**IN THE MATTER OF**

**A Draft Decision by the Essential Services Commission**

- and -

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**A response to a Draft Decision by the Essential Services Commission**

**Affidavit of Robert Andrew Forsyth Dunlop**

I, Robert Andrew Forsyth Dunlop, of 101 Collins Street, Melbourne, Victoria, state as follows:

1 I am currently an Executive Director with responsibility for Infrastructure and Resources transactions, based in Melbourne.

2 I make this affidavit from my personal knowledge.

3 This affidavit is made in support of a submission to be made by Multinet Gas (DB No.1) Pty Ltd and Multinet Gas (DB No.2) Pty Ltd (trading as the Multinet Gas Distribution Partnership) ("Multinet") in response to the Gas Access Arrangement Review Draft Decision of the Essential Services Commission in relation to Multinet dated 28 August 2007.

4 My background is in accounting and investment banking. I have been employed by investment banks for over 20 years and prior to that I worked for a major chartered accountancy firm for 3 years. For the last 5 years I have dealt almost exclusively with regulated assets, and have been involved in the consolidation of this industry in Australia. I have been a member of the Victorian Government's Infrastructure Planning Council and have chaired the VECCI Summit on Infrastructure.

5 At page 72 of the Draft Decision the Commission refers to the circumstances in which the OSA was entered into as "part of a broader restructuring arrangement". Some reference is also made to this arrangement, known as the Shearwater transaction, at page 76.

6 During 2002, Aquila, a US based energy utility, held a portfolio of Australian assets including:

- a 25.5% indirect legal interest in what was known as the Energy Partnership Group ("EPG") (ultimately beneficially then owned 48.23% by Aquila and 51.77% by the Australian Energy Fund No. 2, a trust managed by AMPCI on behalf of its clients). EPG held 100% of Multinet;
- a 22.5% indirect interest in AlintaGas Limited ("Alinta") through a 50% ownership of Western Australia Gas Holdings Pty Ltd ("WAGH"). United Energy Limited ("UEL") owned the other 50% interest in WAGH, giving UEL an indirect interest in Alinta of 22.5%. The remaining shares in Alinta were held by the public giving them a 55% share in Alinta.
- Aquila also had a 34% indirect interest in UEL through a majority interest in the Power Partnership Pty Limited which held a controlling stake in UEL. The balance of UEL was held indirectly by AMPCI (23.05% - as Aquila's partner in the Power Partnership) and directly by the public (42.95%) through its ASX listing.

7 Aquila and AMPCI held pre-emptive rights over each other's interests in the various assets, including in Multinet.

8 During the early part of 2002 Aquila experienced significant pressure on its business position as a result of market issues in the US and it began a process of divesting its interests in its Australian assets including Multinet.

9 In about July 2002 Alinta appointed Macquarie Bank to assist it to consider participation in the sale of those Aquila interests. I was one of the joint lead advisers to Alinta on the Shearwater transaction.

10 Aquila engaged Salomon Smith Barney ("SSB" now Citibank) to advise them on the divestiture of its Australian assets. SSB commenced this process by running a competitive sales process that involved potential Australian and international buyers.

11 Towards mid October 2002, it became apparent that the sales process was not going to yield a result for Aquila. During this time, Alinta and AMPCI

discussed a joint acquisition and entered into direct negotiations with Aquila. At the end of October 2002 Alinta and AMPCI presented a formal in principle proposal to Aquila in a joint capacity.

12 Over the next 2-3 months, Alinta, AMPCI and Macquarie worked to bed down the structure of the bid, complete the financial analysis (including the levels of the OSA fees) and negotiate with the mandated group of banks to obtain the necessary approvals for funding.

13 As a financial investor AMPCI required an operator for the assets and one which was prepared to take operating risk to allow cash flow certainty. It was AMPCI's view that any operator would also have to take a minority equity position as this would ensure the operator's short term incentive for efficiencies was balanced with it long term interest as a holder of equity. This model was also required by the banks to the consortium who insisted that any operator had to hold a minimum interest in the asset it operated of at least 15% as a condition to their financing.

14 Alinta was willing to take a minority equity position and the operator role in this model. In reality, Alinta had little choice in this as AMPCI held the pre-emptive rights and it was then very clear that unless a deal could be concluded with AMPCI, then there would be no role for Alinta.

15 Although the structure of the Alinta / AMPCI bid was concluded towards the end of 2002, price negotiations with Aquila continued for some time. On Christmas Day 2002, Aquila amended its price expectations upwards, and during the period up to 1 January 2003, it was considered that the deal may not proceed. The reason for this is that both AMPCI and Alinta believed that they had stretched themselves as far as each of them could go as far as financial metrics were concerned, the debt constraints were at their maximum levels and all structural elements (including the OSA) had been bedded down in terms of pricing, risks and returns.

16 In a meeting with SSB and Aquila in early January 2003, the Alinta / AMPCI price was tabled. Aquila viewed the price, pushed the offer back at Alinta / AMPCI and stormed out of the meeting declaring that the deal was off.

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17 The CEO of Alinta met his counterpart from Aquila in Collins Street about 30 minutes after the meeting. This resulted in a toe to toe yelling match, and all parties were convinced that this was the end of the transaction.

18 Later that evening, I rang the Aquila senior manager, Mr Perkins, and agreed to meet him at his hotel in order to have a renewed discussion about price. During that meeting, Mr Perkins made it very clear that he would negotiate on price, but it had to be higher than the price currently on offer.

19 At an Alinta / AMPCI / Macquarie meeting shortly after my meeting with Mr Perkins, we had what we refer to as the "bucket meeting". The bucket meeting required all participants to state (for the final time) what their issues were (either financial or otherwise). The participants put their issues into the bucket and agreed which of them would have responsibility for resolving them.

20 At the conclusion of the bucket meeting, it was agreed that there was a multi million dollar deficiency in the price that was needed to conclude the deal with Aquila. Each of the parties was asked to have internal meetings to determine how each could contribute to the funding shortfall.

21 The transaction represented a number of ambitions for Alinta. Alinta wanted to grow from a Western Australian gas distribution company to a national operator and investor in infrastructure assets through building both scale and breadth in its commercial operations. It saw the opportunity to do that through the strategic development of a business model based on a national services business.

22 It had been frustrated in its ambition in part through the restriction arising from the 45% interest held by WAGH. Also it had become possible in late 2002 for that interest to rise above 50% when a cap at 45% had been removed. The transaction allowed Alinta to remove the risk that control of the company could change without the interests of the minority being fully considered and at the same time, through removing the constraint of the 45% cornerstone interest, its growth ambitions could be furthered. With the prospect of the realisation of these national growth ambitions arising from the transaction Alinta subsequently changed its name to Alinta Limited (from AlintaGas Limited).

23 Securing long term services agreements with Multinet and UEL, including rights to match offers that could be made by alternative contractors in 2013 for Multinet and 2011 for UED and subsequent renewal dates, was to underpin Alinta's national services business and so there were aspects of the securing the agreements other than price which were of considerable value to Alinta.

24 Consequently Alinta saw a number of benefits from the transaction and at a final price negotiation in May 2003, Alinta agreed that all of these benefits were worth meeting the funding deficiency to secure the deal with Aquila.

25 My attention has been drawn to the comments made by the Commission in its Draft Decision at page 72 about a "substantial payment on the order of $16 million" being made by AAM or Alinta "to secure the OSA contract" and, at page 76, that "no explanation has been given as to the prudency…of requiring AAM to pay $16 million for the contract. It is a reasonable inference that a contractor that is required to pay such an amount may seek to recover that expense through the remuneration it received under the contract".

26 As I have explained, when Alinta agreed to make a payment to secure the transaction and the value it would derive from securing its own growth strategy through obtaining services agreements, the fees payable under those contracts had been settled. At the time Alinta agreed to make the payment, there was no re-modelling of the assumptions underpinning the transaction including the fees that would be payable under the contracts. There was no relationship between the payment made by Alinta and referred to by the Commission and the fees payable under the services contracts. There was no 'side payment' that inflated the fees under those contracts.

SWORN by the said )
Robert Andrew Forsyth Dunlop at )
Melbourne in the State of Victoria )
this 23rd day of October 2007 )
)

Before me

Anne Murphy Cruise
ANNE MURPHY CRUISE
Solicitor + Barrister.