

**PRIVATISATION OF AUSTRALIA'S GOVERNMENT OWNED PIPELINES**

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## ABSTRACT

### PRIVATISATION OF AUSTRALIA'S GOVERNMENT OWNED PIPELINES

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Since 1969, state and federal governments have been the principal owners and operators of most of the long distance gas pipelines in Australia. However, during the 1990s, there have been ideological shifts in the policies of various governments, which, together with a need to provide additional revenue to balance a budget or retire debt, have resulted in the sale of three major natural gas pipeline networks, with two others planned. Governments have recently privatised the Moomba to Sydney Pipeline System (The Pipeline Authority), the Moomba to Adelaide Pipeline System (Pipelines Authority of SA) and the Queensland State Gas Pipeline (State Gas Pipeline Unit). State governments have also announced their intentions to sell the Victorian Gas Transmission Corporation and part of Western Australia's AlintaGas Transmission Division.

This paper will provide insight into the privatisation process, including the management of the process by both government task forces and consultants; the effects on staff and technical operations of the organisation; industrial relations; commercial aspects, including the need to "grandfather" some contracts and develop new ones; land and easement matters; licensing, regulation and the effects of competition policy on the process. The paper will also address the methodology adopted by governments and bidders in their assessments of the value of pipeline networks.

No privatisation is easy. There is potential for conflict between the government's agenda and the bidders' perceptions of market and regulatory regimes. Conflict may also exist between the various arms of government which have control of the asset sale process. There are valuable lessons to be learnt from the three privatisations which have already occurred, and the paper will provide insights into the processes of privatisation which both governments and bidders may find useful.

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Mr Kimber is on the Board of Directors of the Gas Transmission Corporation of Victoria and has made significant contributions to the new regulatory regimes and technological innovation in the Australian gas pipeline industry. He provides consulting services to the major corporations and governments involved in the Australian gas and pipeline industries, including Tubemakers of Australia, Nova Gas Australia, Pacific Gas Transmission, AlintaGas, Pipeline Authority, Gas Transmission Corporation, Government of South Australia and Federal Government. Since 1994, he has advised governments and pipeline companies on the privatisation of three government owned pipelines.

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### INTRODUCTION

Australia's natural gas pipeline industry began in 1969 with two government owned pipeline systems (Natural Gas Pipeline Authority of South Australia and the Gas and Fuel Corporation of Victoria) and one privately owned pipeline system (Associated Pipelines in Queensland). By 1992, approximately 8000 km of pipelines were owned by State or Commonwealth governments. In the last four years, 3700 km of these pipelines have been sold to Australian, Malaysian, US and Canadian companies as shown in Table 1. The locations of these pipelines and others referred to in this paper can be found by reference to Figure 1

PIPELINE	OWNED BY	GOVERNMENT	SOLD TO	DATE SOLD	PRICE PAID
Moomba to Sydney + Laterals (1960 km)	The Pipeline Authority	Federal Government	Australian Gas Light (51%) Nova (25%) Petronas(24%)	30 June 1994	\$534 million
Moomba to Adelaide + Laterals (1110 km)	Pipelines Authority of South Australia	South Australian Government	Tenneco Energy	30 June 1995	\$304 million
Roma to Gladstone + Laterals (630 km)	State Gas Pipeline Unit	Queensland Government	Pacific Gas Transmission	30 June 1996	\$162 million

**Table 1 Listing of Government Owned Pipelines Sold 1993 - 1996**

By the end of 1997, most of the remainder are most likely to be sold, (see Table 2) thus completing the transition to majority of private ownership of all gas transmission pipelines in Australia.

PIPELINE	OWNED BY	GOVERNMENT
Dampier to Bunbury * + Laterals (1950 km)	AlintaGas Transmission	Western Australian Government
Victorian Gas Transmission System (2330 km)	Gas Transmission Corporation	Victorian Government

\* Possible partial sale of 50%

**Table 2 Listing of Government Owned Pipelines that are Likely to be Sold Before 1998**

In association with the sale of government owned pipelines, there has been strong government commitment to the development of robust and internationally competitive industries in Australia. As part of this process - referred to as "micro-economic reform" - governments and industry associations have combined to develop a market approach to infrastructure industries, such as railways, ports, and electricity and gas supply, transmission and distribution. The privatisation of the remaining government owned pipeline assets will be carried out at a time when the effects of micro-economic reform are being felt by the gas industry. One would expect that the Council of Australian Governments (CoAG) Gas Reform Task Force would have finalised its National Third Party Access Code for Natural Gas Pipeline Systems by the end of 1996, although its 12 July "Exposure draft" has not been warmly received by the natural gas pipeline industry. At the time this paper was prepared (August 1996), several commentators were predicting that implementation of the Code in its present form would seriously affect the value of gas pipelines. The prescriptiveness of the current draft goes far beyond the original concept of "light handed" regulation and has some international pipeline companies looking for alternative countries in which to invest.

### GOVERNMENT POLICY

## **Ideology**

Governments choose to sell state owned assets for a variety reasons. Once the primary reason was thought to be ideological, where conservative governments sold assets while socialist governments bought them. This conventional wisdom has been turned on its head in the gas pipeline industry in Australia, where conservative governments were instrumental in setting up various pipeline corporations to own and operate gas pipelines in South Australia, Victoria and Western Australia. The first government owned pipeline to be sold in Australia was put on the market by a government with socialist leanings.

## **Political Consideration**

There are political drivers for sale that usually relate to the perceived inappropriateness of governments being in commercial enterprises. Investments in pipelines are usually large and if these are funded by the public sector, the borrowings must be approved by the Premiers' Conference and form part of the Public Sector Borrowing Requirements. The Commonwealth, States and Territories do not wish to be branded as being profligate with borrowings, particularly when much more politically sensitive borrowings for capital works for schools, roads and hospitals are competing with pipeline developments and expansions.

Government ministers and the bureaucrats who advise them are not used to the commercial drivers that operate in a pipeline company, and aspects of the operation of a pipeline company which its board and management consider as imperatives, are often not regarded in the same light by governments. Government owned companies do not always respond to market demands, nor are they prepared to enter into speculative investments to develop markets.

There has been an increasing realisation of these problems in the last few years, and governments have found the inconsistencies difficult to manage, even though most government owned pipeline companies have been a source of considerable de facto tax revenue for governments for many years.

## **Budget Considerations**

Most Australian governments have had budget difficulties in the 1990s, and asset sales are attractive as a means of obtaining one-off large revenue boosts. The Commonwealth, South Australian and Victorian governments have each benefited significantly from the sale of gas, electricity and other assets.

In order to maximise the returns from a particular asset sale, a government might be tempted to set up a legislative or commercial regime for the privatised asset which provides a good revenue stream for the purchaser and encourages it to bid a high price. This, too, is de facto taxation, in that the government benefits in a one-off payment which is probably less than the present value of the tariffs surcharge paid by the users of the service after privatisation. The government also forgoes a profit stream from its asset.

Clearly, governments wish to obtain a fair price for their assets, but they must also recognise that the well-being of their constituents is best served by an efficient infrastructure which is built and operated in a manner which encourages continuous improvement, adds value to the economy and provides an encouragement for its owners to invest in extensions and develop the market.

Some governments have profited immensely during a privatisation process by developing a very competitive bidding environment where companies are prepared to pay high prices for assets whose cash flows would not necessarily support reasonable rates of return - some observers refer to this as a "feeding frenzy". This type of bidding process can not only result in regret by the highest and successful bidder, but pressure on the regulator and hence the customers for higher tariffs and improved returns. Again, this action results in a de facto tax on consumers.

## **SALE METHOD**

Since no government owned pipeline has been owned and operated by an Australian registered company, all three pipeline privatisation processes have been essentially asset sales, where the statutory authority or corporation has been deprived of its assets and then wound up. All sales have been by way of a trade sale where potential purchasers were required to bid on the basis of information gathered during a due diligence process. The next two pipeline systems to be privatised (Gas Transmission Corporation and AlintaGas Transmission Division) will almost certainly be managed in the same way.

## Asset Sales Task Force

Each government has established an asset sale task force, primarily made up of bureaucrats from Treasury or Finance Departments and augmented by consultants, financial advisers and, in some cases, representatives of the statutory authority whose assets were being sold.

Board members of the statutory authority are often excluded entirely from the sale process. In this context, the Chairman of the Pipeline Authority, Ms Elizabeth Proust, was moved to state in the Authority's 1993-94 annual report, "The Government's right to decide to sell Government owned businesses is of course undoubted. However, the Directors of the Authority found the sale process a difficult one from which they were largely excluded. If the Government in future wishes to retain directors of calibre to oversee Government businesses it is crucial that thought be given to greater involvement by directors in sale processes when they arise."

This type of response indicated that there were difficulties in administering the process of sale of the Pipeline Authority's assets. Ms Proust provided some clear guidance for future asset sale task forces, which was heeded by the South Australian Government in its sale of the assets of the Pipelines Authority of South Australia (PASA). PASA's board, management and staff were much more closely involved in the sale process than those of the Pipeline Authority. PASA's asset sale was administered by a steering committee on which PASA was strongly represented. The sale process being planned for the sale of the AlintaGas Transmission assets is also being administered by a steering committee chaired by the Chairman of AlintaGas.

Some asset sale task forces are beset by bureaucratic "turf wars", where the department responsible for the statutory authority, usually the energy department, is disenfranchised by the treasury or finance department. Sometimes the energy department is responsible for the licensing or tariff determination and endeavours to re-assert its control through these processes, leaving the potential purchaser unsure about the government's policy. Consistency and clear direction are most important. Obviously, government ministers play an important role in ensuring that disputes between departments do not impact on the sale process and subvert the government's agenda.

## Information Memorandum

The three gas pipeline systems reviewed in this paper have been sold through the issue of an information memorandum. The information memoranda were compiled by the asset sales task forces, with the assistance of consultants. In each case they were heavily qualified and made it clear that any bidder would be required to bid on the basis of its own due diligence, rather than rely on the information contained in the information memorandum - a clear case of *caveat emptor*.

The information memorandum in each case described the pipeline assets and provided a general overview of the gas markets each pipeline served. Capital, operating and historical costs were also provided.

Prior to the sale of PASA's assets, a detailed technical audit was carried out by a consultant for the assets sale task force to provide a good basis for the preparation of the information memorandum and collect documentation for the data room.

## Data Room

The establishment of a Data Room is essential for a potential purchaser to carry out due diligence on the assets being purchased, contracts in place, staff, easement matters, operating costs, environmental matters, litigation pending and all other aspects associated with the assets and associated liabilities. A Data Room must provide a complete set of records and data which describe all aspects of the assets being sold. Those involved in the assembly of data must be aware of the type and extent of the data required by potential purchasers and understand the particular requirements of purchasers who have to rely entirely upon their own inquiries in the bidding process. A properly managed Data Room must anticipate all the likely questions posed by potential purchasers, but in the event that certain aspects are not covered by existing data, the Data Room must also provide a question and answer process which offers very quick turn around of answers to questions posed by potential purchasers. The answers must be coordinated and present a common theme.

It is preferable that answers to questions by any one purchaser be provided to all purchasers to ensure consistency and fairness. Each of the three privatisation processes approached this matter in a different way.

### **Inspections**

Inspections, site visits and meetings with senior management form an important part of the potential purchasers' information gathering processes. Each privatisation process endeavoured to be scrupulously fair to all potential purchasers by referring to each as "Company A, B, etc", but given the close contacts between all pipeline companies throughout the world, this process was a charade. Several task forces were so paranoid about the representatives of "Company A" meeting those of "Company B", that they quarantined the former representatives in a remote town while the latter's aircraft was delayed at the town airstrip.

The cost of sending separate parties to remote locations, shepherding them through the same processes using the same sources of information has proved to be a very costly, time consuming, and in the author's view, fruitless exercise for the task forces.

### **Learn from Earlier Privatisations**

The Australian industry now has a significant and increasing body of experience in the sale of government owned pipeline assets, but it has not been fully tapped by new entrants, and mistakes and increased costs have resulted. There is a perception that "It's different in my state", which can lead to significant inconvenience to prospective purchasers and reduction in value of assets being sold. State governments should understand that most of the parties interested in purchasing Australian government pipeline assets have already examined three pipeline systems and have high expectations about the process. Governments will be disadvantaged if they fail to meet the expectations of potential purchasers.

### **Dealing with Potential Purchasers**

Asset sale task forces have been and will be expected to deal professionally with sophisticated potential purchasers. Members of the task force must be well informed about the assets being sold and demonstrate a very clear understanding of all the political, regulatory, commercial, technical and financial aspects of the assets and the sale process to be able to interact with financial advisers, engineers, accountants and human resources experts who will be retained by the potential purchaser to carry out all aspects of due diligence. Failure of a task force to provide adequate responses, on the spot, to these specialists has already resulted in dissatisfaction from potential purchasers during previous asset sales.

### **Dealing with Sales Task Force**

Potential purchasers must understand that the asset sales task force is an arm of government and is responding to a political direction, sometimes with few guidelines. Most members of the task force are not specialists and, as bureaucrats, often unused to providing concise, and consistent answers, and without some qualification. Patience and persistence on behalf of the purchasers are essential. Purchasers should ensure that they are well informed about the asset they are considering, and if they are not part of the pipeline industry in Australia, they should recruit local advisers to spearhead the information gathering phase.

### **Cost to Seller**

The cost of selling a pipeline is high, but to date no government has published the cost of selling any of the three pipelines. However, each government has used external financial and technical advisers, both internal and external legal counsel and a great deal of resources from the statutory authority whose assets were being sold. The costs are considerable, and must be offset against the sale price. In some cases, it has been necessary to buy out certain contracts or obligations which the government considers might impede the sale or leave the government with a claim for compensation. During the sale of the Moomba to Sydney pipeline system, for example, one contractual obligation was bought out for \$20 million, while another was bought for \$30 million, thus reducing the price to the Commonwealth Government by \$50 million.

Some asset sale task forces have lacked good financial and commercial negotiating skills, and instead of retaining the appropriate negotiators, have insisted upon using bureaucrats who are often unable to match the negotiating ability of purchasers or disaffected parties. The cost of these inadequacies has not been quantified, but there is evidence that it was considerable.

## Costs to Bidders

Delays and inconsistencies in responses by governments have a significant effect on potential purchasers' costs. Most purchasers commit a large amount of resources to a due diligence process. Those purchasers who do not have an Australian operation find that the cost of travel and accommodation for expatriates is very high, and any delays that result from inadequate responses by a task force can add materially to their costs. Task forces can reduce these costs by having carried out a very thorough seller's due diligence process so that all the relevant information is on hand through the Data Room. This aspect is most important on environmental and land tenure matters.

## GOVERNMENT EXPECTATIONS

### Initial Ownership

Governments have usually become pipeline owners because private companies were not willing or able to take the risks of long term supply contracts for gas to be sold into an uncertain market. Gas producing companies often felt comfortable with dealing with governments who were both pipeline owners and gas distributors. In some cases ideology and grand development plans were drivers towards government ownership. In the two decades from 1965 to 1975, capital funds were available to governments at low rates and raising finance was not difficult.

The availability of natural gas was a very important consideration for state governments wishing to attract industrial developments, or in the case of South Australia, overcome electricity supply problems. In most cases governments had quite a clear mandate to build and operate natural gas pipelines. The construction of the Moomba to Sydney pipeline system was taken over by the Commonwealth Government in 1973 to facilitate national development and to prevent a private owner from collecting monopoly rents through a vertically integrated gas company. This so-called "take-over" was vigorously opposed at the time, but was ultimately beneficial for the gas consumers of New South Wales.

### Continuing Ownership

After an initial close involvement in the planning and construction of a strategic natural gas pipeline system, the responsible Minister (quite often, the Premier) would have to concentrate on other affairs of state, or may well have been voted out of office. In these circumstances the administration of the pipeline system would fall to junior ministers and bureaucrats who had little interest and no commercial expertise in managing a pro-competitive pipeline infrastructure. In a number of cases, the pipeline systems were not owned by a specialist pipeline group, but were incorporated in a gas or energy utility which operated in an uncompetitive and monopolistic environment with guaranteed rates of return. Governments continued to benefit from a good revenue stream from the pipeline company or utility and maintained it through price control of gas and haulage tariffs.

Since 1990, governments have realised that there are significant incompatibilities between government administration and running an efficient pipeline company. The concept of risk and reward were well understood by the politicians and their advisers when governments first took the decision to build and own a pipeline, but subsequently, bureaucrats and Treasurers began to take a different view and government owned pipeline companies began to be starved of risk capital.

### Reasons for Asset Sales

Governments sought to privatise pipelines for a variety of reasons:

- There ceased to be a need for a government to be involved in establishing infrastructure
- Banks and financial institutions understood pipeline financing better and private funding for new pipelines became available
- Budget deficits and government debt had increased significantly
- Governments signed on to a pro-competitive process and receipt of Commonwealth grants was conditional upon establishing a competitive environment for energy
- Governments believed that a transfer of the asset to private industry would result in improved efficiency and reduced costs. Benefits could be passed on to customers.

- Statutory authorities are not necessarily well equipped to develop gas markets and governments are now looking to privately owned pipeline companies to act as catalysts for industrial and mineral processing developments.

Having decided to sell a pipeline asset, a government has to put in place a sale process which will satisfy its agenda.

## **SALES TASK FORCE AND ADVISORS**

In all recent cases of the privatisation of pipelines, governments have appointed asset sale task forces, which were attached to Treasury or Finance Departments. Staffing was mostly drawn from the bureaucracy, who sought information and advice from the staff of the statutory authority which operated the pipeline, and commissioned commercial, legal and technical advisers to assist with the process.

### **Commercial & Financial**

Selling a pipeline asset is a complicated matter and requires a high level of commercial and financial expertise to ensure that the task force provides prospective purchasers with the appropriate data in the information memorandum, and throughout the sale and bidding process. Considerable commercial expertise is required in the assessment of bids and during the negotiation with the bidders. In the sale of the Moomba to Sydney Pipeline System and the Moomba to Adelaide Pipeline System, financial advisors had a close involvement throughout the process, while they had a lesser and more peripheral role in the sale of the State Gas Pipeline in Queensland.

### **Legal**

As with any complex commercial matter, legal advice is always sought during a pipeline sale. During the three asset sales described in this paper, legal advisors worked quite closely with the task force and the owners of the pipelines. However, it is essential that the owners of the pipeline assets have their own legal representation to facilitate this close working relationship. During the sale of the Moomba to Sydney pipeline system, many contractual complications were found and these required detailed analysis by the Pipeline Authority's staff and their legal advisors, who, in turn advised the task force of the methods by which these complications could be resolved. The construction of the Moomba to Botany ethane pipeline for ICI added another layer of complication to the sale process.

In each of the three sales, legal advice was obtained from government solicitors and private firms.

### **Technical**

During the sale of the Moomba to Adelaide Pipeline System, expert advice was obtained to address specific aspects of the pipeline system to ensure that the proper technical information was collated for presentation to potential purchasers. In the cases of the sales of the Moomba Sydney Pipeline System and the State Gas Pipeline, technical input was provided by the staff of the pipeline owners and placed an increased burden on them during the sale process.

## **DUE DILIGENCE**

### **Vendor Due Diligence**

In order to prepare an information memorandum and to satisfy itself that the assets can be sold, it is essential that the sales task force carries out a thorough due diligence process. In all the sales in which the author has been involved, the due diligence process has revealed many legal, contractual and technical aspects which required attention prior to sale, and if they had been left unresolved, could well have affected sale value.

### **Purchaser Due Diligence**

All three asset sales have incorporated the principle of *caveat emptor* - let the buyer beware. In these circumstances, it is essential that the potential buyers carry out their own due diligence to ensure that they are

well informed about the asset, its legal standing, unresolved matters and, most importantly, any aspect which could be an ongoing liability. Where contracts are novated, as they were in the case of the Moomba to Sydney Pipeline System, the purchaser must understand that it will be responsible for past as well as future obligations under those contracts.

## **LEGISLATION**

Any asset sale must be supported by the appropriate legislation to ensure that proper title passes to the purchaser. Both the Pipeline Authority and the Pipelines Authority of South Australia were created by an Act of Parliament. Each Act contained provisions which were either inappropriate to the changed circumstances or hindered transfer of assets. Consequently, each Act had to be amended substantially. The Queensland Government felt that the Petroleum Act provided sufficient legislative provisions to accommodate the sale of the State Gas Pipeline, so no specific legislation was enacted.

### **Regulatory Regime & Statutory Certainty**

One of the primary requirements of any purchaser of government assets is an assurance that the legal and statutory framework in which it developed its purchase price should remain constant for the life of the contracts which underpin the purchase. This was achieved by enacting of the Moomba Sydney Pipeline Sale Act 1994 (Commonwealth), the Pipelines Authority of South Australia Amendment Act 1995 (South Australia), the Natural Gas Pipelines Access Act 1995 (South Australia) and amending the Petroleum Act 1923 (Queensland) prior to the sale to establish an open access regime for gas pipelines.

In the absence of any national or state code of practice or legislation to regulate the pricing for services on a gas pipeline, each government was required to enact some legislation to provide a framework on which a purchaser could develop appropriate commercial arrangements. The Commonwealth's Moomba Sydney Pipeline System Sale Act set out certain commercial requirements and nominated the Australian Competition and Consumer Commission as the regulator for the pipeline. The South Australian Government also enacted specific legislation to administer the regulatory aspects of pipeline operation. The Queensland Government used its recently amended Petroleum Act as the regulatory regime for the sale of the State Gas Pipeline.

### **Land Matters Requiring Legislation**

The land and easements on which Government pipelines are built are usually acquired through a compulsory acquisition process under the various lands acquisition acts. During the sale of each of the three pipelines, due diligence revealed that the statutory authority did not have proper title to some parts of the land through which its pipelines had been built. This resulted in an uncertainty about ownership of the pipelines and also affected the right of the governments to transfer title. There were particular problems about sections of easement which crossed Crown land for which no title had been required by the government owner, but a purchaser needed to be assured of a right to own, operate and gain access to a pipeline within the Crown land.

There are also difficulties associated with the registration of the easement by the Registrar for Titles in the name of the purchaser. Most Acts dealing with registration of easements "in gross" give the Registrar some discretion to register the easement on titles. This adds to the purchaser's uncertainty on land tenure and legislation must address this issue, or specific instructions must be given to the Registrar of Titles.

Uncertainty also arises if the survey of the easement and the location of the pipeline therein are found to be in error, or no "as built" survey has been done. Prudent purchasers will require the government vendor to certify the fact that the pipeline is within the easement in these circumstances. In the author's experience, this guarantee is difficult to give unless a comprehensive (and expensive) survey is undertaken by the vendor. Asset sale task forces often have some difficulty understanding the importance of this aspect and have been unwilling to provide the guarantee. They are unaware of the importance placed upon certain land tenure by the financial institution providing the funds for the pipeline's purchase.

### **Native Title**

Any section of the easement that traverses unalienated Crown land could attract a native title claim in the establishment of firm title for the new pipeline owner. Unalienated Crown land could include seemingly innocuous crossings such as stock routes and creek beds. While the extent of this risk is small, it still must be

considered and managed by the legal advisers to the task force. Prospective purchasers should pay close attention to this aspect.

## **CONTRACTUAL ARRANGEMENTS**

The contracts for transport of gas through a pipeline represent the pipeline's base value. Contracts which might be written by the new owner to expand the market represent the upside and the opportunities for the purchaser to earn a higher rate of return than its base. Despite protestations to the contrary, governments, like any vendor, wish to maximise the price obtained on the sale of an asset. This is particularly so when a government is confronting large deficits and burgeoning public sector debt. The existing contracts or newly negotiated ones form the basis of the price expected by the government.

### **Current Contractual Arrangements**

In most cases, gas transport contracts are assigned to the new owner. During the lead up to the sale of the Moomba to Sydney Pipeline System, a new contract was negotiated between the Commonwealth Government and AGL, with a considerable amount of input from the Pipeline Authority. This new contract allowed AGL to book a certain capacity on the pipeline. The new contract came into effect on sale day. It was this contract that underpinned the purchase price for the pipeline system.

Prior to the sale of the Moomba to Adelaide Pipeline System, the government renegotiated the haulage arrangements with the Electricity Trust of South Australia and Sagasco. Again the current owner, the Pipelines Authority of South Australia made a very significant contribution to this negotiation. These contracts also underpinned the purchase price for this pipeline system.

It could be inferred that in each case the governments were not in a good bargaining position with the incumbent customers. The governments wanted a favourable contract so that they could sell the asset, while the customers wanted to minimise the cost of transport and saw no advantage in re-negotiating the contract. In each case, there were contracts already in place.

In the case of the sale of the State Gas Pipeline, the Queensland Government was prepared to assign the contracts to the purchaser, but in the event, the new owner chose to negotiate new contracts with each of the customers in order to establish an open access non-discriminatory regime from the beginning.

There is always a risk that there are other contracts entered into by either the government or the pipeline owner which are assigned or novated to the purchaser. Sometimes these contracts contain provisions which are unacceptable to the purchaser or are relics of earlier negotiations between the parties and have little relevance to the purchaser. There were a number of contracts between the Cooper Basin Producers and the Pipeline Authority which have little relevance to the new owners, but were novated nonetheless, and require administration. Other contracts or understandings between the Commonwealth and the Cooper Basin Producers and AGL were "bought out" by the Commonwealth. Governments and potential purchasers have to be aware of the costs of these residual obligations which have often remained dormant for years, but are re-awakened by the sale process and can result in significant problems for the vendor and the purchaser.

### **Inclusion of Purchase Price In Tariff Base**

In the sale of both the Moomba Sydney and Moomba Adelaide pipeline systems, there appeared to be a clear nexus between the purchase price and the haulage tariff. The Queensland Government asserted that the purchase price for the State Gas Pipeline was less important than an attractive tariff regime which would assist in market growth. The different attitudes could well be a function of the budget positions of the governments involved.

Future pipeline asset sales will have to address this issue much more carefully in the new pro-competitive regime, particularly if the prescriptiveness of the current draft (12 July 1996) of the National Third Party Access Code for Natural Gas Pipeline is carried through to the version which is to be approved by CoAG. There is a risk that high prices paid for pipeline assets may not be able to be recovered through the tariff. Potential purchasers for the Gas Transmission Corporation's pipeline assets and those of AlintaGas may be well advised to seek some clear definition on this aspect prior to entering the bidding process.

## Pipeline Capacity Determination

Pipeline capacity is also closely linked to contractual and tariff matters, since it is capacity that is being sold and the owners of capacity allocations have a great deal of market power, particularly if capacity is limited.

During the sales of the Moomba Sydney and the Moomba Adelaide Pipeline Systems, the capacity available was limited and the incumbent customers wished to secure as much capacity as possible to maintain their market positions. In order to minimise holding costs in these circumstances there was an incentive to minimise the capacity to commodity ratio in the pricing structure (the result was  $\approx 80:20$ ). Minimising this ratio results in lower holding charges for unused capacity.

Capacity was not an issue in the sale of the State Gas Pipeline and hence customers chose to minimise their capacity reservation and were content to maximise the capacity to commodity ratio (the result was 100:0).

The definition of capacity also proved to be a vexed question for both the Moomba Sydney and the Moomba Adelaide Pipeline Systems, and the task forces and the pipeline owners spent a considerable amount of time and money to produce figures which are at best an indication and at worst an illusion.

The definition of capacity depends, in turn, on the definition of a large number of variables, including, but not limited to:

- Transient behaviour of gas supplies and markets over several weeks
- System pressures
- Ambient and ground temperatures
- Heat transfer between gas and soil
- Gas specification
- Compressor powers, which in turn are a function of compressor condition, temperature, gas specification
- Compressor outages, maintenance and standby availability
- Gas cooler performance
- Pipeline operating philosophy
- Management of linepack

The definition of capacity for a pipeline with a number of receipt and delivery points is even more elusive.

In the end, a customer enters into a contract for a particular sort of service (interruptible, firm, backhaul etc) and expects the pipeline owner to provide that service. It is immaterial to the customer how and what facilities are used by the pipeline owner to provide the service. Pipeline capacity determination should be used as a design tool and not as a contractual obligation.

## Assignment or Novation

In non-legal terms, assignment requires the assignee to take up all aspects of a contract from the date of assignment. Novation, on the other hand, requires the novatee to take responsibility for past obligations as well. In the two state government sales, the purchasers were assigned the contracts, whereas the Commonwealth required the purchaser to take novation of the contracts.

## Legislate out of Unacceptable Contracts

There is a temptation for governments to legislate out of their obligations (or those of the statutory authority) in an effort to provide an unencumbered, and therefore more valuable, asset. This can result in litigation for compensation for loss of contractual rights that have been repudiated by the legislation. Legislation should be seen as a last resort only. There has been some history of bureaucrats recommending legislative action when they find that they do not have the negotiating skills or the time to negotiate to resolve contractual matters. Asset sale task forces must ensure that they and their governments do not suffer from any of these restrictions.

## **Involvement with Existing Customers and Other Stakeholders**

Many asset sales are commenced without informing existing customers and other stakeholders. This often results in alienation and resistance to any changes to, or assignment of contracts between the pipeline owner and the stakeholders. In the preliminary planning for an asset sale, a task force should work with stakeholders and discuss the proposed sale and the methods by which the sale will be accomplished. Potential purchasers are well advised to contact all the stakeholders as well, with particular emphasis on customers and potential customers, since they can be allies during the bidding and selection processes.

Management and staff of the pipeline owner or statutory authority must also be involved in the process of the lead up to sale; firstly, because their collective knowledge is very important to the task force and secondly, because they will probably represent the core staff required by the purchaser to continue operating and maintaining the assets.

## **INDUSTRIAL RELATIONS**

Industrial relations matters need special consideration during the sale process. Staff represent key stakeholders in the process and are very important to potential purchasers.

There have been significant differences in the management of staff related matters for the privatisation of the assets of the Pipeline Authority, Pipelines Authority of South Australia and the State Gas Pipeline Unit. All staff of the Pipeline Authority were required, by legislation, to accept an offer of employment by the purchasers. If they refused, they were deemed to have resigned, and thus would not get any recognition of prior service or superannuation benefits. If a staff member was not offered a job, he or she would be declared redundant under the appropriate Commonwealth Act. In the event, all but a few were offered jobs and all accepted their offers. However, the process was quite draconian, and not designed to improve staff relations throughout the difficult sale process.

In the case of the Pipelines Authority of South Australia, staff matters were handled in a significantly different manner. All staff had the choice of

- redeployment with the South Australian Government
- a reasonably generous redundancy package
- acceptance of a job offer from the new owner together with a cash incentive and salary plus benefits level was maintained by the new owner

These arrangements were quite well received by staff.

The situation for the employees of the State Gas Pipeline Unit was similar, except that the staff of Bridge Gas, who provided the maintenance services for the State Gas Pipeline, were required to be employed by the new owners and were offered a reasonably attractive cash bonus if they stayed with the new owners for a period of time.

## **Enterprise agreements**

The Pipeline Authority and Pipelines Authority of South Australia each had enterprise bargaining agreements (EBA) in place, which had been negotiated some time before sale. Legislation requires that these EBA remain in place, despite ownership changes. In each case, the EBA formed the basis of terms and conditions of employment, including overtime, travelling allowances and remote area allowances.

It is important for potential purchasers to review any EBA and discuss with staff and union representatives the implications of its continuation or the means by which parts of the EBA can be incorporated in new contractual arrangements with transferring staff.

## **Relationship with Unions**

Union representatives became deeply involved in the transfer of ownership from TPA to EAPL (which they perceived as AGL, because neither of the other partners was present in any of the negotiations). Union representatives also maintained a close interest in the terms and conditions applicable to staff of the Pipelines Authority of South Australia.

There has been a tendency for asset sale task forces to seek to isolate union representatives and to prevent them from becoming involved. This approach can only result in confrontation and the likelihood of industrial action, which in turn creates a need to settle dispute through an arbitration process in the Industrial Commission. These events contribute to a feeling of mistrust between the asset sales task force and the staff of the pipeline owner. Any industrial action and discontent among the staff makes the pipeline owner's task of management of the asset during the sale process much more difficult and could lead to threats to gas supplies or the safety and integrity of the pipeline system.

### **The "Revolving Door" Problem**

Asset sales task forces seem to find difficulty in accepting the situation where staff of the pipeline owner take a redundancy package and re-appear as either employees or contractors of the new owner of a pipeline system. The Commonwealth Government legislated against this and the state governments have made it plain to all staff that such a practice was not acceptable. However, if staff attempt to "double dip", they are not well regarded by their workmates who have transferred with no significant benefits. Intending purchasers should manage this aspect carefully.

## **ENVIRONMENTAL MATTERS**

### **Outstanding Matters**

Potential purchasers from North America are very sensitive to environmental matters which could represent a residual liability. This attitude probably has its origins in the difficulties encountered by North American companies with polychlorinated biphenyls (PCB) which were a significant constituent of synthetic compressor oil which escaped into many pipelines and contaminated pipelines and distribution systems. The costs of clean up are high. Synthetic oils containing PCBs have not been used in Australian compressor units and PCB contamination is not a problem, except for some minor electrical components.

Some pipeline sites have been found to be contaminated with hydrocarbons from blowdowns and disposal of liquids from scrubbers, but these problems do not represent significant environmental liabilities. However, governments which wish to sell pipelines must ensure that records describing all such spills and contamination are provided in the data room information to allow prospective purchasers to assess their exposure.

### **Land & Environmental Obligations of Government**

In some circumstances, governments have entered into environmental agreements with landowners, national park managers, water resources departments and other land care organisations to implement certain environmental management plans. The cost of complying with the requirements of these agreements can be significant and may also affect the owner's freedom to loop or otherwise modify a pipeline. Agreements with the NSW National Parks and Wildlife Service did affect certain aspects of the easement management plan for the Moomba to Sydney Pipeline and required special attention by both the Commonwealth and the purchasers.

There must be an obligation on governments to ensure that all these special arrangements which might affect the value of a pipeline are set out quite clearly in the data room. Prospective purchasers must also seek out as much information as possible on this matter and factor their findings in the bidding process.

### **Price**

The price to be bid by the prospective purchaser is of critical importance to the bidder and the government, particularly if the government wishes to maximise the price. The selection of the successful bidder for both the Moomba to Sydney and Moomba to Adelaide pipeline systems were each based on price, although there were some differences which mostly related to the fact that AGL had a preferential right to 51% ownership of the Moomba - Sydney Pipeline system and the price was determined by the price offered the other bidders.

Given that in each case, the government had negotiated a gas transport contract which was to go into effect on sale date, the bidders' flexibility was limited to a determination of an acceptable rate of return based on a

debt to equity ratio with which they were comfortable. Some refinement of operating costs could have been factored in but this would have little effect on the price.

When the State Gas Pipeline was sold, bidders were offered another degree of freedom to set their bid price. They were asked to offer both a haulage tariff and a purchase price. While there is no information available in the public domain, this bid process probably resulted in a range of bids from those who were locked in to the cost of service mentality and who established a clear nexus between price and tariff, and those market oriented companies who offered a price and tariff which would satisfy the requirements of the government to obtain a fair price, but also to provide an environment where market growth and new gas supplies would be encouraged.

### **Competition**

Competition among bidders can be quite fierce, particularly if one or more of the bidders wishes to gain a foothold in Australia and is prepared to pay a premium to do so. This could result in unacceptably high prices being paid for an asset with marginal growth potential. However, there may also be competition for some of the less tangible assets of a statutory authority, such as its engineering or project management skills. The new purchasers of both the assets of the Pipeline Authority and the Pipelines Authority of South Australia gained a good cross section of skills to assist them in further pipeline developments in Australia.

### **Market Assessment**

An assessment of the market for pipeline transport services is, perhaps, the most critical aspect in the determination of a bid price for a pipeline asset. There has been evidence of quite superficial market analyses for pipelines sold in Australia and one wonders, therefore, on what basis a particular bid price was developed. Some bidders may have taken comfort in the contracts already in place on a pipeline and looked no further. In this way the tariff setting methodology and its effect on the market may well have been overlooked.

### **Financing & Financial Modelling**

Prospective bidders should have a financing strategy in place, including the development of close associations with financial institutions. Governments are often impatient to settle a sale, particularly near the end of a financial year (30 June), and will put considerable pressure on the successful bidder to provide payment as quickly as possible. Another essential part of the financing process is a need to have developed, well in advance, robust financial models to allow a detailed analysis of the effects of variations in interest rates, gearing, return on equity requirements and changes to tariff setting principles. Modelling must be done in parallel with bid preparation, negotiations with potential customers and negotiations with government.

### **STAMP DUTY**

The legislation which facilitated the sale of the Moomba to Sydney Pipeline System specifically excluded a requirement to pay stamp duty, but in the sale of both state based pipelines, stamp duty was deemed to be payable. The treatment of stamp duty must be addressed by both the asset sale task force and potential purchasers well before bidding closes to ensure that each party understands the requirements.

### **SALES TAX**

Until recently, most state owned pipeline corporations were not required to pay sales tax on any purchases, although state governments have often insisted that an equivalent wholesale sales tax should be paid in accordance with rulings by the Australian Tax Office. Prospective purchasers should seek a ruling about the payment of sales tax on inputs to operations to assess operating costs properly.

### **LICENSING**

#### **Conversion of Existing Licensing Arrangements**

Some government owned pipelines do not operate under any form of licensing, and when those pipelines are sold to the private sector, licences are required. Both asset sale task forces and prospective purchasers need to define the licensing regime prior to completion of the bidding process, otherwise pipeline technical regulators, who are often not part of the sale process, may introduce onerous operating requirements which

may add significantly to operating costs. For example, a new licence may require intelligent pigging to be carried out every five years, despite no similar provision in the previous licence.

### **Post Purchase Licensing**

Pipeline or petroleum legislation may not contain any provisions for licensing existing pipelines - this applied in New South Wales until recently. This can result in an inability for a licence to be issued immediately after sale and the new owner has to face the risk of onerous requirements in a new licence when it is ultimately issued. Asset sale task forces must ensure that these uncertainties are resolved prior to sale to avoid any effect on the prices bid for a government owned pipeline.

## **PUBLIC RELATIONS**

### **Stakeholders and Land Owners**

It is very important for asset sales task forces to keep all stakeholders informed of progress on the sale process and to be willing to accept advice and criticism from them. Customers of the existing government owned pipeline must be kept fully informed because they have direct contractual and financial interests in the outcome. If this communication process breaks down, the customers will become alienated and will be more likely to sue the government for failure to meet contractual provisions.

Likewise, the landholders, through whose properties the pipelines pass, must be kept up to date with progress. The new owner must ensure that any changes to easement management practices that are to be implemented after sale are also communicated to landholders.

### **Staff**

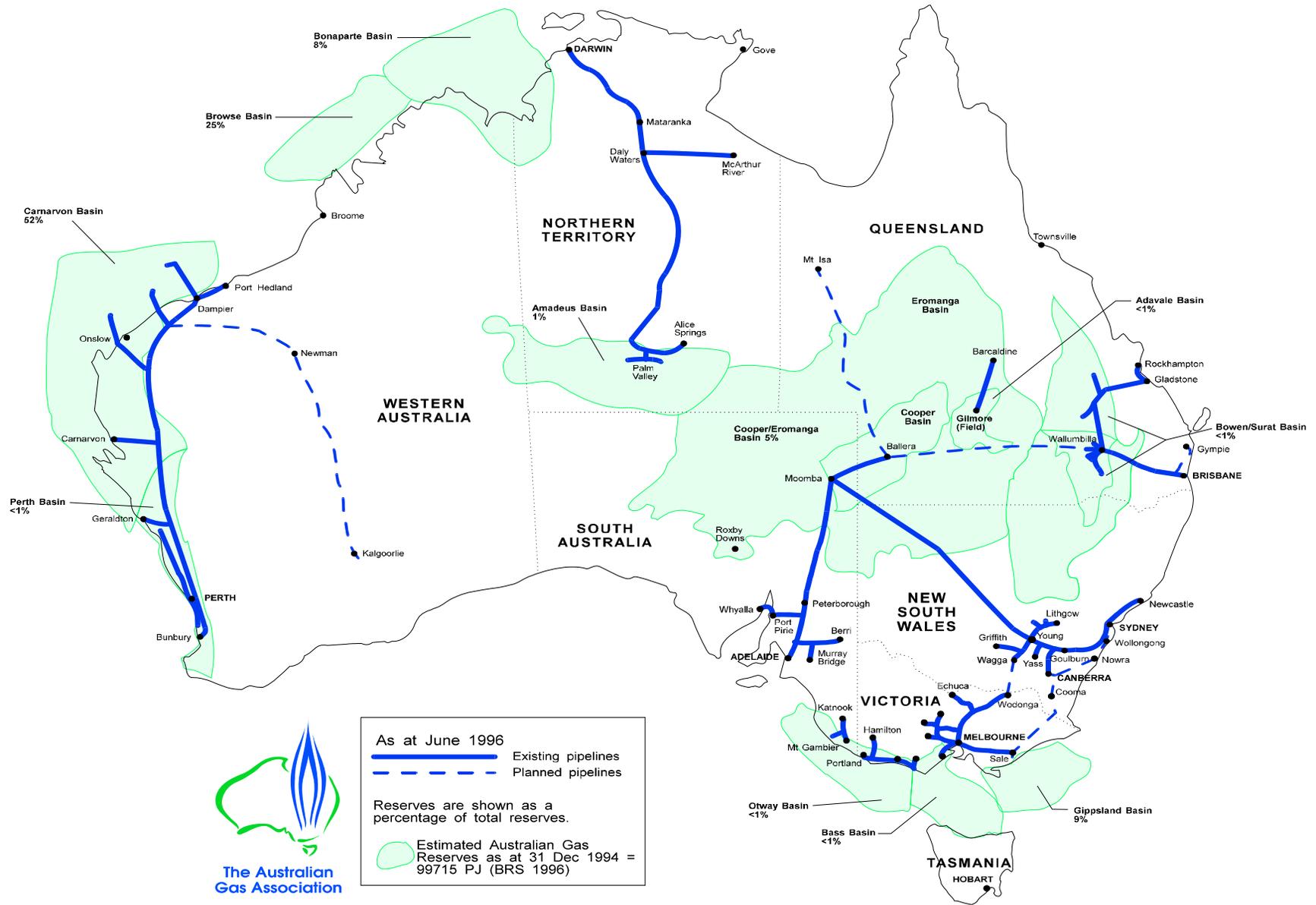
More importantly, the management and staff of the government pipeline owner must be kept fully informed of all aspects of the sale process. If this is not done, rumour and innuendo will result, productivity will fall and industrial action is likely. The relationship with staff was not managed very well in most of the recent pipeline asset sales, and confrontations occurred as a result.

### **Managing the Relationship between Vendor and Pipeline Owner**

As indicated at the beginning of this paper, Boards of Directors of government owned pipeline corporations are often alienated by the government's asset sale task force. It is better for the government and the ongoing effective management of a pipeline system during the sale process for Boards and management to be kept fully informed about the progress of all activities managed by the task forces and to ensure that the Board and management are involved in the decision making throughout the sale process. By maintaining good communication, any potential conflict can be resolved quickly

## **CONCLUSION**

The privatisation process of any government owned asset can be difficult and complex, but provided there is good cooperation between the pipeline owner and the asset sale task force, and if the task force is well informed and has a comprehensive management plan, an asset sale should be able to be accomplished satisfactorily. The difficulties encountered in recent sales resulted from inadequate planning and poor communications. Future assets sales should be undertaken only after those responsible take advantage of the experience accumulated during these first three sales by task forces, pipeline owners and advisors.



**Figure 1 Australia's Gas Producing Sedimentary Basins and Natural Gas Pipelines**  
 (Map reproduced by permission from AGA)