

28 February 2003

Dr Ken Michael
Acting Gas Access Regulator
Office of Gas Access Regulation
6th Floor, 197 St Georges Terrace
PERTH WA 6000

OffGAR
28 FEB 2003

Dear Dr Michael

DAMPIER TO BUNBURY NATURAL GAS PIPELINE (DBNGP) ACCESS ARRANGEMENT

This submission is made as a result of my deep concern about the reputation of this State and Government. My fear is that if an affordable tariff is not recommended the public interest will not be served and many State projects will stagnate and cause irreparable damage to the State economy and the international standing of the State Government.

In this I acknowledge the most vital aspect of your role is the regard you give to the public interest and the role of our Government to communicate the public interest.

I believe that you would not want the West Australian community to be misled as to what the short and long term effects of an adverse and negative result of a tariff which deviates markedly from the \$1.00/\$1.08/GJ would actually mean.

In addition, I cannot express enough concern about the recent AlintaGas media articles referring to a possible DBNGP takeover. These articles might suggest an unethical effort to take significant commercial advantage by one company over another. Given AlintaGas' role as 'contradictor' in the recent legal challenge, the community could very easily perceive that the State Government and its agencies have been exploited in Alinta's efforts to take back an asset that the State Government explicitly desegregated. Clearly, AlintaGas does not have WA public's interest at heart and I can only see if this were the case a situation where State energy costs are rising not falling.

To follow, I have raised some issues which are imperative to your assessment, contradictory to Labor's' policy and as I see it – not in the public interest of our WA community.

We have inherited a sale. We should stand by the sale.

"No Government inherits a blank canvas onto which it can paint its own picture. There's always an inheritance that limits and challenges an incoming Government. The first task of Labor is to come to grips with and sort out a number of problems."

1. Dr Geoff Gallop (2001)

The DBNGP sale process cannot be ignored. It is a sale where the purchaser has honoured all aspects of the agreement and has demonstrated it is interested and committed to growth and expansion for this State.

Epic Energy has fulfilled their purchase terms including:

- already reducing the tariff from \$1.27/GJ (1999) to the proposed \$1.00/GJ (2000)

- committing to \$875 million further development of which \$120 million has already been spent on capacity expansion
- relocating their corporate headquarters to Perth (and all associated indirect benefits).

As part of their DBNGP Access Arrangement, Epic Energy sought a \$1.00/GJ to Perth and \$1.08/GJ south of Perth (escalated at 67% CPI). Their proposal was not an ambit one rather a fair proposal which merely reflected the agreed terms of the sale.

It's time for the State to honour their agreement.

The State's Sale Objectives achieved

Epic Energy are the victims of a "*badly managed privatisation*"² – this however is still not an excuse for us to ignore that Epic Energy participated in a sale process set out by the State. This State benefited greatly from the \$2.4b sale proceeds retiring significant State debt. Epic Energy was successful because it offered the bid the State wanted. The State rejected lower bids. It did so to meet *its* sale objectives.

One of those objectives was to have a viable operator. Acceptance of the Epic Energy bid would not have occurred if the GPSSC had no proof that this could be achieved. Another objective was for Epic Energy to commit to further development. In all instances Epic Energy satisfied the GPSSC basing its long term plans, expansion, operational stability and viability on the 'affordable' \$1/\$1.08/GJ tariff and did no whilst still reducing the \$1.27/GJ tariff to the proposed \$1.00/GJ- another key sale objective.

Epic Energy fully understood that independent regulation would exist. It also understood it had an agreement with our State. The Regulator is duty bound to consider this as part of his assessment of Epic Energy's proposed Access Arrangement. It does not give license to the Regulator to discount the sale and its objectives, among other things.

The Threat of Sovereign Risk

The DBNGP sale brought five significant shareholders to our State: Hastings Funds Management, AMP Henderson, DB Capital, El Paso Corporation and Dominion Resources. The marriage of Australian and foreign investment delivered international expertise and gave Australian 'mum and dad' investors including superannuation funds an opportunity to contribute to our economy and earn a legitimate return.

"It is my contention that Government and business must engage each other, and work together, if we are to successfully project an image of WA as a progressive State within the federation and a great international base from which to do business.

The Government has undertaken a number of reviews of processes with the aim of promoting business investment and encouraging business activity in Western Australia.

We are committed to building important infrastructure". ³ Dr Geoff Gallop (2002)

² 2001 (April) Hon. Dr Geoff Gallop MLA Premier of Western Australia Speech to the Chamber of Commerce and Industry Corporate Leaders' Luncheon.

³ 2002 (June) Hon. Dr Geoff Gallop MLA Premier of Western Australia Speech to the WA Business News Success and Leadership Series.

Epic Energy's owners invested around \$600m of their own funds in purchasing the DENG, the balance was provided through a non-recourse loan by a syndicate of 29 banks. However the owner's equity is currently close to zero due to the volume of growth expected but not having materialised in the time frame everyone expected. Under any tariff scenario we need to understand the owners will never make a return on their \$600m unless they make a further equity injection. The owners' investment is lost. As you are also aware some of Epic Energy's owners now have significant issues of their own which further limits their ability to absorb any further shortfall.

What is now at risk is the banks' \$1.9b as they cannot recover any shortfall from the owners. In this instance the banks will be looking for the best outcome for themselves – not the State. It will not be prepared to expand a pipeline and all contracts that an external administrator/receiver considers to be unfavourable to the owner of the pipeline can be voided. The State will have no control over who will walk in and take over the operation and ownership of the pipeline.

There are many examples in Australia and particularly overseas where companies have walked away from assets acquired under the privatisation process. Is this a risk we want to take? This is not an image of a 'progressive State.' How will we manage the interim and damage to our reputation? It will have significant impact on investor confidence in our State.

And what of the *promise* of a new operator? There are overseas investors who may walk in and purchase a mature asset with no incentive to develop or an investor who will be conflicted (i.e., AlintaGas, Wesfarmers). Is this the type of *'business investment'* we want to encourage? Epic Energy's proposed tariff is tied to the sale which ties them to the sale objective to develop. Given Epic Energy is a pure pipeline – it is in their interests to expand. As a pure pipeliner Epic Energy can only increase their revenue by increasing the flow of gas – therefore they have an incentive to grow the market.

Epic Energy is strategising for long-term efficient development. They are willing to shoulder the burden of expansion and volume risk in this early part of the 20-year plan. This model further supports the Governments power procurement directions encouraging new players to enter the market by providing a level playing field – which will ultimately drive prices down. For conflicted companies there is an incentive to manipulate the market. They have greater ability to 'strengthen' developments in Eastern Australia demonstrate the tendency of 'vertical' players to attempt to constrain the supply and transport of gas.

A new pipeliner will be charging an incremental tariff for new capacity higher than the Draft Decision tariffs no matter what they pay the pipeline. The cost of constructing the new capacity together with the company's rate of return is what will truly determine the incremental tariff and not the price that the purchaser pays for the existing pipeline.

The 'Affordable' Tariff delivers on Energy Reform

"In order to utilise natural gas resources it is first necessary to transport it to centres of demand. In Western Australia there is an established network of privately owned gas transmission pipelines established for this purpose. The Western Australia Government recognises the value of this infrastructure, and the need to ensure that the availability of adequate transmission capacity is planned well in advance of demand needs." 4. Dr Geoff Gallop (2001)

4. 2001 (Sept) Hon. Dr Geoff Gallop MLA Premier of Western Australia "Oil and Gas – A Business Opportunity" Speech to the WA Seminar in conjunction with 'Offshore Europe'

Currently, the DBNGP has no spare capacity and despite demand, regional development is affected. The \$1.00/\$1.08 tariff is designed to encourage development. The proposal ensures a level playing field for existing and new capacity, allowing new entrants into the key downstream markets of electricity generation and gas retailing to compete with the existing incumbents. Anything other than \$1.00/\$1.08/GJ would likely result in any new capacity at the cost of that capacity – approximately \$1.40/GJ. This would mean that any new entrant in a downstream market would be at an immediate disadvantage to any incumbent in that market who has access to existing capacity on the DBNGP. Even incumbent players will be paying significantly more for any new capacity than under \$1.00/\$1.08/GJ.

“The Government has (also) started the process of electricity reform, recognising that high energy prices are a major disincentive to economic development in WA.
..... (reform) is the crucial next step in driving energy prices down.” 5. Dr Geoff Gallop (2002)

The State’s power procurement program is at risk if the \$1.00/\$1.08/GJ proposal is not accepted. Two classes of customers will exist deterring any new player from entering the market given that they are already at such a cost disadvantage. Electricity generation is already a marginal business and fuel is the most significant cost input in the generation of electricity. An open playing field for all energy forms used by power generators must exist. Full Retail Contestability will also be affected as new competitors will not have access to any existing or new capacity and the delivered price of gas will increase because of capacity constraints.

We must ensure that WA remains competitive for new projects and an estimate of delivered gas prices in our major capital cities indicated that WA currently has a significant price advantage: Perth (\$2.95); Sydney (\$6.90); Adelaide (\$3.35); Melbourne (\$2.85); Darwin (\$6.00), and Brisbane (\$4.45). But further development needs to occur if new projects are to materialise.

The best environment for our Government’s energy reform direction to move forward is one that maintains Epic Energy as a key player.

I believe that Epic Energy has demonstrated it’s working for the public interest. It is not apologising for its opportunity to earn a legitimate return on its investment nor should it – the asset has been privatised. It has but demonstrated that it is a corporate citizen who has honoured its part in the sale and continues to demonstrate its commitment to responsible and efficient development for our State by promoting a tariff that will deliver one class of customer.

I have reminded our Government of comments recorded in Hansard three years ago that I believe fully reflect the obligation this State has towards Epic Energy.

Mr Barnett: Yes; I was required to have a view on Epic’s as it was one of the things assessed in the sale process as a matter of policy.

Dr Gallop: What do you mean?

Mr Barnett: It was a condition was looked at in the sale process.

Mr Ripper: It sounds like a regulatory compact to me.

Mr Barnett: No. If the Leader of the Opposition had listened instead of interjecting, he would have heard that the sale process required people to put in scenarios on matters such as future tariffs and future pipeline capacity.

Dr Gallop: Is that what Epic said?

Mr Barnett: *Yes. The Leader of the Opposition would have found out if he had listened that it was not part of the sale documentation, but was a policy issue which was part of the process.*

Dr Gallop: *That sounds like an agreement to me.*

Mr Barnett: *I spent a long time explaining this matter as this debate is about politics not commerce. That is the process. Does the Leader of the Opposition believe that I, as minister, should in any way limit or seek to influence a submission made by AlintaGas or Western Power to the regulator?*

Dr Gallop: *It depends upon whether you reached an agreement as part of the sale. If you did, you should honour it. I have a view that if you have an agreement with someone, you carry it through. I do not know whether the minister shares that view. 6.*

I firmly believe that the State Government does have an agreement, although unwritten and it certainly appears to have had a policy and that should be part of your deliberations when considering the tariff. Without this consideration, I believe the public interest and this State will not be well served.

Epic Energy is here to work with Government for the public interest. It is here to work with you. I hope the Company will be afforded the fairest opportunity to continue to contribute within Western Australia. I trust this pivotal time you are fully conversant with Epic Energy's complex circumstances and fully understand and appreciate the effect and impact of a negative Final Decision on the company's financial viability.

I look forward to the opportunity of supporting this public submission with a verbal submission of the same. If you require any further information, please contact me on mobile 0438 181 245 or telephone 9228 4011.

Kind regards



NICK CATANIA B.Ec JP