

05 November 2007

the **australian**
PIPELINE industry

association Ltd



Mr Andrew Taylor
Acting Executive Officer
Joint Working Group on Natural Gas Supply
Department of Industry and Resources
Mineral House
100 Plain Street
EAST PERTH WA 6004

*By email to
Andrew.TAYLOR@doir.wa.gov.au*

Dear Mr Taylor,

**Australian Pipeline Industry Association –
Joint Working Group on Natural Gas Supply**

The Australian Pipeline Industry Association (APIA) welcomes the opportunity to again provide input to the Joint Working Group on Natural Gas Supply (JWG).

APIA re-iterates its position provided in the previous submission to the JWG, dated 31 July 2007 (attached), that this industry strongly supports policy measures that support existing investment in infrastructure and provide opportunities for investment in new transmission infrastructure.

In particular, APIA

- supports streamlining of regulatory processes to reduce barriers to domestic gas supply;
- is not convinced that the draft NGL and NGR legislative package will reduce the regulatory burden on gas transmission pipelines;
- would prefer to introduce a Bulletin Board to address information and trading requirements prior to further consideration of a short term trading market (STTM);
- considers that physical pipeline capacity constraints are generally better addressed by contracting for increased capacity in order to adequately underpin pipeline capacity expansion;
- notes that capacity-signalling issues are likely to be addressed with the introduction of the bulletin board scheduled for 2008;
- believes regulatory approaches to capacity expansion are appropriately addressed through contracts for additional throughput that underpin capacity expansion;
- is supportive of enhanced assessment of the commerciality of retention leases; and
- does not support measures that involve government intervention in gas transmission infrastructure projects.

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APIA emphasises that the development of infrastructure may be hampered under new gas laws if they do not sufficiently encourage new pipeline infrastructure and/or expansion and extension of existing pipelines. It is also quite possible that investment may be delayed or deterred by inappropriate regulatory decision making.

The development of a bulletin board and the creation of the Australian Energy Market Operator are likely to assist in addressing gas market issues, however, existing contracts must be preserved when developing these market structures.

Yours sincerely

A handwritten signature in black ink, appearing to read 'C. Cartwright', with a long horizontal stroke extending to the right.

CHERYL CARTWRIGHT
Chief Executive

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Australian Pipeline Industry Association submission to the Joint Working Group on Natural Gas Supply

31 July 2007

Introduction

The Australian Pipeline Industry Association (APIA) welcomes the opportunity to make a submission in response to the report by McLennan Magasanik Associates (MMA) to the Joint Working Group on Natural Gas Supply, established by the Ministerial Council for Mineral and Petroleum Resources and the Ministerial Council on Energy. APIA is the industry representative body for the gas transmission pipeline industry in Australia.

The issue of institutional or market barriers to the commercial development of natural gas supplies in Australia is of critical importance to all elements of the gas supply industry, including upstream producers, transmission and distribution pipelines and end users.

The gas transmission pipeline industry has historically developed on a commercial basis, with investment and expansions of capacity typically underpinned by bilateral contracts. APIA considers that this market-driven approach has resulted in the competitively priced supply of gas to users. APIA expects the market to evolve naturally over time in line with greater possibilities for trading provided by more interconnection and greater depth of suppliers, pipelines, and users. As such, APIA strongly supports policy measures that are consistent with this market-driven approach rather than a more interventionist and centrally planned model.

The Joint Working Group requested MMA to address three related gas supply issues:

- the barriers to domestic gas supply;
- the risks and benefits of major inter-jurisdictional gas projects; and
- policy options that balance domestic and export needs.

APIA's comments in relation to each of these issues is provided below.

Barriers to domestic gas supply

MMA identified sixteen barriers to domestic gas supply. Those of particular interest to APIA are addressed below.

Infrastructure approvals process

MMA identified that approval processes are time consuming, particularly when multiple jurisdictions are involved. Recommended policy responses include harmonising regulations and/or regulatory bodies and processes across jurisdictions. MMA also cite the new National Gas Law (NGL) and National Gas Rules (NGR) as intending to reduce the burden of regulation on gas pipelines, particularly those with limited market power.

APIA supports any streamlining of regulatory processes to reduce barriers to domestic gas supply. However, it should be recognised that infrastructure approvals and licensing, particularly for inter-jurisdictional assets such as pipelines are impacted by considerably more processes than simply the NGL and NGR. Pipeline and easement approvals, surveying, construction and maintenance are complicated by state-based regulations and processes. These include regulation associated with licensing, land management, environmental and cultural heritage management. Duplication of these processes adds costs and time to any inter-jurisdictional project.

APIA doubts whether the new NGL and NGR legislative package will succeed in reducing the regulatory burden on gas pipelines. While the draft NGL provides the welcome opportunity for some light-handed regulatory options to apply in certain circumstances, we consider that the NGL and NGR could increase the regulatory burden on transmission pipelines.

Retail market balancing mechanisms

MMA conclude that present balancing mechanisms are inefficient and present a barrier to new entrants. It supports the Short Term Trading Market (STTM), recommended by the Gas Market Leaders Group, as the preferred solution.

The details of the STTM proposal are still unclear and, as such, the benefits of this approach have yet to be demonstrated. The possibility of significant costs is an issue of concern. APIA notes that the Gas Market Leaders Group has not yet made a firm decision on progressing with an STTM at this stage.

APIA's preferred approach is the introduction of a Bulletin Board system (discussed further below) as a means of improving transparency of important market information, and hence, promoting efficiency. This approach allows the market to be informed cost effectively and as such represents a prudent step before more expensive options are considered.

Delivery point capacity access

Inability to access pipeline capacity under the contract carriage model is also identified as a barrier to market entry. MMA noted that, at present, this is manifested more through a lack of capacity at certain delivery points. This occurs where delivery points are fully contracted by existing users, thus preventing new entrants from selling gas to end users downstream of those delivery points (without expansion of capacity of that delivery point) rather than due to aggregate pipeline capacity constraints. MMA recognised that there are no easy solutions to this issue, but notes a number of possible responses, including greater definition and signalling of 'unutilised capacity'.

Typically constraints in existing pipelines have been addressed through contracts for additional throughput that have underpinned capacity expansion. This process has worked well.

In terms of unutilised capacity, it should be recognised that infrastructure is sized and built to meet peak day and peak hour demand, and not average day and average hour demand. As such, apparently spare capacity may not in fact be spare on a firm basis. In addition, the issue of unutilised capacity is explicitly addressed in current regulations, including through the requirement to have a capacity trading policy and provisions regarding the sale of unutilised contracted capacity. Similar provisions are included in the draft NGL and NGR. APIA considers that these regulations have worked well and can be expected to continue to work well under the NGL and NGR. APIA also notes that capacity-related issues are likely to be addressed with the introduction of the bulletin board scheduled for 2008 which will be designed to enhance transparency of capacity-related information in the market.

In terms of ownership of delivery points by distribution companies, APIA notes that it is open to access seekers to negotiate expansions of delivery points by contracting with the pipeline owner. This can also be achieved through capital contributions by the access seekers, which are provided for in present regulations.

Pipeline regulation

The impact of pipeline regulation has often been cited as a disincentive to gas transmission pipeline investment. MMA notes that recent changes introduced to the legislation allowing for binding no coverage rulings and price regulation holidays for greenfields pipelines are intended to address this. However, these measures do not apply to expansion of existing pipelines. MMA identify the process of capacity expansion on contract carriage pipelines as a particular issue, noting that pipelines are reluctant to expand unless they have long-term contracts for the expansion.

APIA believes that issues with regard to incentives for expansions are not limited to contract carriage pipelines. In fact, the process to expand a market carriage pipeline is possibly more onerous as it involves third-party regulatory processes and approvals rather than commercial negotiations between affected parties.

Ageing infrastructure

Ageing infrastructure is also suggested as a possible barrier to gas supply and market efficiency. However, MMA consider that infrastructure failure results in only short-term supply problems and is unlikely to create a long-term barrier to supply.

While APIA understands this conclusion, it should be recognised that the issue of infrastructure failure is broader than merely the case of emergencies. In particular, the risk that capital and operating expenditure that is required to be undertaken by a regulated pipeline owner might not be recognised by the regulator in determining allowable revenue can create a disincentive to undertake such expenditure.

Retention leases and production licences

MMA has identified that retention leases and production licences could be used to withhold gas from the domestic market. It recommended a number of options including non-renewal of leases, requesting re-evaluation of commerciality under the lease and termination of production licences in which no petroleum is produced.

APIA is supportive of enhanced assessment of the commerciality of retention leases. Requiring holders of retention leases to justify the claim that the lease is currently non-commercial is unlikely to materially impact on exploration incentives and is likely to have the significant benefit of ensuring that new gas fields are brought to the market as soon as commercially feasible.

Risks and benefits of major inter-jurisdictional gas projects

Regulatory approval processes can impose costs and unnecessary delays, particularly for inter-jurisdictional pipelines. Accordingly, APIA endorses efforts to not only provide proponents with assistance in negotiating government approval processes, but also to streamline and simplify these processes where possible. These measures are focussed on removing unnecessary regulatory impediments to gas supply and minimising the cost of applying regulations.

APIA does not support measures that involve more extensive government intervention, as these are inconsistent with the present commercial and competitively focussed industry. For example, APIA does not support government involvement in tenders for projects where the private sector is willing to construct the project on its

commercial merits to meet identified demand. Such measures can create distortions in the market, resulting in inefficient investment and a reduction in economic welfare.

Policy options that balance domestic and export needs

MMA have recommended a National Natural Gas Plan (NNGP) with the objectives of:

- capacity adequacy – to indicate short-term domestic demand/supply imbalances and the options open to redress them within the available timeframes;
- reserves adequacy – to indicate long-term domestic and export demand growth potential and the implications for supply, taking into account current reserves, likely new discoveries and potential imports.

The policy would detail information relating to demand and supply projections, balance indicators, capacity constraints and development requirements and measures of supply security and reliability.

APIA recognises concerns about long-term energy security, including the security of domestic gas supplies. Nevertheless, APIA continues to support market-driven co-ordination in favour of centrally planned and regulated approaches to meeting emerging energy demand. Reducing regulatory burdens and creating an environment conducive to efficient investment in infrastructure are key factors.

APIA is not committed to a national planning process. Market-based approaches have historically worked well in the gas industry. Pipeline investment has grown in response to demand, where demand is underwritten in bilateral contracts. This suggests that there are limited barriers to investment and contracting and that the concerns in the electricity industry that have led to calls for central planning to facilitate inter-state investment are not applicable to the gas transmission industry. Gas transmission pipelines and markets are different from electricity in many important respects and, therefore, efforts to impose electricity industry approaches on the gas industry are unlikely to be beneficial.

In light of this, APIA is concerned that any moves to develop a national gas plan may have unintended consequences in terms of interfering with efficient market-based outcomes, potentially undermining the efficient provision of infrastructure and development of reserves. In particular, APIA is concerned that such a plan could become the focus for centralisation of industry functions, particularly market functions. It could also tend to reduce upstream competition and pipeline-to-pipeline competition, such that planned outcomes become preferred to market outcomes. In addition, there is a risk of costly reporting burdens on industry, and the development of a planning framework that may become divorced from market realities.

Nevertheless, if this option was to be further considered, APIA believes that any plan should be:

- voluntary;
- industry driven, rather than government driven;
- for information purposes only, imposing no binding obligations;
- present multiple future options rather than a preferred option;
- aggregated to a level where individual asset commercial positions cannot be identified and confidentiality is protected; and
- not present revenue or price forecasts beyond those which are already public (for example, through covered pipeline access arrangements).

Conclusion

In conclusion, APIA:

- supports streamlining of regulatory processes to reduce barriers to domestic gas supply;
- is not convinced that the draft NGL and NGR legislative package will reduce the regulatory burden on gas transmission pipelines;
- APIA would prefer to introduce a Bulletin Board to address information and trading requirements prior to further consideration of a STTM;
- considers that physical pipeline capacity constraints are generally better addressed by contracting for increased capacity in order to adequately underpin pipeline capacity expansion;
- notes that capacity-signalling issues are likely to be addressed with the introduction of the bulletin board scheduled for 2008;
- believes regulatory approaches to capacity expansion are appropriately addressed through contracts for additional throughput that underpin capacity expansion;
- is supportive of enhanced assessment of the commerciality of retention leases;
- does not support measures that involve more extensive government intervention in major gas projects; and
- does not support a national planning process as market-based approaches have historically worked well in the gas industry and any moves to develop a national

gas plan may have unintended consequences in terms of interfering with efficient market-based outcomes.