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20 October 2016

ASX ANNOUNCEMENT

APA Group (ASX: APA)
(also for release to APT Pipelines Limited (ASX: AQH))

APA'S SUBMISSION TO THE VERTIGAN INQUIRY

SUBMISSION HIGHLIGHTS 'GRID' EFFICIENCY BENEFITS TO THE MARKET OF OVER $100 MILLION

APA Group (ASX:APA), Australia's largest gas infrastructure business, today released its submission[1] to Dr Vertigan's Consultation Paper (the "Vertigan Inquiry") setting out its arguments against changing the current coverage test for the regulation of pipelines.

APA Group Managing Director, Mr Mick McCormack, said, "Australia leads the world in having built an interconnected gas pipeline grid, which is delivering real efficiencies and flexibility for the benefit of the gas market, while pipeline tariffs have not increased in real terms in more than a decade.

"More regulation, as recommended by the ACCC in its report to the East Coast Gas Inquiry ("ACCC Report"), will be a retrograde step that will take us back to the last century where we had point-to-point transmission pipelines and next to zero flexibility and service innovation. It was a time when you tended not to innovate because the ACCC would have had the last say on whether or not you would get a return on the money you invested that brought about that innovation.

"Increased regulation will not stimulate more gas supply because it will stymie investment and innovation in infrastructure, which is essential to supporting suppliers in getting their gas to market in this geographically vast and population sparse continent. It is also likely to cause increased costs to the gas industry.

"Importantly, a policy decision to increase regulation on gas pipelines will have implications for other infrastructure in Australia. Infrastructure builds nations and there is general consensus that infrastructure development is an economic imperative for Australia."

In its submission, APA contends that the ACCC's evidence has not been tested and that the main findings of its Report were based on misinterpreted evidence or findings that have been extrapolated from isolated issues absent appropriate context.

Gas Transmission Prices have not increased in real terms in over a decade

In relation to gas transmission pricing, Mr McCormack said, "It must be recognised that domestic gas prices are affected by the internationalisation of the commodity. For context, gas transmission tariffs make up only 5-10% of the delivered gas price for retail customers. Also important to note is the fact that for pipeline companies like APA, our tariffs have stayed absolutely flat in real terms notwithstanding a 65% increase in the price of gas since 2002."

APA's East Coast Grid has delivered efficiency savings to the market of between $120 million - $150 million

The Brattle Group, a global economics research firm, has quantified the efficiency benefits which could not have been achieved without the integration and operation of APA's "grid". The Brattle Group estimated direct quantifiable efficiency benefits to the market associated with the development of APA's East Coast Gas Grid since 2012 to be $120 million to $150 million to date, and $15 million to $32 million annually going forward.

1. *APA's submission to the 'Vertigan Inquiry' is available on APA's website at www.apa.com.au*

Mr McCormack said, "In our submission to the Vertigan Inquiry, we have set out clearly and factually the costs and consequences of increased regulation. Were it regulated, APA would have had no incentive to develop and operate the East Coast Grid on an integrated basis, and these extraordinary efficiency gains would have been lost to the gas market."

ACCC's Recommendation is based on misinterpreted evidence or findings that have been extrapolated from isolated issues

The ACCC Report proposed that rates of return ("ROR") on incremental projects are excessive, however, APA has pointed out that most of the projects cited involve small capital works projects to augment APA pipelines (representing less than 1.25% of APA's enterprise value). APA said that of the six APA incremental projects referenced in the ACCC Report, three were developed as a competitive response to other projects and three involved making pipelines bi-directional in response to customer demand. APA further states that the ACCC's analysis was flawed as it failed to take into account the value of the underlying pipeline, looking at the incremental investment on a stand-alone basis only.

APA responded to the ACCC's claim that ancillary services were too high by noting that the cases the ACCC relied on were isolated and not representative of APA's general contracting approach. For FY16, ancillary services made up less than 1% of APA's total revenue.

Finally, APA responded to the ACCC's proposition that older pipelines that have recovered construction costs should only charge operating costs.

Mr McCormack said, "The ACCC in its Report says monopoly pricing is "in excess of what would prevail in a workably competitive market" but then asks a completely different question, namely; what would the price be if a pipeline had been regulated from day one? In a workably competitive market, an income producing asset would not be valued at zero.

"To use a simple analogy, just because the capital costs of an old office building have been recovered, it does not mean tenants are at that point only charged outgoings. Imagine the outcry if this were legislated, and applied to all infrastructure be it gas pipelines, gas networks, or electricity poles and wires – the economic impact to investors in that infrastructure would run to billions of dollars evaporating overnight."

"Further, the ACCC's approach is inconsistent with the current regulatory regime and regulatory practice. It is difficult to understand why the ACCC has given this argument any oxygen, apart from needing to be seen to be doing something."

Gas is the transition fuel of choice to a cleaner energy future

Mr McCormack commented, "The risks to Australia's secure and reliable energy future will be heightened if there was increased regulation because, as our submission to Dr Vertigan demonstrates, more regulation will stymie investment and innovation in the development of essential infrastructure.

"The cleaner energy future that all of Australia wants should not be put at risk through more unnecessary regulation.

"Regulators like to regulate, and typically without regard to any cost benefit analysis of the impact of that regulation. But there is no case to support the ACCC's recommendation for a complete rewrite of the coverage test as the current test is fulfilling its purpose with pipelines only subject to regulation where appropriate.

"The market should be allowed to focus on delivering outcomes that benefit all participants by continuing to work collaboratively with the AEMC to facilitate the implementation of reforms that are already underway. After all, pursuing the current industry agreed reforms will facilitate more gas into the market in the immediate term, something which the ACCC recommendations missed entirely."

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About APA Group (APA)

APA is Australia's largest natural gas infrastructure business, owning and/or operating around $20 billion of energy infrastructure assets. Its gas transmission pipelines span every state and territory on mainland Australia, delivering approximately half of the nation's gas usage. APA has direct management and operational control over its assets and the majority of its investments. APA also holds ownership interests in a number of energy infrastructure enterprises including SEA Gas Pipeline, SEA Gas (Mortlake) Partnership, Energy Infrastructure Investments and GDI Allgas Gas Networks.

APT Pipelines Limited is a wholly owned subsidiary of Australian Pipeline Trust and is the borrowing entity of APA Group.

For more information visit APA's website, apa.com.au

APA Submission to the Vertigan Review on gas pipeline coverage criteria.

Presented by: Mick McCormack and Nevenka Codevelle

energy. connected.

20/10/2016

why are we here?

1. First opportunity to respond to the ACCC Report

2. Important matter of public policy

3. Good public policy demands rigorous analysis

4. ACCC Report findings on pipelines are flawed

Key points from APA's submission

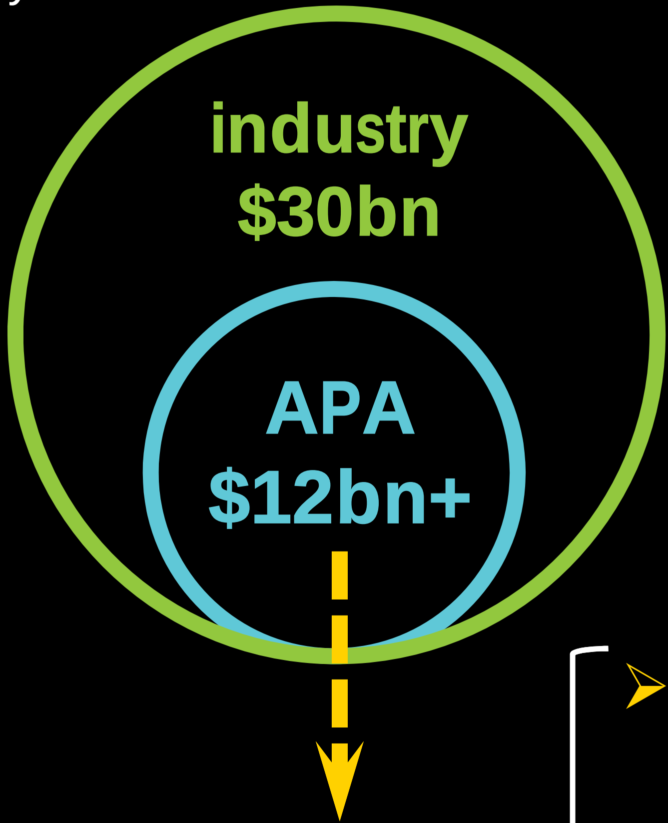
- **Pipelines have delivered – outstanding record of investment, innovation and responsiveness**
- **ACCC assertion of widespread monopoly pricing and resultant market inefficiencies is flawed**
- **Cost of increased regulation and regulatory uncertainty is significant**
- **Current coverage test works to regulate where more efficient and provides certainty for continued investment and innovation**

Pipelines have delivered – innovation and investment since 2000

...enabling optimised efficient use of network of assets and innovative service delivery

- ✓ service availability
- ✓ reliability
- ✓ flexibility

supporting a trebling of demand



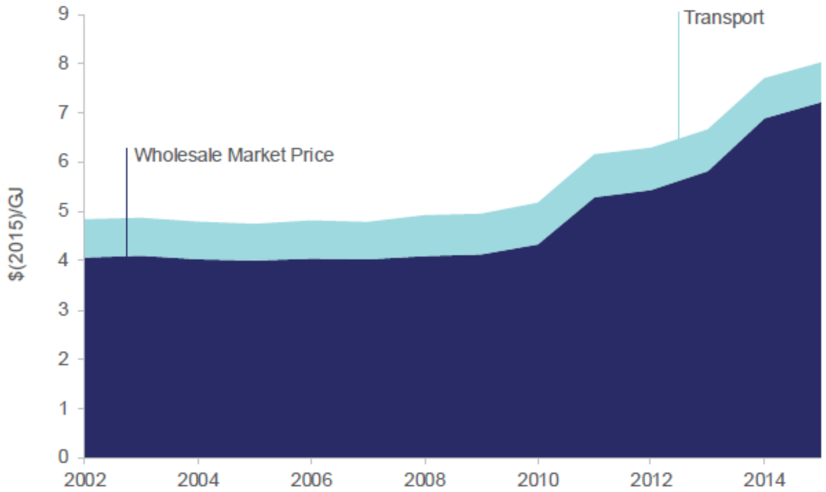
market efficiency benefits

- **$120m - $150m** since 2012 from the East Coast Grid
- **$15m - $32m p.a.** going forward

The Brattle Group Report, 2016

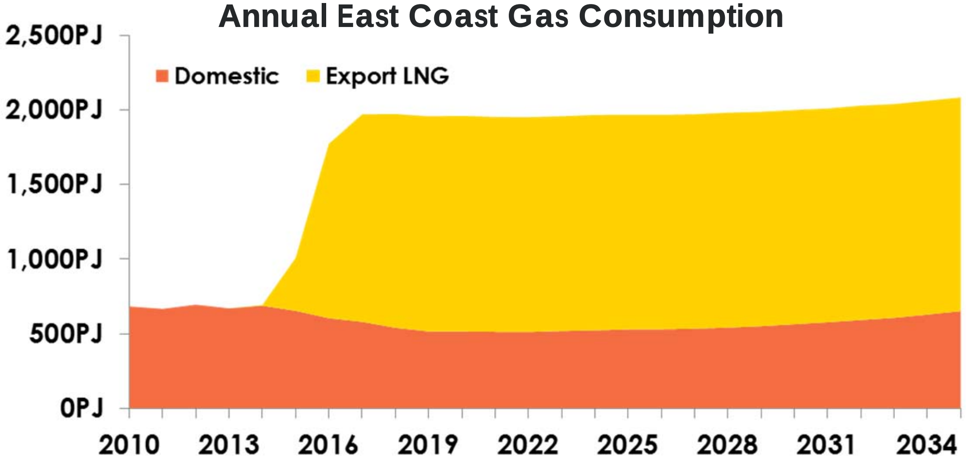
some facts on pipeline pricing

Eastern Australia industrial market wholesale gas prices



Source: Gas Market Report 2015, Department of Industry, Innovation and Science.

Annual East Coast Gas Consumption



Source: AER State of the Energy Market Dec 2015 ; Company reports; APA data as at 31 Dec 2015.

- gas transmission charges have not increased in real terms year on year since 2002, notwithstanding a 65% increase in delivered gas prices in that time

- gas demand has trebled on the east coast due to 3 LNG plant start-ups

Transmission pipeline tariffs make up 5-10% of the delivered price of gas for retail customers **Source:** AER 2016 section 4.4.2

impact on gas prices

- ACCC claim that 10-50% reduction in transport tariffs could lead to $0.20/GJ to $1.02/GJ reduction in delivered price of gas is overly simplistic and unreliable
- Under no feasible scenario would regulation lead to a 50% reduction in tariffs
- Unrealistic assumption of 100% pass through by producers to customers of any transport saving
- Increasing flow of gas north – reduction in pipeline tariffs may result in an increase in price of gas in southern markets (CEG, Morningstar, JP Morgan)

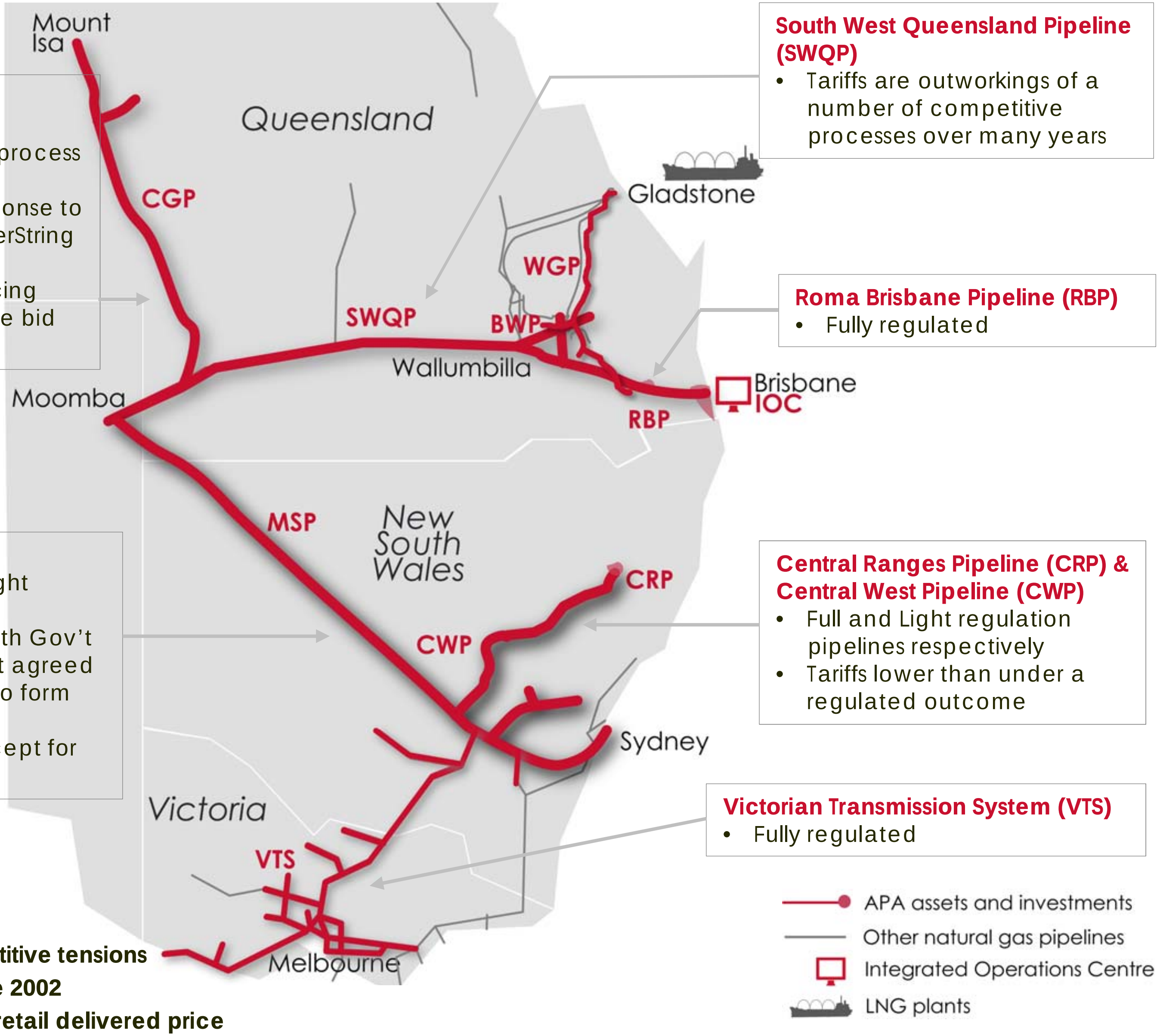
Additional compression capacity added at Winchelsea, Victoria to help push more gas north into NSW

pipeline tariffs are outworkings of competitive process or regulation

Carpentaria Gas Pipeline (CGP)
- Light regulation pipeline
- Constructed 1997, competitive bid process by Qld Gov't
- 2012 tariffs re-set downwards in response to competitive alternative from CopperString Project
- Published standing tariffs reflect pricing from outworking of NEGI competitive bid process

South West Queensland Pipeline (SWQP)
- Tariffs are outworkings of a number of competitive processes over many years

Roma Brisbane Pipeline (RBP)
- Fully regulated



Moomba Sydney Pipeline (MSP)
- Combination of unregulated and light regulation pipelines
- Constructed 1976 by Commonwealth Gov't
- Sold to AGL under pre-existing gov't agreed tariff arrangements (then spun out to form APA)
- Tariffs remain same in real terms except for uplift for capacity maintenance

Central Ranges Pipeline (CRP) & Central West Pipeline (CWP)
- Full and Light regulation pipelines respectively
- Tariffs lower than under a regulated outcome

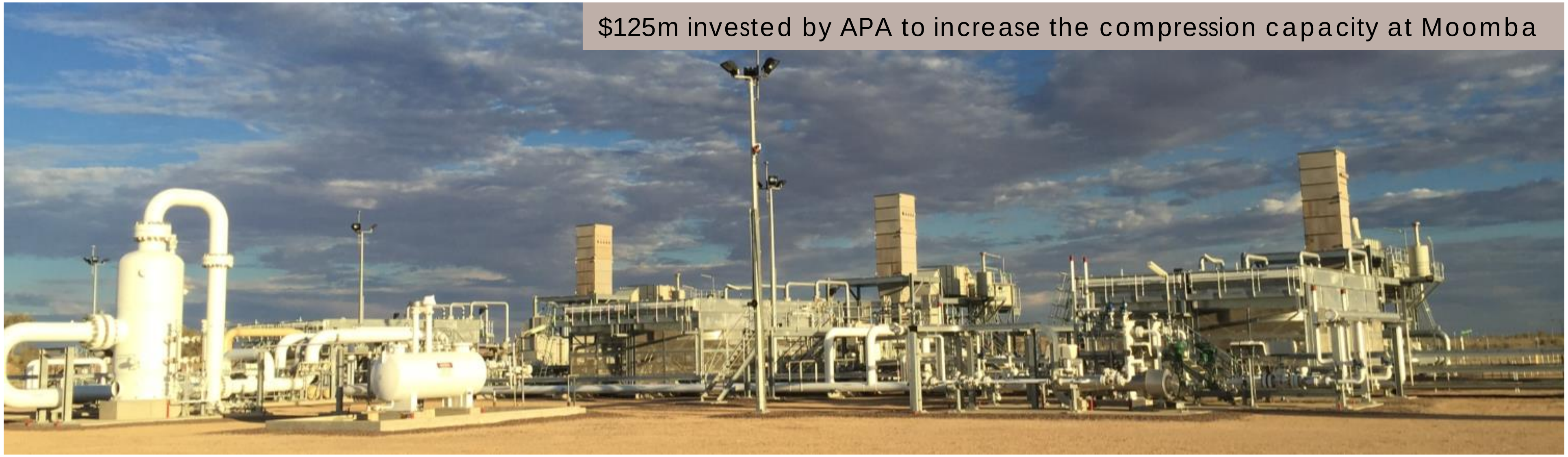
Victorian Transmission System (VTS)
- Fully regulated

- **Greenfield pipelines subject to competitive tensions**
- **No increase in tariffs in real terms since 2002**
- **Transmission price represent 5-10% of retail delivered price**

ACCC findings of monopoly pricing are flawed

- ACCC accepts active competition for pipeline development with shippers securing competitive price outcomes

- ACCC relies on 3 flawed propositions:
  1. **excessive rates of return on incremental projects**
  2. **pricing for ancillary services is too high**
  3. **charging above operating costs on older pipelines is not warranted**



rates of return on incremental projects

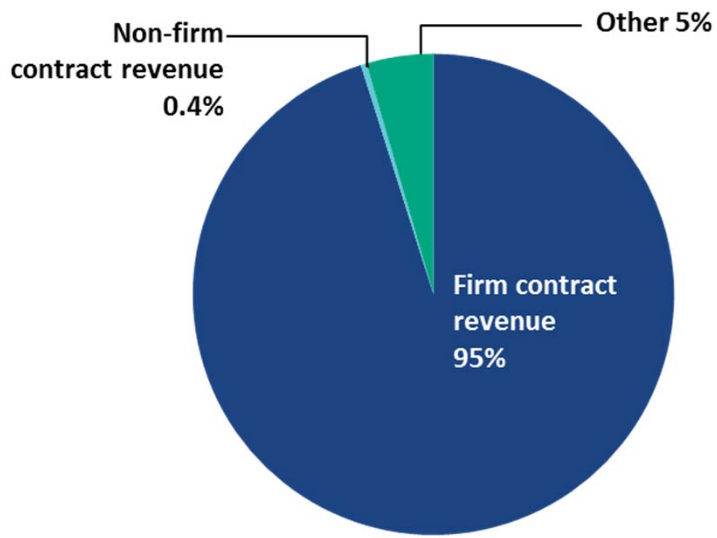
- ACCC gives no context to its "sticker shock" chart showing selected incremental project returns are above regulated returns
- Some perspective – in aggregate, the 6 APA projects **account for less than 1.25% of APA's enterprise value**
- Misleading to look at incremental project returns on stand alone basis without regard to underlying asset value
- Regulated return not an appropriate benchmark – risks borne by unregulated assets are higher than if regulated


Roma Brisbane Pipeline was converted to bi-directional in FY2016

pricing of minor ancillary services

- Ancillary services made up **less than 0.5%** of APA's total revenue for 1HFY16
- Only 2 instances out of some 300 contracts of APA pricing above ACCC benchmark with negligible revenues - each was atypical and does not reflect APA contracting practice
- APA standard pricing for ancillary services is consistent with that approved by the AER for regulated pipelines

1H16 East Coast Grid revenue split



charging for older pipelines

- ACCC assertion that once the construction costs have been recovered, tariffs should reduce to operating cost only
- Approach is inconsistent with charging in competitive industries which reflects new entrant costs, and also with well established regulatory principles and the National Gas Rules
- ACCC approach would destroy billions of dollars of current and future investment

APA's newest greenfield pipeline, the 293km Eastern Goldfields Pipeline in WA has increased fuel reliability for gold mine customers, reduced their exposure to fuel price volatility and taken 1,500 diesel transportation movements off the roads

cost of regulation

- ACCC acknowledges dampening effect of regulation on investment and innovation

“Thus the impacts of [increased regulation] would firstly have very negligible immediate effect on pricing, but more importantly, have detrimental long term impacts on pipeline owners which could result in underinvestment in infrastructure in the long term. Such a move could result the opposite of the intended effect of encouraging gas exploration and production”
(JP Morgan)

Additional compression capacity added at to the South West Queensland Pipeline in preparation for LNG start ups

coverage test

- Since Hilmer in 1993, three reviews by Productivity Commission (2013, 2004 and 2001) and the Harper Review (2015) – no substantive change recommended
- ACCC asserts the current test does not deal with monopoly pricing, non vertically integrated industries and inappropriately considers competition instead of efficiency
- Each assertion is incorrect and ignores how decision makers, the Competition Tribunal and the Courts have applied the test

“The conclusions the ACCC reaches based on the examples amount to no more than unsubstantiated assertions” Neil Young QC


APA’s investment in its centralised Integrated Operations Centre has enabled a more agile approach to customer needs and services APA can provide

consequence of ACCC's Test is uncertainty…stymies investment

- Current alignment between the gas pipeline coverage test and general National Access Regime would be broken
- Would lose 20 years of established principle and regulatory certainty
- ACCC test is extremely broad and confers "considerable discretion" on the decision maker and doesn't provide any "practical guidance", Neil Young QC
- Uncertainty stymies investment incentives

$325m investment on expansion projects on the South West Queensland Pipeline to increase capacity and flow direction flexibility

a final word

- Industry has delivered for the market – unrivalled record of investment and innovation
- ACCC claims of monopoly pricing are flawed, no case for change to current coverage test
- ACCC test would destroy investment and innovation, at a time when particularly needed to enable transition to a cleaner energy future
- Increased regulation is not the solution to increasing gas supply

$6bn investment by APA to acquire the Wallumbilla Gladstone Pipeline, increasing the seamless, interconnected East Coast Grid by another 556kms

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