

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 Peter Scott Lowe

I, Peter Scott Lowe, of 58 The Eyrie, Eaglemont, Victoria, state as follows:

- 1 I am currently a director of Multinet Group Holdings Pty Ltd and Multinet Gas (DB No.1) Pty Ltd and Multinet Gas (DB No.2) Pty Ltd.
- 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 I am currently a non-executive director of six private companies and their subsidiaries. I have had extensive experience at senior management level in all aspects of finance including as a chief financial officer for both Australian and US public companies in the energy utilities sector.
- 5 Between 1994 and 1999, I was the chief financial officer of United Energy Limited ("UEL"). In 2000, I was appointed the chief financial officer of Aquila, Inc, a US based energy utility and major shareholder of Multinet. In December 2001 I was the managing director of Utilicorp Australasia, with total responsibility for the Australasian operations of Aquila including Multinet.
- 6 I have a Bachelor of Commerce and a Master of Business Administration from the University of Melbourne and I am a Fellow of CPA Australia and a member of the Australian Institute of Company Directors.



My role in the Shearwater transaction

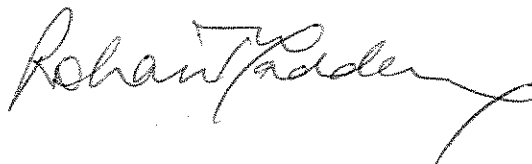
- 7 At the beginning of 2002 Aquila, together with AMP Capital Investors (“AMPCI”) (the fund management arm of AMP Limited then known as AMP Henderson), held interests in UEL, Multinet and AlintaGas Limited (“Alinta”). Any references to AMPCI below refer to AMPCI in its capacity as trustee and/or manager of its clients’ interests.
- 8 During 2002 Aquila experienced difficult business conditions in the United States and decided to exit its Australian assets. AMPCI was interested in an acquisition of those assets and in February 2002 I was retained by AMPCI to work on a proposed transaction having by that time left Utilicorp. I worked on the proposed acquisition of Aquila’s interests by AMPCI and ultimately Alinta from February 2002 until July 2003 when the acquisition reached completion.
- 9 I had responsibility for certain aspects of the proposed transaction. My primary responsibility was negotiating the detail of the operating services agreement (OSA) with Alinta for Multinet (as well as for United Energy Distribution) to implement the high level terms and conditions for the OSA that were agreed by the negotiators for the transaction overall.

AMPCI’s objectives in the transaction

- 10 With Aquila’s proposed departure, AMPCI developed a strategic objective to maximise value for its clients by holding majority interests in infrastructure assets while appointing a capable operator to operate those assets. It intended to establish a diversified energy fund to hold those assets acquired from Aquila, which it subsequently did and which is now known as DUET. Consistent with the assets being acquired from Aquila, it was AMPCI’s intention that DUET would seek to achieve its investment objectives by targeting energy utility assets:
- (a) with established historical or contracted volume levels;
 - (b) which were governed by regulatory regimes or have long term supply agreements; and
 - (c) which were operated by capable operators.

The intention was to establish a fund with stable cash flows which would enable an offering to the market of securities with a secure and stable yield.

- 11 Accordingly, it was important in the transaction that AMPCI secure operating agreements with an operator that was capable, willing to take an equity interest and



willing to take operating risk. It was important that the operator take an equity interest to achieve a balance between the incentive to seek out operating efficiencies in the short term and the long term benefits of holding equity in valuable assets. It was important that the operator take operating risk to achieve a secure cash flow position for the fund.

- 12 After consideration by AMPCI of a number of operator possibilities, by late in 2002 AMPCI and Alinta submitted a joint in principle bid to Aquila which was subsequently accepted subject to negotiations which ensued over many months.

How the fees were struck

- 13 The negotiation of the general terms of the OSA took place between late 2002/early 2003 when the fundamental commercial structure of the deal had been agreed and July 2003 when the transaction completed. Whilst the OSA was not signed until the completion of the transaction on 23 July 2003, the detail of many of the commercial terms had been resolved by March 2003. In particular the calculation of the fees to accord with the commercial deal agreed in late 2002 had been agreed in principle by March 2003.
- 14 To maximise the value of the investment in Multinet it was in the best interests of AMPCI that the fees payable under the OSA be as low as practicable.
- 15 Conversely, AMPCI had no incentive to pay above that level for the services to be provided to Multinet. AMPCI had a positive commercial imperative to ensure its equity returns were maximised because any reduction in those returns would adversely affect the value of the investment vehicle (DUET) it was planning to establish. At all relevant times it was the intention of AMPCI that DUET would hold a significant majority interest in Multinet (and this subsequently transpired with DUET holding 79.9 per cent of the equity in Multinet with Alinta holding the remaining 20.1 per cent). In these circumstances DUET derives 80 cents from every dollar of earnings of Multinet and so it follows that an uncommercial service arrangement if it existed would damage that flow of earnings to DUET, its distributions to unit holders and its value.
- 16 Consistent with its objectives, AMPCI had at its disposal an important piece of information to use to determine the fees under the OSA. This was the knowledge it had that the then cost of operating the business was very low as a result of efficiencies that had been introduced. AMPCI decided to set the fee at that level.



- 17 AMPCI was aware through board representation that Aquila had innovative service models which had been introduced to Multinet and that the business was being operated effectively and efficiently. Multinet had been privatised by the Victorian Government in 1998 and it had thus been the subject of private sector discipline for many years.
- 18 For my part as chief financial officer of Aquila and managing director of Utilicorp Australasia it was also my observation from 5 years exposure to Multinet that there had been a significant reduction in its cost profile. In addition, the size and rate of reduction in costs to that time made it a real risk that costs would increase as the business stabilised. From my observation of the business and my confidence that Multinet led the industry in terms of cost minimisation but was at risk of cost increases, I was very confident that the setting of the OSA fee at the forecast level for the business at the time was a level of cost that would achieve AMPCI's objectives. It simply would be a good deal for AMPCI.
- 19 The process for the calculation of the fee in early 2003 was as follows. The budget for operating Multinet for 2003 had been set as part of the 2003-2005 Financial Plan prepared in late 2002. That budget reflected not only the reduction of costs over time discussed above but also the particular pressure Aquila had put on operating costs leading up to the sale of Multinet to improve the profitability of the business and so to maximise the sale outcomes.
- 20 For these reasons AMPCI decided that budget for 2003 should form the starting point from which to derive the operating fee for the services that were to be performed by Alinta under the OSA. Adjustments were then made to subtract from that budget the cost to the Multinet group of services that were not to be performed by Alinta. These were costs then being incurred by Multinet and which related to matters that were to be the responsibility of the asset owner (for example licence fees) and corporate services that were to be necessary for the conduct of the Multinet gas distribution business (for example treasury services, corporate overheads and management services). In this way, the budget for 2003 for that part of the operations of Multinet that was to be provided by Alinta under the OSA became the operating fee for those services.

The nature of the fee

- 21 To achieve AMPCI's objective noted above of a secure cash flow to support the stable and secure nature of the securities to be offered in DUET it was important that operating cost risk be taken by Alinta and so the fee was fixed for the initial period of




the OSA after which there was to be renegotiation. As discussed above, given my knowledge of the then cost performance of Multinet I was satisfied that not only had Multinet achieved a low cost level but there was a real risk that the cost of operating the business may rise. Accordingly contracting with Alinta and locking in the fee at the budget level for 2003 was considered the best option for AMPCI to achieve its objective.

Relevance of other payments

22 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 \$16million” being made by AAM or Alinta “to secure the OSA contract” and, at page 76, that “no explanation has been given as to the prudence...of requiring AAM to pay \$16million 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”.

23 During the negotiation of the OSA between early 2003 and when the fee was settled and OSA was signed, I was not aware that any such payment was proposed to be made and accordingly I negotiated the OSA with Alinta without reference to such payments. There was no relationship between the OSA fee and any other payment. As I have explained above the OSA fee was set by reference to the budget for operating the Multinet business at the time.

SWORN by the said)
Peter Scott Lowe at Melbourne in)
the State of Victoria this 18th)
day of October 2007)
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Before me

Robert Padden

SOLICITOR
38/530 COLLINS STREET
MELBOURNE