



3 October 2008

Mr John Hawkins
Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Mr Hawkins

Inquiry into matters relating to the gas explosion at Varanus Island, WA

The Australian Pipeline Industry Association (APIA) welcomes the opportunity to provide comment for the Senate Standing Committee on Economics Inquiry into matters relating to the accident at Varanus Island in Western Australia (the Inquiry).

The gas explosion at Varanus Island in early June 2008 was an incident related to gas supply in Western Australia. Varanus Island is an oil and gas processing hub, supplying approximately 30% of Western Australia's gas demand. The explosion caused the shutdown of the production and processing facilities on Varanus Island, leading to an inability to supply gas into transmission infrastructure for transportation to users.

The shutdown resulted in a total cessation of supplies from the processing facilities until early August 2008. While partial production has recommenced, APIA understands that full production from the processing facilities at Varanus Island is not expected to be achieved until December 2008.

During the outage at Varanus Island, it should be noted that gas transmission pipelines were available to supply all the gas that was available for Western Australia's domestic users.

Thus the Varanus Island incident impacted on the capacity of gas production and processing infrastructure to supply gas to Western Australian users - not on the capacity of gas transmission pipeline infrastructure to transport gas.

As a result of the Varanus Island incident, there have been calls for further expansion of Western Australian gas transmission infrastructure. However, the proponents of this suggestion do not clarify how investing in pipeline spare capacity would improve diversity of gas supply to users in Western Australia or reduce the impact of any future, similar incident. APIA considers that these calls:

- ignore the reality that, in the last three years, more than \$1,800 million has been committed to investing in pipeline capacity through expansions to meet customer demand; and

- avoid the most apparent means by which diversity of gas supply to customers can be improved, that is by encouraging additional supply and processing facilities.

APIA would like to clarify that:

- additional gas transmission infrastructure or capacity would not change the fact that, during the recent incident, insufficient gas to supply all users was being fed into transmission infrastructure as a result of the incident;
- gas transmission infrastructure is built to connect supply and demand, it does not substitute for gas supply. In order to ensure adequate gas supply, diversity of gas production ownership and gas processing facilities capable of supplying the Western Australian market must be encouraged and this should be the focus of any recommendations from the Inquiry. APIA considers the Commonwealth Government's review of the retention lease regime provides an effective first step in addressing the issue of diversity of gas supply;
- existing gas transmission infrastructure meets existing demand in Western Australia; and
- additional gas transmission infrastructure can be constructed faster than the construction of downstream users' plants.

With regard to the discussion about additional investment in transmission pipelines, it should be noted that the current pipeline economic regulatory regime effectively discourages investment in spare pipeline capacity. Any pipeline capacity that is not contracted or utilised is subject to scrutiny, including price setting, by the economic regulator, the Australian Energy Regulator (in WA the Economic Regulation Authority). Under the framework of the Gas Code and its replacement instrument, the National Gas Law, infrastructure investors in regulated pipelines face a real risk that the cost of building spare or unutilised capacity will not be rolled into the capital base and will not be included in the setting of the reference tariffs set by regulators.

Infrastructure investors considering investing in gas transmission pipeline spare capacity rather than building to contract requirements, even in unregulated pipelines, face the real risk of regulatory intervention and insufficient tariffs being set for that spare capacity and will, usually, opt to invest in infrastructure that is built to full capacity.

This uncertainty of return on investment under the regulatory regime means investors in transmission pipelines will be unwilling to commit funds to invest in spare or unutilised capacity. As a consequence, almost all pipelines are built, or expanded, to only meet contracted capacity.

Any finding by the Inquiry, therefore, that increased pipeline capacity is required would also need to recognise the barrier that the regulatory environment presents to speculative investment.

APIA is aware of arguments that the absence of spare transmission capacity discourages the development of spare gas production capacity. It is problematic to require pipeline companies to invest in transmission capacity when the production and processing infrastructure to physically supply the gas required for the pipeline capacity does not exist. Alternatively, if spare production capacity did exist and there

was demand for that supply, the necessary gas transmission infrastructure could be built in time to meet the demand.

It is also noted that calls have been made to broaden the gas quality specification applicable to Western Australian transmission pipelines. Again, APIA considers that this will not result in an improvement in the diversity of gas supply to users in Western Australia nor will it avoid a similar event occurring in the future.

I am happy to discuss these issues further with the inquiry.

Yours sincerely

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

CHERYL CARTWRIGHT
Chief Executive