



29 August 2008

Committee Secretary
Senate Select Committee on Fuel and Energy
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Via email to fuelenergy.sen@aph.gov.au

Dear Sir/Madam

Senate Select Committee on Fuel and Energy

The Australian Pipeline Industry Association (APIA) appreciates the opportunity to comment to the Senate Select Committee on the challenges facing the petrol, diesel, and gas industries. These industries are facing commercial challenges stemming from increased global demand, increased regulation and the likely introduction of an emissions trading scheme. APIA believes that more effective regulation of the gas transport sector, and careful and conservative implementation of an emissions trading scheme, are important in ensuring gas prices are not unduly impacted.

APIA has provided comment on the terms of reference in the attached submission. Please contact me on (02) 6273 0577 or at ccartwright@apia.asn.au if you have any queries relating to APIA's submission.

Yours sincerely

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APIA Submission to Senate Select Committee on Fuel and Energy

The impact of higher petroleum, diesel, and gas prices

APIA considers that gas markets are currently working effectively and competitively to set prices.

As in many other markets, there have been some upward price pressures on delivered gas prices. These pressures have been the result of a range of factors such as increases in wages, construction materials, and costs of exploration and production, as well as increases in demand, including power generation demand and international demand.

It is important that governments do not intervene in a reactive manner in an attempt to constrain prices to consumers. Any intervention by governments to limit gas prices to consumers can squeeze margins across the gas supply chain and increase the risks to participants of operating in the market. In turn, this can limit return on investment, discouraging participants from operating in the market or investing in exploration, production and infrastructure. Thus, in the longer term, price intervention may restrict supply and as a consequence, can actually lead to increased prices.

The operation of the domestic petroleum, diesel and gas markets

The demand for gas in residential, commercial, industrial and power generation markets will continue to be strong over the medium and long term.

The key challenge will be meeting this increased demand. This will require major new investment, including in new and expanded gas transmission pipelines, production and refining facilities. The costs of not meeting this increased demand will be much higher than any costs associated with early investment to meet demand as it develops.

Governments can assist the market to meet this challenge by avoiding over-regulation of gas markets, and in particular of transmission infrastructure.

At present, governments regulate the prices that many gas transmission pipelines can charge. Governments are also considering the mandated introduction of a short term trading market and requiring greater reporting by gas pipelines on a range of areas. Such measures are likely to impose significant costs on the gas transmission sector.

Governments have recently replaced the Gas Code (which regulated gas transmission charges) with the National Gas Law. In an effort to reduce the discouraging impact of

regulation on gas transportation, the new Law provides the option of lighter-handed regulation (allowing *some* gas pipelines to seek price monitoring rather than price control of gas pipelines) and price regulation holidays for new pipelines (allowing for a break from price control for up to 15 years).

While the National Gas Law permits the option of lighter-handed and lower cost regulation of gas pipelines, some pipelines are barred from applying to the regulator for light-handed regulation and the time required for such application also discourages participation by potential investors.

The National Gas Law has set new pricing and revenue rules designed to balance the investment returns required by pipeline owners and the interests of users and producers. Under the Gas Code, regulators focussed on driving down the cost of gas transport, setting unduly low charges for gas transmission pipelines. The regulatory system limits the available returns on pipelines to a level where necessary new investment is not necessarily attractive.

It remains to be seen how the new pricing and revenue rules under the National Gas Law sufficiently acknowledge the risks of investing in gas transmission pipelines, particularly in the current uncertain investment climate.

Given the critical value of gas in driving economic expansion, under-investment would be very costly to the nation. Reasonable rates of return are important in encouraging continued private sector investment in gas transportation infrastructure, which increases reliability of supply and creates greater competition among pipeline companies, gas producers and gas wholesalers and retailers.

The impact of an emissions trading scheme on the fuel and energy industry

APIA supports the introduction of a Carbon Pollution reduction Scheme (CPRS) to address global warming subject to addressing the challenges involved in its introduction. These challenges include:

- (i) determining the point of liability under a CPRS and whether these liabilities can be passed on through the gas supply chain;
- (ii) ensuring the scheme does not distort markets;
- (iii) ensuring the scheme operates at minimum cost; and
- (iv) selecting appropriate pricing mechanisms, ensuring neutrality between options (e.g. no exemptions) and considering compensation (if any).

The Carbon Pollution Reduction Scheme Green Paper proposes to impose liability on gas transmission pipelines for gas emitted during the transportation process.

Gas pipelines typically provide transportation under long-term contracts that may or may not provide the ability to pass on to shippers any new sources of liability, such as those that arise under the CPRS. Strictly speaking, these liabilities may not be considered to be tax liabilities and so may not be able to be passed through under provisions in long-term contracts entitling gas transmission entities to pass on tax liabilities.

It is critical to ensure a level playing field for all industries that either a mechanism is found to permit the passing-on of any liabilities under the CPRS, or liability is imposed on end-use

customers. If end-use customers do not receive the price signal intended by the CPRS then the system will not achieve its objectives.

It is critical to ensure that the CPRS operates at minimum cost. One significant additional cost at present is the mandatory renewable energy target (MRET) scheme. The MRET scheme aims to provide subsidies to renewable energy at the same time as the CPRS aims to impose liabilities on fossil fuel generation.

APIA notes that the overall effect of having both the MRET and CPRS in place at the same time would be to unnecessarily increase the costs of reducing emissions. This is because the MRET scheme effectively mandates a preferred solution of renewable generation to meet the CPRS emissions targets, and this mandated solution of 20 per cent renewable generation would be far more costly than alternative systems of reducing emissions, such as switching from coal to gas-fired generation.

The argument in support of the MRET scheme is that it is required to support the development of new low-emissions technologies. However, the main forms of renewable generation (hydro, wind, nuclear) are already well researched and developed and do not need targeted assistance, and key new technologies that must be developed to address global warming, such as fuel cells, gas micro-generation, carbon capture and storage for coal and gas generation, may not be eligible under the MRET scheme because they relate to fossil fuels.

It is important that a CPRS provides adequate compensation for trade-exposed emissions intensive industries (TEEIs), particularly while other nations are not participating in emissions control. To do otherwise would result in industries shifting offshore to countries which do not impose liabilities on emissions.

TEEIs are a major proportion of gas demand. If demand from TEEIs should fall following the introduction of a CPRS, then the capital-intensive fixed costs associated with gas production, transmission, and distribution would be borne by the remaining pool of demand. This would substantially increase the costs of gas supply, including to non-trade exposed small businesses and domestic users.

The existing set of state government regulatory powers as they relate to petroleum, diesel and gas products

APIA welcomes any streamlining of State and Territory regulatory processes that would reduce the costs and delays associated with infrastructure approvals and licensing. These costs can be significant, particularly in relation to interstate pipelines.

A possible solution for interstate gas transmission pipelines would be for one jurisdiction (for example, the jurisdiction where the pipeline is mainly situated or operated from) to assume the lead on the processes to be followed, with other jurisdictions recognising the lead jurisdiction's process as far as possible. For example, the lead jurisdiction could be responsible for issuing the pipeline licence, which would then be recognised by other jurisdictions. A second solution would be for jurisdictions to more closely align their approvals and licensing processes.

Alternative fuels

Natural gas can be used as a cleaner option in transport compared to petrol or diesel, and in power generation compared to coal or diesel.

The price that a CPRS puts on greenhouse gas pollution should result in increased use of natural gas in transport and power generation, reflecting gas's advantage as an energy source with lower carbon emissions. To ensure that this occurs, it is important that the CPRS does not disadvantage the transmission sector. If the CPRS does not operate broadly and fairly, it could encourage increased diesel generation in preference to gas generation which would not be the aim of the Government's emissions reduction policies.