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Address by Nevenka Codevelle Company Secretary & General Counsel, APA Group to the Grattan Institute's Energy Futures public forum*, 19 May 2016*

Gas pipelines investing and innovation for gas markets

Response to ACCC east coast gas inquiry report

Introduction

Thank you for the opportunity to speak this evening.

The gas market

As the programme for this evening, and the other speakers have noted, much has been made of high delivered gas prices and potential gas shortages. The term "gas crisis" was used a couple of years ago, which ultimately lead to the ACCC inquiry.

The conclusion from the inquiry that there is sufficient gas forecast to be produced to satisfy both LNG and domestic demand to 2025, 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 $40 million was 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.

Gas prices

When it comes to gas prices, there is no doubt that the LNG market has exposed domestic customers to LNG export pricing. Increases in gas prices have not however been a result of pipeline transmission charges.

Transmission charges make up between 5-10% of the delivered price of gas for retail customers. 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.

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.

ACCC report

It is therefore, disappointing that the ACCC report tends to characterise the pipeline industry as part of the problem rather than a critical part of enabling the solution.

Incremental projects – small part of total business
The ACCC points to a number of incremental pipeline projects as "evidence" of broader concerns regarding monopoly pricing in the industry. The allegation is a serious one and one APA rejects.

To put the claim in perspective, the half a dozen APA projects that we understand were relied upon by the ACCC, on a net present value basis, make up less than 1.25% of APA's enterprise value. In relation to as available and interruptible services, also considered to be highly priced by the ACCC, these services 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 is derived.

Context missing
Second, almost all of the APA projects relied on were subject to competitive pressures either from another pipeline or from customers. The tariffs and returns therefore were out-workings of competitive processes and reflected market conditions. 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 potentially 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.

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.

No case for changing the regulatory test

It is on the basis of this "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 thereby limiting market growth.

In the case of coal for example, the infrastructure bottlenecks during the resources boom that began in 2004, are estimated to have cost the Australian economy in excess of $10 billion in lost coal export revenue.

The Productivity Commission has warned that "regulators should be circumspect in their attempts to remove monopoly rents perceived to attach to successful infrastructure projects" noting the potential loss of major benefits to the community where infrastructure projects are foregone.

Maintaining the 15-year greenfields regulatory holiday is not, as the ACCC suggests, an answer to addressing the risk of undermining investment incentives. The time, delay and process, simply don't work when developing greenfields projects which are invariably part of competitive processes. The greenfields holiday has not, as far as APA is aware, ever been relied upon prior to project commitment.

In closing

Finally, the gas market is a substantial the 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.

Thank you.

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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, www.apa.com.au