that decision, the WA Regulator still adopts the position that all costs of the regulator are to be borne by industry.¹

Therefore the primary purpose of this submission is to supplement the APIA submission by demonstrating why the WA Funding Regime should be avoided at all costs as a model to use in the MCE reform process. This is done by:

- Outlining the types of costs that the Regulator has attempted to pass on to Epic Energy and other Service Providers under the WA Funding Regime.
- Providing examples of actions by the WA Regulator, the costs for which have been sought to be included in industry levies notwithstanding the decision of the Supreme Court in the Epic Energy funding charges legal challenge².
- Providing a summary of the decision of the Supreme Court of Western Australia in relation to the WA Funding Regime.

¹ See Economic Regulation Authority web page under the heading “Fees and Charges” – www.era.wa.gov.au

² Epic Energy (WA) Nominees Pty Ltd & Anor v Dr Kenneth Comminos Michael Western Australian Independent Gas Pipeline Access Regulator [2003] WASC 156

2. Costs Of Regulation Under The WA Funding Regime

Under the WA Funding Regime, there are two mechanisms for the recovery of costs - standing and service charges. Standing charges are intended to be for the recovery of common costs, while service charges are intended to recover costs incurred in carrying out specific functions or powers.

The Regulator has taken the view that all of its costs can be recovered via these mechanisms. Moreover, the Regulator's ability to spend money remains effectively unchecked. While the Minister sets a budget for the Regulator, Epic Energy's experience is that this is merely a "rubber stamping" process, as the budget for the DBNGP Access Arrangement process was arbitrarily increased on numerous occasions, as is evidenced by the following table:

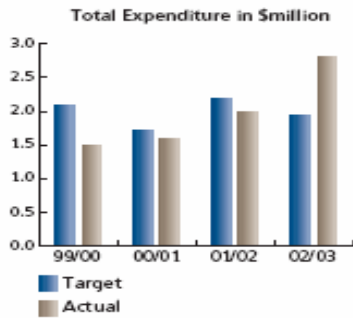
Date	Budget	Increase (%)
1999 – 2000	150,000	-
2000 – 2001	185,000	18.92%
Q3 & 4 2001	390,000	52.56%
Q1 & 2 2002	535,000	27.10%
Q3 & 4 2002	1,320,000	59.47%
Q1 & 2 2003	1,755,000	24.79%
Q3 & 4 2003	2,055,000	14.60%

In addition, the standing charges, which reflect the "overhead" or "common" costs incurred by the Regulator have increased without any proper justification. The following table shows the increases since the Funding Regulations were introduced in 2000.

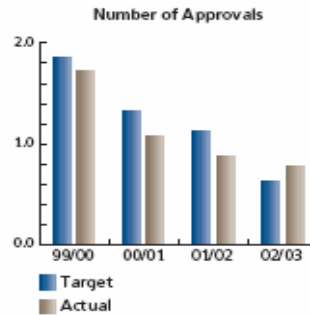
%	18.12	3.31	5.35	20.31	3.91	49.00	OffGAR/ERA
2000	GGT	Kambalda	Parmelia	AGN	Origin	Epic	Total
1st Qtr	31,327	5,722	9,249	35,113	6,760	84,714	172,885
2nd Qtr	38,351	7,006	11,323	42,986	8,276	103,709	211,650
3rd Qtr	43,584	7,962	12,868	48,852	9,405	117,861	240,532
4th Qtr	43,028	7,860	12,704	48,228	9,285	116,355	237,459
	156,290	28,550	46,145	175,179	33,725	422,638	862,526
2001	-	-	-	-	-	-	-
1st Qtr	41,864	7,647	12,360	46,923	9,033	113,207	231,035
2nd Qtr	49,333	9,012	14,566	55,296	10,645	133,407	272,259
3rd Qtr	50,770	9,274	14,990	56,906	10,955	137,292	280,187
4th Qtr	48,300	8,823	14,261	54,137	10,422	130,612	266,555
	190,267	34,756	56,177	213,262	41,056	514,518	1,050,036
2002	-	-	-	-	-	-	-
1st Qtr	52,668	9,621	15,550	59,033	11,365	142,424	290,661
2nd Qtr	57,097	10,430	-	63,998	12,321	154,401	298,247
3rd Qtr	53,194	9,717	-	59,623	11,478	143,847	277,859
4th Qtr	56,387	9,892	-	63,295	11,706	149,801	291,081
	219,346	39,660	15,550	245,949	46,870	590,473	1,157,848
%	20.66	2.75	-	23.39	3.30	49.90	
2003	-	-	-	-	-	-	-
1st Qtr	65,246	8,685	-	73,868	10,422	157,588	315808.28
2nd Qtr	72,080	9,594	-	81,604	11,513	174,094	348885.22
3rd Qtr	72,267	9,619	-	81,817	11,543	174,547	349793.26
4th Qtr	62,779	8,356	-	71,075	10,028	151,631	303869.66
	272,372	36,255	-	308,364	43,506	657,860	1,318,356

These increases have occurred notwithstanding that, by the Regulator’s own admission, his workload has diminished over time. The following tables from the Regulator’s annual report for 2003 show that notwithstanding the diminishing workload, its costs are ever increasing, including more staff. Moreover, it is taking longer to complete its regulatory approval processes.

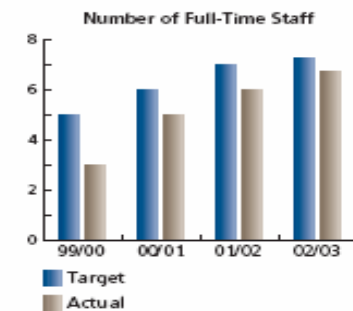
Expenditure



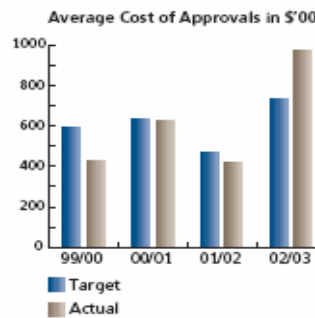
Number of Access Arrangements Approved



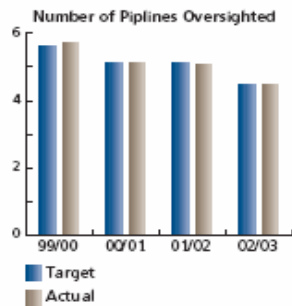
Staff



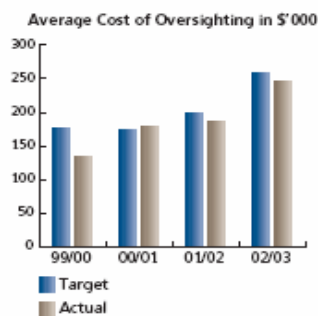
Cost of Approving Access Arrangements



Number of Regulated Pipelines Oversighted



Cost of Oversighting Regulated Pipelines



In addition to the above, Epic Energy notes that with the transfer of the functions of the Western Australian Independent Gas Pipelines Access Regulator to a new Economic Regulation Authority ("ERA") early in 2004, there has been an increase in the number of employees in the Gas Division, and each position is at higher levels than was the case with the prior Regulator. This is so, notwithstanding the fact that the Regulator's workload deriving from gas pipeline systems has not increased.

3. Actions of the WA Regulator sought to be recovered by WA Funding Regime

As Epic Energy has previously mentioned, the WA Funding Regime encourages the Regulator to engage consultants and incur costs without any effective requirement to be accountable or transparent.

In the case of the assessment of the DBNGP access arrangement alone, as far as Epic Energy is aware, the WA Regulator has engaged at least 10 separate consultants for assisting in various parts of the regulator approval process, although it must be pointed out that even this can not be confirmed because the Regulator has refused to confirm whether consultants have been engaged through its lawyers for specific purposes. The table attached to this submission as Attachment 1 provides a breakdown of the wide ranging types of consultants used in the regulatory process and the costs they have incurred.

Epic Energy submits that the structure of the regime in Western Australia does not encourage the Regulator to act in a transparent or accountable way in the case of engaging and passing on the costs of consultants. Following are some examples of the lack of transparency and accountability in the DBNGP assessment process:

- The passing on of the costs of consultants used in undertaking work which Epic Energy considers is outside the scope of the regulatory function. Epic Energy is aware that the Regulator's office has written on at least four occasions to media commentators threatening legal action in connection with articles published by these commentators which the Regulator considered either misleading or defamatory. It appears that the Regulator, as a statutory office, is unable to allow public comment of its decisions.
- The Regulator spent a significant amount (at least \$70,000 as far as Epic Energy is aware) on commissioning a rate of return report seeking to substantiate the Regulator's approach on rate of return at a time where this was a major issue being discussed by the PC in its review of the Gas Access Regime and also when there was only 1 regulatory approval process on foot at the time. Epic Energy raised this concern with the Regulator at the time. Attachment 2 contains Epic Energy's letter of 30 January 2004 and the Regulator's response.
- The Regulator has refused to release all information that was relied upon for the purposes of the regulatory approval process.

Following are examples of the lack of transparency of the Regulator in relation to the process for recovery of its costs:

- Firstly, the Regulator has recently agreed to provide a summary attached to each invoice which outlines in very limited detail, what the costs that

have been incurred relate to. Attachment 3 is an example of such an invoice and summary. As one can see, there are a significant number of consultants engaged but there is very little information to enable Epic Energy to determine whether these invoices relate to costs properly incurred by the Regulator, and are therefore recoverable from service providers.

- Secondly, the Regulator has refused to disclose details of whether consultants have been engaged via other consultants, essentially as subcontractors. Epic Energy would be overly concerned were this to be the practice and moreso, were it done to preserve some confidentiality over the nature of work being undertaken by the subcontractor.

4. WA Supreme Court – Regulator Funding Legal Challenge³

The background to this case was that the WA Regulator had attempted to require Epic Energy to pay, by way of service charges purportedly issued pursuant to the Gas Pipelines Access (Western Australia) (Funding) Regulations 2000, all of his costs incurred in his capacity as Regulator that he unilaterally considered were related (directly or otherwise) to his assessment of the access arrangement for the DBNGP. Epic Energy had persistently refused to pay at least his costs related to his participation in any legal challenges that stemmed from this assessment process. The budget for these costs is approximately \$800,000. Given that the Funding Regulations did not provide a mechanism to challenge or otherwise question the service charges but rather allowed the regulator to commence debt recovery proceedings for any amount unpaid, Epic Energy was forced to commence an application in the WA Supreme Court seeking declarations concerning the proper interpretation of the Regulations.

On 18 August 2003, the Supreme Court of Western Australia delivered its judgement in relation to this challenge.

While a copy of the decision is publicly available, the key points from the decision are as follows:

- The Court declared that the Regulator could not recover by way of the Funding Regulations, the costs incurred in his participation in judicial review proceedings - either as a service charge or a standing charge. This includes the costs incurred in the proceedings and the draft decision legal challenge. The primary reason for this is that the Court had ultimate power to determine who bears the burden of such costs and the Regulator can not use the Funding Regulations as a means of sheeting home his costs to someone else via a statutory mechanism. In both court actions, the Court ruled that the Regulator should bear its own costs.
- The Court also declared that the Regulator may only impose service charges that pass on reasonable costs of a type which it was reasonably necessary or convenient for the Regulator to incur. This is probably the most significant aspect of the decision from a national perspective, particularly given that the Ministerial Council of Energy announced recently that it intends to implement a user pays system to fund regulatory agencies.
- This will require the regulator to not only be more circumspect about what costs he can pass on to pipeline owners but also what information he provides to justify these costs. Up until now, the Regulator has refused to provide that justification. This should require the regulator to be more transparent and accountable in relation to costs he seeks to pass on.

³ Epic Energy (WA) Nominees Pty Ltd & Anor v Dr Kenneth Comninos Michael Western Australian Independent Gas Pipeline Access Regulator [2003] WASC 156

- It is important to note that the Court concluded that Epic Energy did not succeed on its argument that the Funding Regulations were invalid as a whole, or on its other arguments requiring that standing charges only be imposed where the Regulator performed a function in respect of the relevant service provider during the relevant quarter. Also, the Court did not accept the argument that the Funding Regulations did not permit full cost recovery by the Regulator. However, there was no finding that there was an intention to achieve full recovery of costs. Nonetheless, any costs that are passed on can only be costs reasonably incurred by the Regulator.

Attachment 1 – Standing Charge Breakdown

See attached

Attachment 2 – Rate of Return Correspondence with ERA, 30 January 2004

See attached

Attachment 3 – Example of service charge from Regulator

See attached