



The Commissioner
Gas Access Regime Inquiry
Productivity Commission
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3 September 2003

Dear Commissioner

Please find enclosed a submission to the Productivity Commission's Review of the Gas Access Regime by Shell Development (Australia) Pty Ltd.

Yours sincerely
Shell Development (Australia) Proprietary Limited

(original signed and faxed)

Chris Gunner
Chief Operating Officer

Submission to the Review of the Gas Access Regime

Shell Development (Australia) Pty Ltd is pleased to have the opportunity of participating in the Productivity Commission's Review of the National Third Party Access Regime for Natural Gas Pipelines ("Gas Access Regime").

1. Introduction

Shell companies aim to engage efficiently, responsibly and profitably in oil, gas and other selected businesses, and to participate in the search for and development of other sources of energy. Globally, Shell companies work in a variety of changing social, political and economic environments and in general, they believe that the interests of the community are served most efficiently by a market economy.

Energy markets globally have undergone major regulatory reforms in recent years, with varying degrees of success. For both governments and customers, reliability of energy supply is arguably as important as obtaining the economic benefits from market reforms. The problems inherent in a failure to maintain a reliable energy supply have recently been demonstrated by the shortages in the USA and New Zealand. Security of supply requires sufficient capacity in the energy supply infrastructure. Achieving this level of capacity in a market economy, where energy supply is dependent on private investment, requires a regulatory framework which is commercially attractive to investors.

The reliable supply of natural gas has an additional dimension in the Australian context. Reserves in close proximity to South-East Australian domestic demand centres are predicted to be insufficient to meet demand in the medium term. With the bulk of Australia's natural gas located in the North West of the country, one possibility for meeting the demand is the construction of a trans-national pipeline.

However, private investors will only invest in such a pipeline if they can be confident of obtaining a commercial return on their investment. They will be looking for:

- Confidence in a stable and predictable regulatory regime that enables the investors to discount the risk of future regulatory changes, and gives confidence in a present and future level competitive playing field;
- A regulatory environment that enables them to aggregate sufficient initial market demand at supportive gas prices to "anchor" the investment commercially;
- Flexibility of government to recognise the specific features of a particular investment decision and to provide support when necessary.

The Gas Access Regime has contributed to the development of a gas market which is becoming more competitive and the on-going dialogue with industry is a welcome element of the Regime. Although no wholesale changes to the Regime are recommended,

certain improvements could be made to provide stable and predictable regulation to stimulate investment in capacity and supply by minimising regulatory risks for investors and give confidence in a level playing field.

2. Predictability and Flexibility

Delivering competitive energy services without compromising security of supply is seen as a key challenge by governments and regulators internationally. There are a number of cases where inadequacies of infrastructure appear to have resulted at least in part from a regulatory framework that is unresponsive to long-term investments. The regulatory frameworks in these jurisdictions have the tendency to be too prescriptive and inflexible to recognise the particular characteristics of individual projects.

In order to encourage long-term investment, there are various international examples where regulation is more “light-handed”, and balances a competitive market with an adequate return on investment, commensurate with the level of risk involved. Key features of a light-handed approach are the predictability and flexibility of the regulatory framework.

In Europe, for example, the need for flexibility has been recognised in the amended 2003 EU Gas Directive adopted in June 2003, which allows specific exemptions from third party access to major new infrastructure investments. The Directive allows – on a case-by-case basis and subject to certain criteria - for the suspension of Third Party Access (TPA) regulations to major new infrastructure projects such as main interconnectors, LNG terminals and underground storage facilities. This is in addition to the initial 1998 EU Gas Directive which already provides for exemptions for “emergent markets” for up to 10 years after first commercial gas supplies, and for “isolated” markets for as long as they remain unconnected with other European Union national gas markets.

The Italian Regulator has approached the issue of flexibility by providing priority access for operators investing in new LNG re-gasification terminals. The Regulator allows operators to use up to 80% of available capacity free from regulation for a period of 20 years if this will encourage the construction of new LNG terminals. The remaining 20% is made available to third parties at tariffs set by the Regulator.

In the United Kingdom, the Regulator (Ofgem) provides the maximum possible regulatory certainty for new investment decisions as early as possible. By signalling that new developments will be subjected to light handed regulation, Ofgem hopes to encourage developers seeking to build new gas importation facilities.

The experience with the Australian Gas Access Regime has shown that the access regime can be slow, unpredictable and inflexible in facilitating pipeline investment. The consequential uncertainty is likely to hamper development of the pipeline network as well as related parts of the energy chain.

The WA experience, with the dispute over the access arrangements of the Dampier to Bunbury Natural Gas Pipeline is an example of this. The resolution of the dispute between Epic Energy Nominees Pty Ltd (Epic) and the Regulator has been a process protracted over a number of years, with no certainty of outcome yet.

In addition to the direct business impact, the Epic matter has created uncertainty within the WA gas market and may have stalled other new developments due to the perception of a higher regulatory risk. As an example, the Public Power Procurement Process was intended to meet the growing electricity demand in WA. However, with the Dampier to Bunbury Natural Gas Pipeline currently at full capacity and the timing of expansion in question, the likelihood of new gas-fired power stations being built in the near future to meet the growing demand has been diminished.

Australia is competing with other countries for investment and the perception of an increased regulatory risk would have negative ramifications in attracting both pipeline investors and major international domestic gas users. If a predictable and flexible regulatory framework were established (and recognised internationally as such), the combination of this framework with competitive gas prices and political stability which currently exists in Australia, would attract increased international investment.

3. Conclusions

Shell welcomes the increasing international recognition of the need for an investment climate that is conducive to new investments, both in the pipeline business and the energy sector in general. Regulation is important, but overly prescriptive legislation should be avoided.

Consistent with the international examples described above and the recommendations made by the Council of Australia Governments in its Energy Market Review, Shell advocates that the Gas Access Regime be framed to allow light-handed regulation, for example:

- The Gas Access Regime should provide early guidance (or possibly binding rulings) on pipeline regulation, especially on tariffs and gas specifications, which would apply for a specified period, to give certainty to pipeline investors prior to their decision to invest.
- Periods during which new pipelines are exempt from the access regime could be offered, with the relevant period being judged on a case-by-case basis by agreement with the Regulator.

A Gas Access Regime which is predictable and appropriately flexible is required to stimulate pipeline investments. However, it is unlikely to be sufficient by itself to encourage significant investments such as a trans-national pipeline, where support by the Government may be necessary.

3 September 2003