6 July 2001

Dr Ken Michael
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Dear Dr Michael

Draft Decision on the GGT Pipeline

I am writing on behalf of the Australian Pipeline Industry Association (APIA) in relation to the Draft Decision on the *Goldfields Gas Transmission* (GGT) Pipeline published by the *Western Australian Independent Gas Pipelines Access Regulator* (the Regulator) on 10 April 2001.

The issues dealt with in this submission are sovereign risk resulting from the Draft Decision, commercial considerations relating to the GGT Pipeline and the wider issue of regulatory predetermination by Offgar.

The Association is extremely concerned that the Draft Decision, if implemented, would impose an unacceptable level of sovereign risk in relation to past, and future, infrastructure development in the state of Western Australia.

The Goldfields Gas Pipeline, as the Regulator is fully aware, is covered under the *Goldfields Gas Pipeline Agreement Act 1994*. The specific objectives of such agreements include provision of security over the life of major projects. According to the Government of Western Australia (*Department of Resources Development: In Agreement – How Major Developers Obtain Project Security through State Agreement Acts*):

> *"Certainty of project operation and management is assured because Agreement provisions can only be changed by mutual consent of State and developer."*

The Draft Decision on the GGT Pipeline represents a unilateral attempt to override the fundamental objectives of one such State Agreement without regard to the wider legal and economic consequences (eg sovereign risk implications) or adequate consideration of the Regulator's authority to determine matters of law beyond its enabling legislation.

Despite evidence of the Service Provider acting in good faith to meet the dual obligations of regulation under the State Agreement and compliance with the National Code, the Regulator appears to have taken a restricted and less than

considered view of the situation. This is clearly demonstrated in the Draft Decision where the Regulator states (in Part B, on page 107):

> *"that the reasonable expectations of persons under the regulatory regime that applied to the pipeline prior to the commencement of the Code in respect of the value of pipeline assets are that the provisions of the Code would apply".*

This reflects inadequate consideration of Section 8.10(g) of the National Code and fails to take into consideration the legislative intent behind the specific wording of the enabling Act, to which the Regulator is bound.

It would have been reasonable for the Regulator to accept the existing Access Arrangements for the GGT Pipeline by facilitating the translation of the pre-existing Open Access conditions under the GGT Pipeline State Agreement into the Service Provider's obligations for Open Access under the National Code. That would recognise the intentions of the legislature in enacting the State Agreement. To suggest otherwise is to place the question of sovereign risk firmly on the table.

APIA understands that, in this case, the Service Provider has attempted to provide a transparent tariff justification that conforms to the requirements of the National Code, but remains consistent with the tariff determination methodology under which the pipeline is presently regulated. APIA also understands that the GGT Pipeline is afforded exemption from certain aspects of the National Code under explicit clauses written into the State Agreement. The fact that the Service Provider submitted to the Code shows that the Service Provider was seeking to act in good faith. This observation is reinforced by the fact that the Service Provider chose to continue to offer the existing transportation charge despite having justified a higher tariff (close to that established by the original owners) and despite its right under the State Agreement to publish that tariff increase.

The Draft Decision is dismissive of the need to consider *"the basis on which Tariffs have been (or appear to have been) set in the past..."* in determining the Capital Base under Section 8.10(f) of the National Code, thus failing again to address obligations under the enabling Act and the commercial intent behind it. **In this respect, the Regulator does not appear to have given sufficient regard to the mechanisms available under the National Code to avoid conflict with the State Agreement.**

The low WACC value proposed by the Regulator is cause for major concern as the pipeline in question faces a risk profile which mirrors that of a minerals project. The position is significantly different from that of a normal "distribution" pipeline project which has a much more diversified risk.

The prospects for load growth for the GGT pipeline are restrained by:

- the geographical location of future resource discoveries in the region (if they are to be serviced by pipeline delivered gas, rather than competing energy sources, such discoveries need to be within a reasonable distance of the pipeline); **and**

- world prospects for, and volatility in, the supply of mineral commodities.

It is a matter of major concern that the Draft Decision does not adequately recognise the nature, characteristics and risks of the GGT system and the characteristics of the markets it services. Important consequences of the Draft Decision (quite apart from

the sovereign risk issues for Western Australia) will be a likely negative impact on long term infrastructure investment, with flow-on effects likely to be borne by the Western Australian economy for many years to come, and the view of the investment community of the merits of State Agreements.

The GGT Pipeline Draft Decision indicates to the pipeline industry considerable evidence of regulatory predetermination and potential bias in the consideration of the interests of Users and the Service Provider. It would appear that the Western Australian State Regulator has a predetermined "policy" of pursuing mandatory tariff reductions regardless of merit or history of pipeline ownership or tariff path. This predisposition has been articulated by the Regulator in the Tubridgi Pipeline System Draft Decision [1] and the Parmelia Draft Decision[2].

In applying this "policy" to the GGT Pipeline, the Regulator's draft decision is questionable on several grounds. The GGT Pipeline was built by a joint venture of regional mining companies with the express (but non exclusive) purpose of delivering cheaper energy to their own mine sites. While the GGT Pipeline was always intended to have the capacity to accommodate third party customers, the downstream projects owned by the original proponents continue to comprise the majority of the pipeline throughput.

These are the parties that, under the existing regulatory framework and in full knowledge that they would be divesting ownership of the pipeline, established the tariffs which they would themselves be willing to pay into the future. APIA contends that there can be no better measure than the commercial view of customers on such matters, and that the Regulator's view must be set aside.

There are other aspects of the Draft Decision that APIA considers to be inappropriate. Under the existing regulatory regime, the GGT Pipeline was assessed to have a 42 year asset life for regulatory purposes; this reflected the original owners' (now the major customer base) risk horizon. It is reasonable to assume that the original owners had a good understanding of issues such as the term of their State Agreement/license rights and their assessment of project reserve estimates. The State regulatory authority evidently sanctioned this regulatory life, along with the intrinsically linked gas demand forecast. In the Draft Decision, the Regulator has disregarded these considerations and quite capriciously claimed that a life of 70 years is appropriate to the pipeline. Other than regulatory precedent (which fails to distinguish between assets having quite different characteristics), the Regulator provides no substantive justification in seeking to mandate a longer asset life than was originally determined by existing regulation. In this respect, the Regulator's judgement is flawed.

The Regulator has also sought to impose an early tariff review trigger mechanism. Such arrangements clearly add to the attendant regulatory risk and are totally inconsistent with, and confiscate rights created by, the State Agreement. It is also worth noting that trigger mechanisms, while not precluded under the National Code,

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[1] OffGAR, Draft Decision: Access Arrangement, Tubridgi Pipeline System, 7 August 2000, (Part B, p81), *"For the most part, the criteria for a balance of interests has been that regulated tariffs should not exceed existing tariffs".*

[2] OffGAR, Draft Decision: Access Arrangement, Parmelia Pipeline, 27 October 1999, (Part A, p19), *"...is consistent with the reasonable expectations of Users that regulation will provide for an overall reduction in tariffs".*

are clearly intended to be applied in circumstances where the approved access arrangement period is in excess of five years (refer Section 3.18).

In view of the above comments, the Association urges the Regulator to reconsider its position from first principles in a manner which does not crystallise sovereign risk and which maintains the integrity of the State Agreement which, along with the Code, forms part of the law of Western Australia.

Yours sincerely

Allen Beasley
Executive Director

Cc Mr Parkhurst, Office of Gas Regulation
The Hon Eric Ripper, Treasurer
The Hon Clive Brown, Minister for State Development
The Hon Colin Barnett, Leader of the Opposition
The Hon John Day, Opposition Spokesperson for Resources Development, Energy and the Pilbara