APA submission

Draft regulatory determinations and elections guide

July 2023

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Mr Arek Gulbenkoglu
General Manager
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Lodged by email: AERgasreform@aer.gov.au

26 July 2023

RE: APA Submission to the draft regulatory determination and elections guide

Dear Mr Gulbenkoglu,

Thank you for the opportunity to comment on the AER's draft regulatory determination and elections guide (Draft Guide). We appreciate the opportunity to comment on the development of guidelines that outline how the AER intends to exercise its new powers under the recent gas pipeline reforms.

APA is an Australian Securities Exchange (ASX) listed owner, operator, and developer of energy infrastructure assets across Australia. Through a diverse portfolio of assets, we provide energy to customers in every state and territory on mainland Australia. As well as an extensive network of natural gas pipelines, we own or have interests in gas storage and generation facilities, electricity transmission networks, and over 681 MW of renewable generation.

APA is investing to make sure that gas is available where and when it is needed. Our east coast gas grid expansion is a great example of this. We have invested around $500 million to meet demand in southern markets. Commercial decision-making and contracting, rather than regulatory processes, has enabled the nimble and efficient expansion of infrastructure and the appropriate allocation of risk between parties.

Our submission below addresses various issues raised in the Draft Guide. If you wish to discuss our submission in further detail, [redacted]

Kind regards,

Elizabeth Griggs

Beth Griggs
General Manager Economic Regulation and External Policy
Strategy and Commercial

1 Submission

Key points

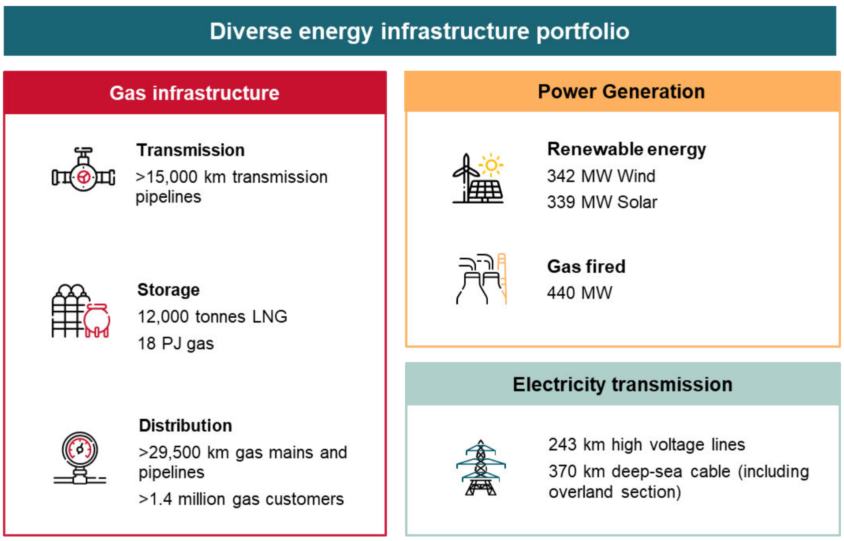
- Market driven commercial negotiations underpin the Australian gas pipeline transmission market. To date, this market driven framework has enabled dynamic and responsive investment by APA.
- Commercial contracting, rather than regulatory processes, has enabled the nimble expansion of the east coast gas network and the appropriate allocation of risk between negotiating parties.
- Such a rapid response to the needs of the market is far less likely if non-scheme pipelines become subject to five yearly regulatory reviews.
- The ability or incentive to exercise market power, on its own, should not be sufficient to justify the full regulation of pipelines.
- Greenfields incentive determination processes should consider a wider range of competitive processes for the provision of energy services than is considered by the Draft Guide.

1.1 Introduction

APA is a leading ASX listed energy infrastructure business. Consistent with our purpose to strengthen communities through responsible energy, our diverse portfolio of energy infrastructure delivers energy to customers in every state and territory on mainland Australia.

Our 15,000 kilometres of natural gas pipelines connect sources of supply and markets across mainland Australia. We operate and maintain networks connecting 1.4 million Australian homes and businesses to the benefits of natural gas. We also own or have interests in gas storage facilities and gas-fired power stations.

Figure 1



We operate and have interests in 681 MW of renewable generation infrastructure. Our asset portfolio also includes high voltage electricity transmission assets that connect Victoria with South Australia, and NSW with Queensland.

In October 2022 we completed the acquisition of Basslink Pty Ltd, which owns and operates the 370km high voltage direct current (HVDC) electricity interconnector between Victoria and

Tasmania. The acquisition adds a third electricity interconnector to APA's infrastructure portfolio and is consistent with our strategy to play a leading role in the energy transition.

APA actively supports the transition to a lower carbon future. In August 2022, we published our inaugural Climate Transition Plan (our Plan) which outlines our commitments to support Australia's energy transition and pathway to achieve net zero operations emissions by 2050.

As coal power stations retire, gas will have an increasingly important role to play in supporting the security and reliability of the energy system. And APA is already taking steps to ensure that gas gets to where and when it is needed, investing around $500 million to increase supply to southern markets.

Our submission outlines views on three important issues in relation to the Draft Guide and the exercise of the AER's new powers under Part 4 of the National Gas Rules (NGR) and Chapter 3 of the National Gas Law (NGL):

- scheme pipeline determinations could impact our ability to quickly respond to market signals and expand the capacity of transmission infrastructure;
- the ability or incentive to exercise market power, on its own, should not be sufficient to justify the full regulation of pipelines; and
- some competitive processes for the provision of energy services would not be captured by the AER's proposed approach to greenfields incentive determinations.

The Draft Guide encourages stakeholders to engage with the AER before applying for determinations or decisions dealt with in the Guide. Similarly, we encourage the AER to engage with regulated businesses before initiating a process to make a form of regulation determination (an AER-initiated review).

1.2 Efficient and nimble expansion of gas infrastructure

Gas infrastructure operators have a strong track record of delivering the necessary infrastructure to ensure customers have sufficient gas in the locations they need it.

To date, the incremental expansion of existing infrastructure has been the most efficient, timely and lowest cost solution to ensure that gas is delivered when and where it is needed. Gas retailers coordinate with:

- producers to ensure they secure gas supplies; and
- pipeline operators to ensure they can transport gas from gas fields to their end customers.

The expansion of the east coast grid has been market driven. Across the east coast gas market, pipeline operators negotiate bilateral contracts with gas shippers, who then gain access to transmission capacity. This is known as the contract carriage model, which extends across the whole east coast gas market, except for the Declared Transmission System in Victoria.

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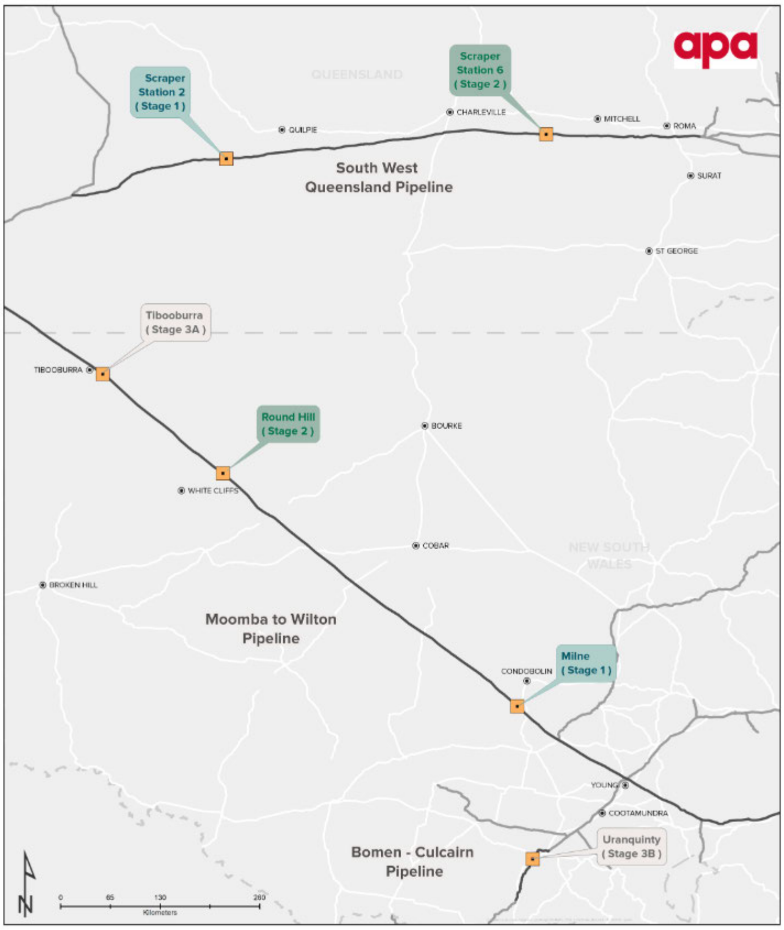
Under this contract carriage model, short term and long term contracts support the operation of the market and the efficient expansion of transmission pipelines and other infrastructure when needed. Bilateral negotiation between parties drives investment, which is ultimately based on the needs of the customer. Through this model, investment in expanded capacity can be done in a timely manner.

Since 2021, APA has announced three expansions of the east coast grid to support energy needs in southern markets:

- In May 2021 APA announced that it would increase the capacity of the east coast grid by 25%. On 3 July 2023 APA announced that construction of this first stage of the east coast grid expansion, which increased capacity by 12%, had been completed.
- Stage two of the east coast grid expansion commenced in the second quarter of 2023. This stage includes the construction of additional compressors to add a further 13% transportation capacity. Stage 2 is on schedule to be operational for Winter 2024.
- While APA has not yet committed to stage three of the expansion, engineering and design works are underway to scope the potential next phase should it be required.

Figure 3



As it becomes clear that further investment in gas infrastructure is needed, market signals and bilateral contracting support the continued expansion of the east coast gas transmission network. Importantly, these expansions are responding to increases in peak demand in southern markets. This means that any investment case must be supported by peak contracting assumptions that may only apply for a small proportion of the year and could be addressed by alternative infrastructure and supply options provided by other parties, including storage or gas swaps.

Incremental expansion also progressively becomes more costly as lower cost and higher yield expansion options are accessed first. This means that risks associated with such investment are increasing and are exacerbated by uncertainty in the gas supply market and the potential for regulatory intervention.

Stage 1 of the east coast grid expansion took around two years from announcement to completion. Commercial contracting, rather than regulatory processes, enabled the nimble expansion of infrastructure and the appropriate allocation of risk between negotiating parties. Such a rapid response to the needs of the market is far less likely if non-scheme pipelines become subject to five yearly regulatory reviews.

Primarily, this is because any capital expenditure can only be rolled into the Regulated Asset Base (RAB) once it has been approved by the AER during five yearly access arrangement processes. Regulated businesses are far less likely to invest in regulated assets if there is uncertainty over whether any capital expenditure will be rolled into a pipeline's RAB.

We recognise that the AER has the power to make an advanced determination with regards to future capital expenditure under rule 80 of the NGR. However, such a determination does not provide the business with a return on the investment until the next access arrangement. This would be a material consideration in any decision to undertake investment on regulated assets without prior regulatory approval through the access arrangement process.

The threat of greater regulation significantly reduces the attractiveness of investment in infrastructure assets, compared to unregulated infrastructure. Given policy uncertainty in gas markets and the increasing risk of asset stranding, the threat of regulated rates of return makes it more difficult to attract capital to regulated infrastructure, compared to unregulated infrastructure.

1.3 Form of regulation decisions

The form of regulation factors require the AER to consider a range of factors relating to the extent of market power, including considering countervailing market power and the presence and extent of any substitute and elasticity of demand.

This reflects the fact that even though an infrastructure provider might be in a monopoly position, there are often constraints on its ability to exercise any market power. Any regulatory intervention should therefore target circumstances where there is strong evidence of misuse of market power.

However, the Draft Guide states that:

> *the AER may consider commencing an AER-initiated review of a non-scheme pipeline where there is evidence to suggest that a service provider may have the ability and incentive to exercise market power, or may be exercising market power, in the supply of pipeline services.*

In our view, the ability or incentive to exercise market power, on its own, should not be sufficient to justify commencing an AER-initiated review of a non-scheme pipeline.

In guidance to applicants for a form of regulation application, the AER lists as possible reasons for a form of regulation application:

- An inability to negotiate access to pipeline services
- An inability to negotiate reasonable price terms and conditions

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- An inability to negotiate reasonable terms and conditions
- The person considers the service provider is exercising market power in dealings with pipeline users.[1]

In our view, there should be firm evidence of these types of behaviours by the pipeline service provider before the AER should consider making a form of regulation determination.

To date, there have been no known instances of refusal to grant third party access to gas pipelines and there is no evidence of market failure that would warrant greater regulatory intervention.

1.4 Greenfields determinations and competition in the provision of energy services

APA supports the development of an effective greenfields exemption framework. The risk of regulation being imposed after a competitive process has been completed changes the risk profile of an investment decision making process. A greenfields exemption process needs to provide increased investment certainty to allow new investment to occur at lower foundation contract tariffs.

The key feature of greenfields investment is that it occurs in the context of a competitive environment. Section 29 of the NGL recognises this fact and requires that an application for greenfields price protection includes:

> *(c) information about whether the pipeline is being developed following a competitive process; and*
>
> *(d) if the pipeline is being developed following a competitive process – a description of the competitive process;*

Section 29, however, does not state that the competitive process must be for the development of a pipeline. Section 29 is technology agnostic and simply refers to a ‘competitive process’.

There are many different types of competitive processes that result in the development of a greenfields pipeline. Section 110 of the NGL recognises that such processes may be ‘formal’ or ‘informal’.

APA frequently participates in competitive tender processes for the provision of energy services. These competitive processes are technology agnostic and highly competitive. Inter-energy competition, such as competition between natural gas (piped or trucked), diesel, renewables and batteries, would not be captured by the current drafting of Section 5.4.1 of the Draft Guide, which states:

Factors that we may consider in assessing whether the development of the pipeline is occurring under competitive conditions and whether this may constrain a service providers market power, include:

- *the number of prospective service providers seeking to develop the pipeline*

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1 AER, *Draft Guide,* Section 3.2.2, p8

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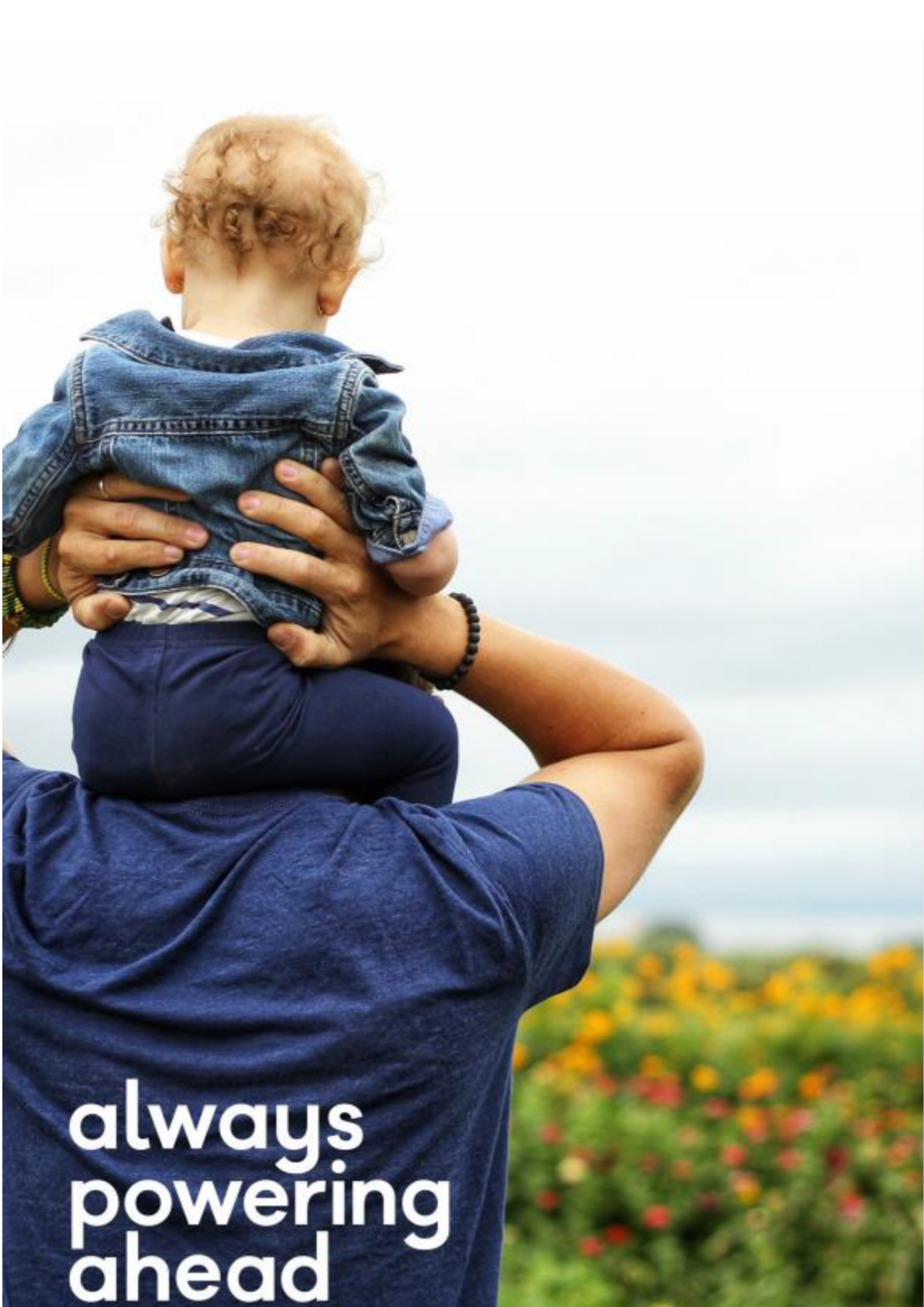
- *the credibility of the proposals to develop the pipeline service*

There are many pipeline developments, such as APA's Northern Goldfields Interconnect, where a pipeline operator takes a risk position based on future growth opportunities in a market with competitive energy alternatives (such as diesel and renewables). In our view, the greenfields incentive mechanism should be broad enough to capture pipeline projects such as these.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