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Address by Mick McCormack, Managing Director and Chief Executive Officer, APA Group to the Australian Domestic Gas Outlook 2016 Conference Sydney, 8 March 2016

The Gas Industry's Backbone: Pipelines innovating, investing and delivering

- **Pipeline sector has invested over $30 billion on building infrastructure critical to the gas market.**
- **Unprecedented levels of innovation, investment and efficiency with coming together of APA's East Coast Grid.**
- **Critical to maintain an environment to foster continued innovation, investment and efficiency in the pipeline sector, particularly as Australia stands to benefit from the $80 billion east coast LNG industry.**
- **Industry led solutions are best to achieve the COAG Energy Market Vision of a sustainable and liquid gas market.**

Introduction

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.

A bit like a backbone, pipelines have supported the gas market from inception through to growth. And they continue to stand ready to carry the load and respond to all of the twists and turns that lay ahead.

Left to do what the pipeline sector does best, it will do so with the smarts and incentives to support and promote the gas industry.

Growth story

I have worked for over 30 years in the pipeline business. These days, I buckle with pride every time I look at the map and see where as an industry, we have come from. Back in the 1980s when I started in the industry, pipelines only provided a point to point service, simply connecting a single gas basin with a single demand centre.

The role of the pipeliner was only seen as an infrastructure provider rather than a value-add, service provider. And this pretty much remained the case when APA was floated back in June 2000, with our key asset being the Moomba to Sydney Pipeline.

With that as the starting base, I unashamedly had a vision for APA from the start. A vision of a gas market that would span the nation. A market in which basin on basin competition would not only be viable, but thrive. A market characterised by liquidity of supply, and incentives to grow. That market vision could only become a reality with pipeline infrastructure to support it.

My vision was of an interconnected Grid that could transport gas from and to anywhere as seamlessly and efficiently as possible. I spent the next dozen years entirely focussed on making the East Coast Grid a reality. And with the smarts and expertise of APA's team, and I'll admit to a bit of luck thrown in, APA's East Coast Grid is now real. Notwithstanding the efforts from our team, all this would not have been possible if the incentives for investment and innovation and regulatory framework were not right.

But first a look at how the gas pipeline sector has evolved. Since 2000, there has been over $30 billion invested in pipeline infrastructure in Australia. During this time, in excess of 5,000 kilometres of new pipelines were built and all of APA's major pipelines on the eastern side of the country have become bi-directional.

APA has invested over $2 billion in growth capex and over $10 billion in acquisitions to create the interconnected grid that has become the backbone of Australia's gas industry. All making for the strong and flexible pipeline system we have today.

In short, infrastructure investment happened, and it happened in large measure. The incentives were right. The pipeline sector has demonstrably delivered for the benefit, ultimately of the nation. And has done so entirely using private sector funds and not a cent from Government coffers.

Contrast this – say with the coal industry ten years ago. At the height of record high coal prices and an export boom, the coal industry was plagued with supply chain infrastructure bottlenecks – witnessed by up and down the east coast, were dozens of vessels laying up at anchor waiting to get into loading docks.

Some have estimated the cost to the national economy of these bottlenecks to have been in excess of $10 billion in lost export revenues and additional costs, as well as over 1,900 jobs.

At a time when Eastern Australia stands to reap the benefits of an $80 billion LNG industry, the importance of its gas pipeline backbone, has never been so acute.

Future outlook

Irrefutably, the LNG industry has been the game changer for the gas market. Australia is set to become one of the largest exporters of LNG in the world. In the last 5 years, some $250 billion has been invested across the nation. The 3 LNG projects with 6 trains at Gladstone will require in total over 4,200TJ per day of additional gas, trebling demand on the east coast of Australia.

With this comes challenges and uncertainties. Gas demand and supply profiles have, and will continue to change. LNG has affected every aspect of the gas market. Gas supply contracts outside of the LNG proponents have become shorter and more disparate, and prices have been affected – both up and down.

These challenges and uncertainties also create opportunities. Opportunities to innovate to provide services the market values in the changing environment. The way forward will be reliant on innovation and efficiency. The pipeline sector we have today is strong, but flexible, and has the smarts to deliver what is needed in this changing market. Maintaining an environment that fosters the necessary innovation and investment will be critical.

Back to the vision. 2012 was a seminal point for APA. We were successful in acquiring the Hastings Diversified Utilities Fund, and its pipelines, including the South West Queensland Pipeline. That acquisition brought together APA's assets in Queensland with those south of Moomba, the last piece of the puzzle for APA's interconnected Grid.

For a market where innovation, flexibility and responsiveness will become increasingly critical, APA's East Coast Grid has arguably been the single most important development in the market.

In the three years since our East Coast Grid came together, APA has focused on expanding our service offering. We now offer services that allow our customers to manage their energy portfolios more flexibly, and dynamically, in response to market signals, such as multi- asset services, bi-directional service, in-pipe trading, and park and loan services, to name a few.

Shippers can now move gas from anywhere to anywhere on our Grid in a seamless, one-stop-shop transaction – one contract, one set of nominations, one invoice from Longford to Brisbane and any points in between. The uptake of these multi-asset or "grid service" gas transportation arrangements has been so strong it has now become the norm for APA.

These 'grid service gas transportation agreements' provide customers with the flexibility that has become a market imperative. The agreements serve as a standing order for a wide range of services and receipt and delivery points, enabling customers to pick and choose what they need, when they need it.

APA is now able to offer services on terms that help ensure projects happen, and particularly for smaller customers who can now get a look in, competing on a like-for-like basis. In fact, a recent deal we did was for a small customer for less than one terajoule per day. It probably cost us more to set the service up in our system than the service itself, but the point is, we are incentivised to have as many shippers, and as much gas as we can, flowing through our pipelines.

Operationally, the efficiencies of the Grid are clear. APA invested around $40 million in IT systems alone to enable the provision of "grid services", in the Integrated Operations Centre (IOC) in Brisbane – our national "mission control", as well as in asset management systems that enable us to manage our assets on an enterprise basis. APA's assets can now be operated in a seamless, optimised manner from the IOC, and our customers can have a single point of contact across all of our assets.

Not only are our pipeline controllers able to better communicate when managing interconnected assets, but the real value of a centralised control centre is the value-add with the addition of engineering and commercial expertise, all able to talk face to face to optimise the operation of assets and get the best outcomes for our customers.

The LNG projects are a case in point. The volumes involved are huge and when an LNG project coughs, the whole system will know it. Since commissioning of these facilities commenced in late 2014, APA has been able to ensure sufficient volumes of gas were available to meet the variable commissioning requirements of the first LNG train in Gladstone. APA did so by using multiple assets in the Grid and reversing flow direction on several occasions to manage demand spikes. More recently APA was able to provide the flexibility required through flexible storage and loan services, managing substantial volumes of gas by using multiple East Coast Grid assets in response to planned maintenance activities, and continues to do so.

Assets such as redundant compressors in one part of the Grid have been innovatively used to enable service delivery in another. It also means lower service interruption risk, as assets and line pack are able to back up and support service delivery on a whole of Grid basis.

The point that I really do wish to highlight, in what may sound like an advertisement for APA in spending serious money to introduce all this innovation and flexibility, is that we did it before the market asked for it, because we could see the benefits that it would bring to the gas market.

The common ownership and operation of the assets comprising the East Coast Grid have been essential in enabling these innovations and operational efficiencies to occur.

Common ownership and operation ensures seamless coordination and alignment of interests in use of the assets, to enable the efficient delivery of services in a dynamic and uncertain environment. Common ownership supports the economics of investment in assets, technology and expertise.

Competition

A word on competition – I'm all for it. Again, I'll put myself out there and say nothing has facilitated competition in the gas market more than the creation of APA's East Coast Grid. The ability to source gas from any basin on the east via a seamless network of operationally integrated pipelines, does more for basin on basin competition than just about anything else.

When it comes to competition between individual pipelines, again, I'm all for it, provided it is meaningful. A pipeline that feeds in to another on a "must use" route does not compete with that pipeline in any meaningful sense. Inhibiting common ownership of such assets denies the market the opportunities to realise real efficiencies.

While investing, innovating and ensuring our assets are operated as efficiently as possible is what gets me out of bed every morning, much of my time these days seems to be taken up with policy reviews. At last count, there are 5 reviews or consultations ongoing into the gas market.

I reflect with irony, on the fact that absent the pipeline infrastructure that we've built, there would be no effective market, and no prospect of gas liquidity, which of course is the subject of the policy debates and reviews. Nonetheless, a few points on the reviews.

First – There seems to be a general acceptance that gas supply is the real concern. The ability of regulators and even policy makers to influence upstream dynamics is limited. The risk is that intervention in those parts of the market where there is a field of influence, such as pipelines, becomes the fall back. All with little, if any, benefit, but with the significant risk of undermining investment and innovation incentives. The spine may be strong, but it can be easily damaged with inappropriate intervention.

Second – While overseas regulatory models are informative, I caution against a direct overlay onto the Australian market. The Australian market is obviously still in development mode, it is far less mature, and the demand and supply dynamics and geography, all make for a very different market to the EU and US. The temptation to think overseas approaches are the panacea for all our challenges is naive.

Whenever I run into a bureaucrat that has come back from a visit to Henry Hub in the US, all excited about wanting to regulate to have a Henry Hub here – I remind them that Henry Hub was built by a pipeline company, Sabine Pipe Line, and has grown on the back of the development of the most liquid gas market on the planet, and has done so with absolutely no direct regulatory oversight, or any Government funding.

I've always been of the view that the Australian market, left to its own devices will see a more liquid trading market develop on the back of evolving market demand, and particularly so now that the LNG projects are moving into full blown operating mode. But nevertheless – in Australia we do seem to have a tendency to want to regulate ourselves to greatness.

Lastly – as my mother has been known to say, "give a man with a hammer a problem, and guess how he's going to fix it – with a hammer". The concern is that regulatory agencies such as the AER or ACCC, will default to a position that all gas market issues can be dealt with through regulation. This is simply not correct and down-right dangerous. Undermine the incentives for investment, innovation and efficiency, and you risk crippling the market. Again – from where I sit, and looking at the billions of dollars that has been invested over recent years, I think, I could be forgiven for thinking that the current regime seems to be working.

Industry lead market reforms

It is in the interests of the pipeline sector to have as much gas flowing through pipelines as possible – indeed that has always been APA's mantra - more gas means more pipelines. The pipeline industry's incentives are aligned with the COAG Energy Market vision of a sustainable, and liquid, gas market.

To this end, the industry has responded. As well as expanding its suite of flexible services, the pipeline industry has invested in and developed services to facilitate trading and enhance liquidity in the market.

For APA this includes:

- Development of an operational transfer service for trading of pipeline capacity. The platform will soon be extended to enable the trading of compression services.

- Development of In-Pipe Trade services that facilitate title transfer of traded gas at a number of virtual points within the APA East Coast Grid. This service has materially underpinned trading at the Wallumbilla Gas Supply Hub, as well as bi-lateral off market trades.

- A commitment to work to move Wallumbilla to a single trading zone by creating additional compression trading and virtual trading points.

- Enhancement of APA's capacity trading website to give near real time information on major east coast assets.

APA has recently proposed a further initiative to encourage liquidity. In response to concerns about unmet market demand and access to contracted, but unutilised capacity, APA has proposed an auction process for unutilised capacity on fully contracted pipelines, with a zero dollar reserve.

APA's capacity trading platform would be extended to facilitate this automated auction process. The proposal was put forward in response to the AEMC's Framework Review, and we look forward to progressing the initiative. This is a significant step in innovation for the pipeline industry. Again, a demonstration of the fact that we are committed to doing what we can to stimulate trading, gas liquidity and utilisation of pipeline capacity – or put simply – we are well on our way to developing a Henry Hub here in Australia.

It is the pipeline industry that has taken the lead on such initiatives. It did so because it saw opportunity. Because it wants a liquid gas market where as much gas can flow as possible.

With the industry aligned with the COAG Energy vision, I am confident it will continue to innovate, and invest, to deliver the services the market requires. Provided however, the policy settings and regulatory environment allows this to continue to happen. Heavy handed regulatory intervention runs the risk of seriously undermining what is working, and of crippling the market.

In closing, and my final point, the industry has both the ability and the incentive to make the COAG vision a reality. Just look at our track record. We stand ready to continue to work with industry, and with policy makers, to achieve the COAG Energy Market vision. And we look forward to doing so.

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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, GDI Allgas Gas Networks and Diamantina and Leichhardt Power Stations.

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