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MEDIA STATEMENT

Address by Mick McCormack, Chief Executive Officer and Managing Director, APA Group to the Australian Pipelines and Gas Association's Sydney Dinner, *7 July 2016.*

Pipelines, gas market dynamics and the energy debate

Thank you for the opportunity to speak this evening. It's been quite some time since I last addressed fellow pipeliners at an APGA event. I am pleased to see many new faces – a clear sign that our industry association is continuing to grow and engage with our industry members.

For those of you who may not know me well, let me start by saying that I am a career pipeliner - it's in my DNA. It's the only real job I've ever had, and I believe in the pipeline industry. The gas industry is critical to the Australian economy, and the pipeline sector is critical to the gas industry.

Indeed, as I look back over my 30 plus years in the industry, it astounds me to see where we've brought this industry to today, the benefits of billions of dollars of new gas pipeline infrastructure that has hugely contributed to the Australian economy over that time.

And tonight, if you will indulge me, I would like to share with you some of my views about the current gas market dynamics, the critical role of pipeline infrastructure in the gas supply debate, and innovation and investment in the pipeline industry. Later, I will also touch on some of the projects we are working on at APA.

Let's start with the gas market.

I'm sure you are all aware that much has been made in recent times of high delivered gas prices and potential gas shortages, particularly in the lead up to the commissioning of the LNG projects at Gladstone. The term "gas crisis" was widely bandied about up until recently, with such talk, in my view, ultimately leading to the ACCC inquiry.

The most important thing that came out of the inquiry is that there is sufficient gas forecast to be produced to satisfy both LNG and domestic demand to 2025 – this is good news for consumers.

That finding is predicated on forecast production occurring and, one would assume, on the ability for gas to get to market. That's where the pipeline industry comes into play.

Pipeline infrastructure is critical to increasing gas supply, and increasing gas supply will put downward pressure on prices. The pipeline industry's success is dependent upon more supply coming into the market, and more customers having access to gas.

To this end, the pipeline industry has a demonstrated record of investing and innovating to give customers the services they need to ensure gas projects proceed.

Over the last decade under the current regulatory regime, APA has spent over $12 billion on infrastructure, systems and technology to provide more pipeline capacity and flexible services to meet customer needs.

APA invested in developing the East Coast Gas Grid, which links all major sources of gas to all major demand centres on the east coast making basin-on-basin competition a reality. Around $100 million has been spent on IT and asset management systems to enable the provision of seamless, one stop shop services across the entire East Coast Gas Grid.

All of this investment and innovation has occurred without a cent of Government financial support, or regulatory oversight – the free market well and truly at work here.

So, what about gas prices?

There is no doubt that the LNG market has exposed domestic customers to LNG export pricing – noting that since the crash of crude oil prices in recent years, there is a question as to what the current LNG export price is. I remember a couple of years ago seeing some domestic gas producers going into print saying the impact of export prices would see domestic gas prices rise 3 or 4 times.

Contrast that with a J P Morgan research report I read recently that is predicting gas prices will increase by 40% over the next decade. That aside, one thing that is certain is that any domestic gas price increases have not been a result of increasing pipeline transmission charges.

It might surprise some people, but these days transmission charges make up between 5-10% of the delivered retail gas price. The 2015 Gas Market Report published by the Department of Industry indicates that transmission tariffs for the industry as a whole have not increased in real terms since 2002, notwithstanding rising gas prices over that time.

This is a fact recognised by the ACCC. So the pipeline industry hasn't been the party putting very steep price increases to the market – we've just charged what we've always charged and tried to grow the gas market.

We are all in agreement that we need to develop more gas reserves. Gas reserves need infrastructure development, and that's where the pipeline industry has, and will deliver.

I am disappointed, but not surprised, that the ACCC report tends to characterise the pipeline industry as part of the problem rather than a critical part of enabling the solution. I'll now make a few observations on the ACCC's findings.

Incremental projects – small part of total business

First, the ACCC points to a number of incremental pipeline projects as supposed "evidence" of broader concerns regarding monopoly pricing in the industry. The allegation is a serious one and one APA absolutely rejects.

To put the claim in perspective, the half dozen APA projects that we understand were relied upon by the ACCC to make this claim make up less than 1.25% of APA's enterprise value on a net present value basis. And 'as available' and 'interruptible' services - also considered to be highly priced by the ACCC - account for less than 0.5% of APA's total revenues.

No evidence of monopoly pricing was noted in respect of the remainder of APA's business, with the ACCC acknowledging the existence of competition in the market for pipeline development, this being the basis on which the bulk of APA's revenues are derived.

Context missing

Second, the ACCC acknowledged that competition occurs for greenfield projects and that resultant tariffs are an outworking of that competitive process. Tariffs charged by APA for capacity on existing assets are generally consistent with foundation shipper tariffs, so in this regard, subsequent users get to piggy back off the competitive tariffs negotiated by foundation shippers.

Similarly, almost all of the APA projects relied on by the ACCC as evidence of monopoly pricing, were subject to competitive pressures either from another pipeline or from customers. Our customers are large, well-resourced companies, well able to look after their own interests when it comes to doing deals.

Incremental projects can't be looked at in isolation

Third, the projects selected were incremental projects that add value to existing pipeline assets (such as bidirectional or compression projects). It is misleading to look at rates of return on incremental projects on a stand-alone basis without any reference to the costs or returns attributable to the underlying asset.

ACCC benchmark

Further, the ACCC's benchmark of what an appropriate return should be, is questionable. There is certainly much room for debate around appropriate metrics and methodology – for example, asset base valuations, cost allocation methodologies and appropriate rate of return hurdles to compensate for project risk.

I really struggle with what seems to be the ACCC's overarching proposition that infrastructure developers should be happy with a regulated return irrespective of the risks inherent in the project and whether the project is yet to be constructed, or is well into operating phase.

Unfortunately, the ACCC's inquiry process did not provide an opportunity for industry to comment on a draft report, so much of the debate that should have happened, didn't happen.

Of course, with no consultation, the issue the industry faces is the blanket assumption that the ACCC's recommendations are reliably worked up from a firm basis of fact or supposed "evidence" as the ACCC likes to portray it – which is definitely not the case, and in my view is not the way sound public policy should be developed.

No case for changing the regulatory test

It is on the basis of this supposed "evidence" that the ACCC recommends a change to the test, presumably a lower threshold, for the regulation of pipelines.

The change to the test is a fundamental shift in the regulatory regime, introducing uncertainty and increased regulatory risk.

Increased regulation comes at a cost – that is well accepted.

The cost is both direct (compliance, administration costs, etc) but most significantly, the cost of distorting incentives to invest and innovate in critical infrastructure and so thereby limiting market growth.

The gas market is a substantial way through the biggest transition it is ever likely to see. The market needs time to transition and adjust, which it is doing. Changing fundamental regulatory settings at this time simply is not the answer to increasing gas supply.

The industry is working with the Australian Energy Markets Commission as part of its Framework review aimed at increasing liquidity and access to capacity. Improved capacity trading platforms, information transparency and, most recently, a proposal for capacity auctions with a zero dollar reserve for unutilised capacity are all on the cards.

It is by enhancing market mechanisms such as through these initiatives, rather than the prospect of increased heavy handed regulation, that gas market growth will be facilitated.

While the ACCC report has taken up much of my time recently, APA continues to deliver smart, reliable and seamless energy services for our customers. On top of that, we have delivered some important initiatives and milestones recently.

As you may know, we have refreshed our brand.

Our new brand reflects a freshness, vitality and new customer focus. Our new logo is a symbol of a bolder, stronger APA. We will continue to be smart, reliable and connected. And we will continue to play a key role in connecting Australia to its energy future. 'energy.connected.' is how we say this in the simplest way.

We've also been busy with some corporate development initiatives.

Diamantina Power Station acquisition

We recently acquired the 50 per cent of the Diamantina Power Station that we didn't already own, from our project partner AGL. This acquisition was a "perfect fit" for APA – particularly in supporting our long term growth strategy.

The acquisition includes two power stations with shared infrastructure – the 242MW Diamantina Power Station with combined cycle gas turbines and the 60MW Leichhardt Power Station with an open cycle gas turbine. These energy assets are connected to our East Coast Grid and we understand them well. They supply electricity to mines and communities in the mineral-rich northwest Queensland.

EPX Takeover

We have also acquired the Ethane Pipeline Income Fund, owner of the Moomba Sydney Ethane Pipeline. Again, the acquisition fits well with APA's strategy. The asset is one we know well – we've been operating it since 2007 and it runs beside our Moomba Sydney Pipeline for most of its length. The acquisition offers the opportunity to increase our equity position in a pipeline asset with a long term contract in place which runs until 2030.

Mortlake Pipeline

You may also have seen that we've recently participated with our SEA Gas partner, REST Industry Super, in the acquisition from Origin Energy of an 83km pipeline in western Victoria. The onshore pipeline supplies gas from the offshore Otway Basin to the Origin-owned Mortlake Power Station. Again, this is an asset we know well. We have been involved with it since 2010, and have maintained it on behalf of the SEA Gas partnership for Origin since it was commissioned in late 2011.

Ongoing projects

Many of you here tonight are from the contracting space and would be interested to know that APA's Victorian Northern Interconnect Expansion or VNIE project is well underway. We are on track to deliver the first tranche of looping in this program shortly and the remainder of the looping by February 2017. Once complete, the pipeline will be fully looped from Wollert to Barnawatha and from Wagga to Young.

We continue to work with our customers to identify opportunities to deliver natural gas to supply new and ongoing requirements.

Importantly, APA will continue to invest and innovate. As an industry leader, APA will continue to play an active role in shaping the best environment for the Australian gas market and will continue to promote what we believe is best for our industry.

We believe that natural gas provides an energy solution that will enable the world to transition to a carbon-efficient environment, whilst maintaining economic growth. Therefore, a strong and responsive infrastructure sector is essential in allowing gas to fuel our energy future.

I will leave you on that note, thank you and enjoy the rest of the evening.

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About APA Group (APA)
APA is Australia's largest natural gas infrastructure business, owning and/or operating around $19 billion of energy infrastructure assets. Its gas transmission pipelines span every state and territory on mainland Australia, delivering approximately half of the nation's gas usage. APA has direct management and operational control over its assets and

the majority of its investments. APA also holds minority interests in a number of energy infrastructure enterprises including SEA Gas Pipeline, Energy Infrastructure Investments and GDI Allgas Gas Networks.

APT Pipelines Limited is a wholly owned subsidiary of Australian Pipeline Trust and is the borrowing entity of APA Group.

For more information visit APA's website, apa.com.au