



Our Ref: SEPS Coverage Application
Direct Phone: (08) 8343 8137
Email: Clive.D'Cruz@epic.com.au

23 August 2013

Hon Tom Koutsantonis MP
Minister for Mineral Resources and Energy
GPO Box 2832
ADELAIDE SA 5001

Dear Sir,

South Eastern Pipeline System (SEPS) - Coverage determination under National Gas Law

Further to your letter of 6 August 2003 to QIC Global Infrastructure (QIC) requesting a response to Kimberly Clark Australia (KCA)'s letter of 23 April 2013 in relation to the coverage determination recommendation by the National Competition Council (NCC), on behalf of our shareholder, QSuper and their manager QIC, Epic Energy South Australia Pty Ltd (EESA) as owner and operator of the South East Pipeline System (SEPS) thanks you for the opportunity to respond.

On 1 May 2013, the ownership of the SEPS was transferred from APA to EESA/QSuper. This change in ownership is consistent with and supportive of the arguments raised by the NCC in its recommendation that the SEPS not be covered under the National Gas Rules. The SEPS is the only asset owned and operated by EESA/QSuper in the region, a position which incentivizes us to maximize usage of the system especially given the current under utilization of the asset.

A key part of the original submission by KCA is the fact that at the time they lodged their letter, APA was the owner of the SEPS (which is no longer the case) as well as 50% owner of the SEAGas pipeline from Victoria from where gas supplies for the region are currently sourced, as well as 100% owner of the SESA pipeline connecting SEAGas to the SEPS. Given the change in ownership of SEPS to an entity with no other pipelines in the region, the commercial concerns raised in relation to APA at the time coverage was sought are no longer present and the commercial drivers are now fundamentally different under EESA ownership as briefly outlined above. This difference in asset ownership has a fundamental impact on the competitive related market dynamics, which will be addressed below, and in our opinion, reinforces the robustness of the NCC's decision to find that the conditions for coverage have not been satisfied.

Since 1 May 2013, EESA has not received any approaches from any new shipper seeking to negotiate for access to the system. EESA would welcome such approaches and is currently seeking to approach potential interested shippers to discuss potential access arrangements.

Epic Energy South Australia Pty Limited | ABN 54 068 599 815
26 High Street | PO Box 2450 Dry Creek SA 5094
Telephone (08) 8343 8100 | Facsimile (08) 8349 6493

www.epicenergy.com.au

Given the time frame provided to comment on this letter, we have focused our response on the key issues supporting our position that the SEPS should remain uncovered. We would be happy to provide greater detail in support of this position if required.

1. Importance of reasonable pipeline tariffs

The cost of gas for any customer is known as 'the total delivered cost of gas' and for customers of the SEPS, as understood by EESA staff, this cost is currently made of:

- Wellhead cost of gas, sourced from Victoria;
- Cost of delivery to the inlet to the SEPS system, made up of:
 - SEAGas pipeline tariff (50% owned by APA);
 - SESA pipeline tariff (from SEAGas to SEPS, 100% owned by APA)
- SEPS tariff (now owned by EESA/QSuper)
- Distribution tariff
- Retail cost to serve and margin (as appropriate)

Based on some high level analysis by EESA (sourced from a number of areas) it is estimated that currently the SEPS transportation tariff only accounts for approximately 4.5-5.5% of the total delivered cost of gas from the wellhead through the supply chain to KCA.

With the wellhead cost of gas forecast publically to be moving from approximately \$4-\$5/GJ today towards the \$7-\$11/GJ range over the next five years this would further decrease the importance of the SEPS tariff to the total delivered cost of gas, as the SEPS tariff will become a much smaller percentage of the total delivered cost of gas.

In our opinion, "Criteria (a)" requires a lessening of competition in dependent markets to support an application for coverage. Using the markets as defined by KCA, being the market for upstream gas in the region and for tissue production in Australia, and given the very small proportion of total delivered cost of gas attributable to SEPS tariffs, EESA is of the view that its actions can in no way be seen to contribute to a lessening of competition in these markets.¹ The reality is that EESA controls an immaterial amount of the supply chain and it is other factors in that supply chain that have the potential to have a material impact on the total delivered cost of gas.

Apart from the very small proportion of total delivered cost of gas which is attributable to the SEPS tariff, the other relevant argument against SEPS having any ability to lessen competition is that at the moment, there is significant excess capacity in the pipeline. Due to a range of factors, the utilization of capacity on pipelines in the region has fallen to less than 20% of volume and less than 30% of peak capacity. This has impacted on the revenue received from operating the system and therefore EESA would be very supportive of any arrangements which increase the use of the capacity in the system as such arrangements would be of mutual benefit to both EESA and its customers.

¹ EESA would like to note that these comments do not suggest it supports these market definitions as appropriate as it believes these are the narrowest market constructs which can be provided. However, as EESA is of the view that the test fails even with these narrow market definitions, and given time constraints, we do not propose to debate the market definition in this submission.

EESA understands the cost pressures on large industrial customers in the current environment given its relationship with a number of key industrial customers across SA. Within the constraints of its own economic considerations, EESA is prepared to work closely with those customers, retailers and producers in the region to ensure that the customers receive the lowest gas cost possible in the current environment (recognizing that EESA's impact on the overall delivered price of gas to the customer is very minimal given it is such a small percentage of the total delivered price of gas).

Apart from the incumbent retailer, however, no approaches have been made to the current owners of EESA to discuss access tariffs. To help facilitate these discussions, the CEO and Commercial Manager of EESA will be engaging with the key customers and potential producers to discuss access requirements to SEPS for now and the foreseeable future over the coming months.

2. SEPS pipeline should be regulated

EESA acknowledges the process pursuant to the National Gas Law and the ability of the Minister to apply a different outcome to the recommendation of the NCC. EESA, however, strongly supports the NCC recommendation that the SEPS should remain uncovered due to the criteria (a) and (d) of Section 15 of the National Gas Law not being satisfied. EESA further submits that the recent change in ownership of the SEPS from APA to EESA/QSuper only strengthens this conclusion.

3. The NCC has made two critical errors in relation to criterion (a)

We note in the correspondence provided that KCA has highlighted two items of note where it believes the NCC as erred in its judgement is in relation to:

- Misinterpreting 'reasonable time' as the 'short to medium' term; and
- Beach Energy's 'real prospect' of supplying gas be reflected as commercial reality

EESA is of the opinion that the length of 'reasonable time' is not relevant for criterion (a). It is our understanding that Beach Energy commenced exploration prior to the coverage application and therefore the outcome of this application is not their motive for exploration. Furthermore, they have not been prepared to engage EESA on access discussions as their exploration activities are at too early a stage.

In respect of the Beach Energy's 'real prospect' of supplying gas, EESA believes that any arguments in respect of limiting the potential access of local exploration is misplaced in light of the single asset position which it holds in the region. EESA has no incentive to discriminate against local gas production and, further, would benefit from growth in local production assuming it is lower priced than Victorian gas and therefore would help promote further gas usage in the region.

The SEPS was developed on the basis of local gas production to the region and EESA would be happy to assist in the development of new gas reserves in the area to ensure the long term future of the system, whilst also supporting regional development.

EESA is happy to discuss access with any new potential producers, however notes that no such producer has yet sought a quotation on the cost of access given the early stage exploration stage of the local developments.

The above total delivered cost of gas analysis demonstrates the minimal impact which the SEPS tariff has on the delivered cost of gas for customers accessing the SEPS, which will decline further in the future if the wellhead price of gas increases as forecast. Given the very small component of total delivered cost of gas represented by SEPS tariffs and therefore the minimal cost impact, the ability to impact the competitiveness of downstream markets of users (e.g. the tissue market) must, in our opinion, by definition, be minimal too. Therefore, it is not possible for the actions of the SEPS owner to impact on competition in that market, let alone substantially lessen it.

EESA therefore believes that the NCC was correct in its conclusion that criteria (a) cannot be met, which conclusion is further strengthened by the new ownership (and single regional asset) position of the SEPS.

4. The NCC should have given greater weight to consumer interest for criterion (d)

EESA is aware of the National Gas Objective (NGO) which is to:

"Promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas."

Given estimates of the prevailing asset values, EESA believes that the current revenue received from the system is lower than the allowable revenue would be under a regulated system. In addition, regulation is likely to result in additional administrative costs on the system (estimated at an average of at least \$100k pa over a 10 year period) which would need to be recovered from customers, further increasing the cost of delivered gas. Therefore regulation would impose operational and cost inefficiencies into the system, which therefore in our opinion, not satisfying criteria (d).

As highlighted in the sections above, it is in EESA's best interests to maximize access and minimize tariff (subject to recovering its costs) to increase flows to allow for the efficient operation of the system.

In conclusion, given the minimal impact the SEPS tariff has on total delivered cost of gas in the region, the fact that the SEPS is a standalone asset for EESA in the region who are therefore incentivized to maximize access from any supply source (especially local ones which support regional development) and finally that regulation would impose significant extra inefficiencies and costs on the system; after careful review of the information presented to you by KCA, EESA remains strongly of the view that the Minister should support the NCC recommendation that the SEPS remain uncovered.

Should you wish to discuss the matter further, please do not hesitate to contact me.

Yours Sincerely



Clive D'Cruz
Chief Executive Officer

On behalf of Ms Angela Karl from QIC Global Infrastructure