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N M Heath
Gas & Power Marketing Director

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The Presiding Commissioner
Gas Access Regime Inquiry
Productivity Commission
LB2 Collins Street East
MELBOURNE VIC 8003

Dear Commissioner,

I refer to the Productivity Commission issues paper for the Review of the Gas Access Regime dated July 2003. Attached please find ExxonMobil's submission to the Review addressing the key issues.

ExxonMobil believes that this Review is an important step in ensuring the ongoing development of the gas industry including growth in the depth of market competition which ultimately will provide end consumers with improved reliability and choice.

ExxonMobil looks forward to providing further input to the Commission's review as recommendations are developed.

Yours faithfully,

N M Heath
Gas & Power Marketing Director

1. Introduction

ExxonMobil is a producer of gas from the Gippsland basin in Victoria through its subsidiary Esso Australia Resources Pty Ltd, and from the Cooper-Eromanga basin of South Australia and Queensland through its subsidiary Delhi Petroleum Pty Ltd. Gas from these producing basins is supplied to customers in Victoria, New South Wales, ACT, Tasmania, South Australia and Queensland. Critical to the supply of gas to these markets is the maintenance and efficient development of the existing transmission and distribution pipelines throughout the eastern States of Australia.

ExxonMobil is seeking to become a major gas producer in PNG and from the Carnarvon Basin of Western Australia. Our PNG marketing group is actively marketing gas into the north and east of Australia which requires the development of a major new greenfield transmission pipeline system from PNG into northern Queensland and to the southern Queensland and other east Australian markets. While the primary market opportunity for Carnarvon Basin gas is export LNG sales, domestic gas sales opportunities are also being pursued and will be reliant on existing and new transmission and distribution infrastructure and its efficient future development.

As a major Australian gas producer and participant in the Australian gas industry, ExxonMobil has a significant interest in the recommendations to be made by the Productivity Commission during its review of the Gas Access Regime and ultimately any changes that are made by Government.

2. Market Development & the Gas Access Regime

The development of strong and deep competition, including upstream competition will directly depend on the creation of new market opportunities. However, critical to supplying those market opportunities and bringing new resources to the market at competitive prices will be the efficient development of new gas transmission pipelines as well as fair access to existing pipeline infrastructure.

Since its introduction the Gas Access Regime has facilitated access to markets that may otherwise have been inaccessible by third party supplies because that access was via a monopoly pipeline system. By providing mechanisms for producers to have access to pipeline systems where there has been demonstrated transportation market failure, the Gas Access Regime has supported the working of a national energy market.

The Gas Access Regime was developed at a time when the market history was one of very limited interconnectivity between State transmission systems, supply basins and markets, and when transmission and downstream activities were primarily monopoly franchise activities in each State. In this environment the form of the Gas Access Regime was understandably, if not necessarily, heavy handed as it endeavoured to facilitate the rapid development of a transnational pipeline grid to support enhanced upstream and downstream competition. While there is scope for further pipeline development before a fully integrated national grid is realised, the significant and rapid change in the market over the past several years now demonstrates clearly a strong momentum towards deepening competition and interconnectivity. For example, downstream market re-structuring and pipeline access has brought about the emergence of a number of new and planned gas supply projects. Given the development that has occurred, ExxonMobil believes it is now opportune to review the Gas Access Regime and revise those aspects where lighter handed regulation will facilitate ongoing market development.

The development of new upstream projects and new pipelines requires large capital investment and it is vital that the regulatory environment aims to support the efficient development of such infrastructure and therefore aims to minimise regulatory risk. ExxonMobil believes that the existing Gas Access Regime does not always ensure such a balance. ExxonMobil believes that the processes for coverage, access arrangement authorisation and tendering under the existing Gas Access Regime while comprehensive are extremely slow and laborious, therefore presenting significant risk. An example of the difficulty that these processes present was demonstrated recently by the Tasmanian Government's application of the tender procedures for the provision of reticulated gas services. In such a small, undeveloped market, it may well have been more beneficial for consumers and the state as a whole if the Government had simply awarded an exclusive franchise for a significant number of years. In this Tasmanian case, timely development of the supply system and access to gas by end consumers clearly was of critical importance. It now appears gas distribution will occur according to a schedule which is significantly later than originally anticipated. Under such circumstances optimising the economic efficiency of the system may well be initially an unrealistic objective that can be given greater importance further into the future once the system and market have developed sufficient depth.

A further example of the difficulties presented by the existing Gas Access Regime can be seen in the authorisation process for the Moomba to Sydney pipeline and the significant time it has taken to process draft decisions and challenges with respect to coverage and authorisations. These processes are yet to be finalised despite several years of laborious regulatory process.

The Gas Access Regime clearly provides a complex and comprehensive regulatory framework for due diligence, but it is questionable whether there are net benefits in its application to all areas of the pipeline industry. At a minimum, there is a need to simplify and speed up the administration of the coverage and authorisation processes of the Gas Access Regime. ExxonMobil does not believe there could be a measurable net benefit from such long drawn out processes that may add to a perception of transparency, but significantly increase uncertainty, inefficiency and cost. Similarly, unless there is a transmission market failure, where access to available capacity cannot be obtained through commercial negotiation, it is hard to see the net benefit of the application of coverage under the Gas Access Regime.

3. Fundamental Regulatory Principles

ExxonMobil believes that free commercially negotiated market outcomes between transmission pipeline owners and users are the most effective approach to provide the environment for market growth, security of supply and infrastructure investment. In a highly interconnected transmission pipeline system which provides competitive conduits for gas to reach markets, regulated pipeline access of the type prescribed through the Gas Access Regime should not be required. While this environment does not exist in Australia today, the ultimate goal as the system develops should be light handed regulation that in the first instance facilitates commercially negotiated outcomes rather than moving to tighter prescriptive regulation. Further, coverage of transmission pipelines should be restricted to pipelines where free and fair commercial negotiations have failed or are not possible due to absence of competitive forces and presence of monopoly behavior.

ExxonMobil believes these principles should form the basis for access regulation supporting a long term aim for commercial negotiations with light handed regulation and coverage under a regulated access regime limited to protection from clear monopoly behavior.

4. Greenfield Pipelines

Key for the deepening of competition by upstream producers in Australian gas markets is the development of new resources located in existing and remote basins. Critical in enabling these new resources to reach markets will be greenfield gas transmission pipelines. However, large projects of this nature require large investments and bear significant risk both by the upstream gas producer and the pipeline developer. Therefore, fundamental to developing these new opportunities are commercially negotiated offtake and foundation shipper agreements.

It is true that the Gas Access Regime does not automatically impact such greenfield pipelines as they will only be covered at the pipeline developer's request or if determined to be covered by the NCC following a request for a determination by the pipeline developer or following a challenge. It is also true that there has been significant construction of pipelines since the introduction of the Gas Access Regime. However, ExxonMobil believes that this construction has been the natural consequence of (1) deregulation of the gas market with the advent of interstate trade, (2) new market opportunities, (3) new upstream developments, and (4) negotiated foundation shipper arrangements, and not as a result of the Gas Access Regime per se.

Indeed the Gas Access Regime places significant risk on new pipelines because determination of coverage and authorisation of access arrangements typically occurs after construction. Not only is the process very slow and laborious but the pipeline developer does not know what return he will obtain on his investment in spare capacity and potentially his entire capacity (where a foundation shipper has matching rights) until after his investment is made. Further, the pipeline developer's investment has been made on the basis of a return being achieved over a significant number of years while an authorised access arrangement is typically only applicable for a period of five years, placing ongoing uncertainty and risk on the developer. We believe the risk that a determination will be made for coverage of a greenfield pipeline after its construction may be having a negative impact such that pipelines are tending to be built without spare capacity to minimise third party access risk. A good example is the SEAGas Pipeline. It is our understanding that this pipeline has been constructed without spare capacity and the question should be asked, is this the most efficient outcome for the industry as a whole? It is ExxonMobil's experience that there are often significant economies of scale that can be achieved at the time of construction, as additional pipe diameter is cheaper than adding compression or looping the pipeline at a later date. If there is no incentive, or even worse a dis-incentive, for pipeline developers to provide spare capacity, ExxonMobil believes that the industry is missing an opportunity for efficient longer-term growth and additional competition.

While the threat of a lengthy and costly challenge regarding coverage of a newly built pipeline may be a useful stick to encourage the owner to negotiate reasonable third party access, maximising the utilisation of the asset will always be the true pipeline owner's key driver. So as long as there are ring fencing requirements between pipeline businesses and downstream marketing activities and these importantly are demonstrated and enforced, it is difficult to see any significant benefit from heavy handed coverage and access regulation of greenfield pipelines.

In the development of greenfield pipelines the Gas Access Regime not only represents a significant risk for the pipeline developer but also a significant risk for the foundation shipper, particularly in the case that the foundation shipper is a new resource owner who is underwriting the pipeline. If after agreement on foundation shipper tariffs through negotiation the pipeline is determined to be covered, there is some potential that the regulated third party tariffs are set lower than the negotiated foundation shipper tariff. This has the potential to give a competitive advantage to other resource owners using that pipeline and may place significant risk on the foundation shipper particularly for growth volumes. This would seem an unacceptable position for a foundation shipper. The fact is the pipeline would not be built and benefits from competitive gas supplies would not be realised without the foundation volumes to underwrite the pipeline's development. To mitigate this risk a foundation shipper may endeavour to negotiate matching rights, although this then places the regulatory risk on the pipeline developer and may lead to the pipeline either being built with no spare capacity or worse, not being built at all. It needs to be remembered that in the negotiation of the tariffs the competitive forces on the pipeline developer are that the tariffs must enable that source of gas to reach the market at a competitive price. So in effect that new pipeline is competing with pipelines bringing gas from other fields to that same market. Essentially this competitive force was accepted by the NCC in its review of the Duke Energy Eastern Gas Pipeline and recommendation that it remain un-covered.

While the Gas Access Regime and Draft Greenfields Guildeline for Natural Gas Transmission Pipelines paper provides for greenfield pipelines to obtain greater certainty through the competitive tender process or through upfront non-binding opinion of coverage or determinations of some key economic parameters, it is ExxonMobil's experience that these processes in themselves present difficulties for pipeline development. In the case of the tender process approval, it is extremely time consuming with public consultation managed by the ACCC regarding the tender process proposed to be used. While for a simple project with clearly determined markets this process may be suitable, in the case of a large project where development is contingent on obtaining sufficient as yet unidentified customers, the tender process does not provide the flexibility required to assist project development. The tender process effectively fixes the pipeline route and markets with little flexibility in these arrangements. However, ongoing project development as real market opportunities are firmed up may require the pipeline design to be re-optimised regarding capacity and potentially its route. Without this re-optimisation, including the flexibility to alter pipeline route, there is the likelihood that the pipeline will be inefficient and the ability for the new gas resource to provide competition will be affected. An example of this can be seen in the development of the Highlands (formerly PNG) Gas Project where a number of new market opportunities have presented themselves during project development since the original pipeline tender process was reviewed. The most efficient supply of gas to these market opportunities may require redesign of the pipeline route and capacity. Under the current non-flexible tender processes some redesign options may not be accommodated. This leads to an uncertain basis under which the project is being developed.

In the case of a determination of coverage or of key economic parameters, again these processes being extremely slow and laborious may have a detrimental impact on a project schedule and potentially its economics. In the case of coverage, a decision is always subject to challenge and can be revoked at any time if there are changes in the market. Again with the likelihood that a greenfield pipeline may change significantly from conception to final constructed design and route these processes provide little opportunity for providing additional certainty to mitigate risk.

ExxonMobil therefore believes that the existing Gas Access Regime does not sufficiently assist the efficient development of greenfield pipelines that are vital to bring new sources of gas to the market and the further development of competition. Therefore, ExxonMobil believes that it is important that changes are made to the Gas Access Regime through the Productivity Commission's review with respect to new greenfield pipelines to provide greater certainty, flexibility and to minimise risks for both pipeline developers and foundation shippers. ExxonMobil believes the COAG Energy Markets review made a valuable contribution to this debate and in particular supports its recommendation 7.2 that provides an initial regulation free period for greenfield pipelines. The length of this regulation free period should be appropriate to provide sufficient certainty for the pipeline developer and foundation shippers, ExxonMobil supports a view that a period of 20 years is likely to be appropriate. Once this regulation free period has expired ExxonMobil believes that it should not be automatic that the pipeline becomes subject to a regulated access regime. Instead the pipeline's coverage at that point should be reviewed in terms of the competitive forces that protect against monopoly power at that time. Amending the Gas Access Regime in this way will provide greater certainty to not only the pipeline developer but also the foundation shipper.

5. Existing Facilities

ExxonMobil believes that there are often direct or indirect competitive forces operating on pipelines to ensure competitive outcomes. However, we recognise that there may be circumstances where existing pipelines and pipeline systems are subject to limited competition. An example may be the low-pressure distribution pipeline systems and potentially some existing transmission systems where duplication costs may be too high to ever represent a realistic competitive option. In the case of distribution systems, in particular, equitable and competitive access is a vital factor to the development of full retail competition. In these limited cases there may be natural monopoly forces that prevail and make negotiated outcomes difficult to achieve. While ExxonMobil supports a regulatory processes moving toward light handed regulation, we believe that it is best supported in an environment of strong, demonstrated and enforced ring fencing of pipeline businesses from affiliated downstream activities. As such ExxonMobil supports further review of ring fencing as part of the Gas Access Regime.

It needs to be recognised however that in the case of such monopoly pipeline infrastructure it remains critical for industry development that efficient system augmentation, extension and expansion be encouraged. In these instances while there may be a need for regulated access, ExxonMobil believes that such regulated access needs to provide sufficient certainty and encourage ongoing efficient system development. While ExxonMobil does not have specific recommendations for changes to process under the Gas Access Regime to apply in these cases it may be helpful for the Commission to consider alternative process as utilised in other jurisdictions overseas. For example, many European countries have adopted a process whereby generic rates of return are determined and published to apply for a future period. Such rates of return for regulated pipelines are to be based on an investment grade return commensurate with risk. Some jurisdictions for example the United Kingdom, France and Italy provide for higher rates of return for new pipeline developments and yet again for those that add competition. The higher rates of return typically apply for an initial period of the new pipeline’s life, say 6 years. For pipeline systems for which there is an ongoing need for coverage and regulated access, such as distribution systems, up-front published determination of generic rates of return and higher rates of return for new pipelines may provide efficiency of process, certainty and encourage efficient system development while protecting the interests of end consumers. It would continue to be important that new pipelines under such a scenario provide system wide benefits in order to obtain the higher published rate of return.

6. Summary & Conclusions

ExxonMobil believes that recent pipeline developments have been the result of de-regulation where gas market opportunities have been opened up to new gas resources. This market activity has not been directly as a result of the Gas Access Regime, although there are cases where the Gas Access Regime has facilitated market access. In fact, we believe that the risks posed by uncertainty associated with some aspects of the Gas Access Regime may be leading to sub-optimal pipeline developments. ExxonMobil believes it is important that in its review of the Gas Access Regime, the Productivity Commission should address these uncertainties and risks.

In the case of greenfield pipelines the uncertainties and risks involve (1) excessive time of process, (2) return risk for the pipeline developer, (3) risk on the foundation shipper that his upfront negotiated tariffs may ultimately be non-competitive and (4) risks that coverage decisions can be overturned. ExxonMobil believes that changes are required to the Gas Access Regime to ensure more timely processes and to more strongly support free commercial negotiations, particularly those by the foundation shippers who are underwriting the pipeline development. ExxonMobil believes that the COAG Energy Market Review recommendation 7.2 for an initial regulatory free period for greenfield pipelines would help to address these problems and that a regulatory free period of 20 years may be appropriate to provide such certainty.

A fundamental objective of the Gas Access Regime should be an increasing move towards lighter handed regulation and an onus on industry based codes. Today, there are some areas of the pipeline industry that are natural monopolies such as the distribution systems. ExxonMobil believes that in these cases a balance must be made between providing competitive and fair access, and ensuring sufficient incentive for the ongoing system augmentation, extension and expansion. Exxonmobil believes there may be merit in the Productivity Commission assessing a system similar to that used in parts of Europe where up front generic rates of return are published with higher rates provided for new investment with system wide benefits.

ExxonMobil believes in order to ensure fair access by third parties to pipeline infrastructure that it remains important that there is strong, demonstrated and enforced ring fencing of pipeline infrastructure from downstream marketing activities.

A further area for the Productivity Commission to address is the excessive time it takes for coverage or access arrangement authorisation decisions under the Gas Access Regime. While sufficient due diligence must be allowed to continue, it is critical that decisions can be made in timely manner so as not to negatively impact project investment decisions. Regulatory free periods for new greenfield transmission pipelines and up front generic published rates of return for covered pipelines may to some extent mitigate the problems caused by the excessive time taken for the regulatory processes and decisions.