



September 28, 2001

Dr. Ken Michael
Western Australian Independent
Gas Access Regulator
Level 6
197 St. Georges Terrace
PERTH, WA 6000

Attention: Mr. R. Pullella

Dear Sir;

**DRAFT DECISION ON DAMPIER TO BUNBURY NATURAL GAS PIPELINE
ACCESS ARRANGEMENT**

El Paso, as a one third owner of Epic Energy, is deeply disturbed with the draft decision released by the Western Australian Independent Gas Access Regulator ("Regulator") in relation to the access arrangement for the Dampier to Bunbury Natural Gas Pipeline ("DBNGP"). The concern surrounds what El Paso and the other investors in Epic Energy see as the Regulator's incorrect application of the National Third Party Access Code ("Code") to the access arrangement for the DBNGP.

The Regulator is aware of the decision of Epic Energy to commence legal proceedings to have the draft decision set aside. These proceedings claim (among other things) that the Regulator has incorrectly applied the Code.

To augment awareness of these main contentions, El Paso believes that it is important to draw them to the Regulator's attention as part of the public consultation process commenced by the Regulator following the draft decision. However, it should be noted that the failure by El Paso to respond to specific amendments proposed by the Regulator should not be taken to mean that El Paso agrees with them. A specific submission will be made in this regard by Epic Energy.

The Regulator's misapplication of the Code can be grouped into 2 main categories:

- The Regulator has not considered, or at the very least has not given appropriate weight to, certain principles and objectives that the Code requires him to consider and give appropriate weight to when making a decision.

- Because the principles and objectives have not been considered, the draft decision gives rise to certain consequences, which are in direct conflict with the stated aims of the Code.

1. **Required principles and objectives of the Code**

Section 8.10(g) of the Code requires the Regulator, when determining the capital base of the pipeline for the purposes of determining the tariff, to take into account the reasonable expectations of persons under the regulatory regime applying to the pipeline prior to the implementation of the Code. Section 8.10(j) of the Code also requires the Regulator to taken into consideration the price paid for any asset recently purchased by the Service Provider and the circumstances of that purchase.

Representatives of El Paso were intimately involved in the process relating to the sale of the DBNGP. As has been stated in previous submissions by Epic Energy to the Regulator, bidders for the DBNGP were advised by the State entity controlling the sale process to assume that transportation tariffs on the DBNGP would be \$1.00/GJ to Perth as from 1 January 2000. This certainty in tariffs was in consideration for the State ensuring that the sale would achieve the following public policy objectives:

- Maximising the purchase price for the sale of the pipeline.
- A commitment to the further expansion of the capacity of the pipeline so as to maximise the opportunity for the development of the state.

While it was accepted that an access arrangement would have to be lodged under the Code, it was also considered reasonable to assume that these tariffs were consistent with the application of the Code, especially given the nature of regulatory decisions that had been made by regulators at the time of the sale of the pipeline.

The reasonableness of this assumption must be given further weight given that it was not only an assumption of the shareholders of Epic Energy, but also of the syndicate of financiers who agreed to finance the purchase.

The regulator is also required to take into account and give proper weight to the public interest when approving an access arrangement. The fact that the State has already received the proceeds of the sale of the pipeline and those proceeds have been applied by the State to both reduce public debt and to provide for further public infrastructure and given the commitments given in return for the payment of the purchase price, there is an overwhelming public interest to ensure that the commitment in relation to the tariff is fulfilled.

2. Consequences of Draft Decision

The aims of the Code include the following:

- To facilitate efficient development and operation of and investment in a national market for natural gas.
- To promote a competitive market for gas in which customers are able to choose the producer, retailer or trader to supply their gas.
- To encourage the development of and investment in an integrated pipeline network.

The draft decision gives rise to a number of consequences, which are inconsistent with these aims. It is imperative that the Regulator ensure that the final decision does not give rise to such consequences. The inconsistent consequences are as follows:

- El Paso and the other shareholders of Epic Energy, invested in the DBNGP on the reasonable expectation that in return for the price paid for the asset and the commitment given to expand the pipeline, there would be certainty in the tariffs for the pipeline beyond 1 January 2000. Should this legitimate expectation not be accepted by the Regulator or not given the appropriate weight, it will further strengthen the perception that political risk must be a factor which investors in regulated assets in Australia must take into account when deciding whether to invest.

Given that projects such as pipelines require significant amounts of capital and therefore significant amounts of debt, any additional risks posed to investment will make it more difficult to source that debt. One questions how this is consistent with the aim of the Code to promote an integrated pipeline network in Australia.

- The draft decision will place Epic Energy in severe financial distress. If implemented, Epic Energy will be in breach of its covenants under its loan facility with its financiers. Not only will this ensure that Epic Energy will not realise further expansions of the pipeline but it will also place in jeopardy the ability of Epic Energy to continue its capital program to ensure the pipeline's ability to respond to the market and growth needs of Western Australia.
- A regulatory outcome which distorts investment decisions will have serious, adverse, long term ramifications on future private sector investment in public infrastructure assets such as gas transmission pipelines. Given that one of the aims of the Code is to encourage the development of an integrated pipeline network and that gas transmission pipelines require significant injections of capital to proceed and remain viable, if investor confidence is lacking as a direct result of regulatory decisions, this key objective of the Code will not be achieved.

The lack of investor confidence in the Californian energy industry due to the regulatory framework has been held to be one of the main reasons for the crisis existing in that market. Surely this consequence must be avoided at all costs.

The above consequences are evidence that the Regulator has not balanced the vested interests of all parties, including the asset owner.

Furthermore, it should be noted that the Western Australian government agreed to the introduction of the Code on the condition that an independent regulator separate to that created for the balance of the Australian states was required to oversee its application. It was considered by the State that only a state based regulator could properly take into account the unique stage of development of the gas industry in Western Australia and the specific interests that apply in this state when applying the Code.

However, as a result of the Regulator's heavy handed application of the Code, his desire to maintain a degree of consistency with decisions being handed down by other Regulators in the eastern states and the failure to properly appreciate the discretion that is afforded to him under the Code, the state specific issues in Western Australia have been ignored. This will act as a further disincentive to invest in future infrastructure in Western Australia.

El Paso therefore respectfully urges the Regulator to ensure that the final decision properly recognizes the legitimate expectations of those who invested in the DBNGP and that such decision does not have the consequences referred to above.

Sincerely,

E. J. "Jay" Holm
CEO
El Paso Eastern Pipeline Group