Central Petroleum

Central Petroleum Limited

15 February 2016

Mr John Pierce
Chairman
Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney NSW 2000

Dear Mr Pierce

GPR0003: Pipeline Regulation and Capacity Trading Discussion Paper

Central Petroleum Limited ("Central") is generally supportive of the recommendations in the Draft 2 Report. The Report addresses the issue of the lack of transparency in the market but is primarily aimed at the short-term spot market. It fails to address the most significant and structurally ingrained barrier to new gas supplies reaching gas customers - the tariffs charged for the transportation of gas through an existing gas pipeline transmission network which is not based on the actual cost incurred by pipeline owners in providing a service. This is particularly acute where new gas supplies efficiently enter the transmission pipeline network (i.e. actually reduces pressure on pipeline capacity with a reduction in net physical flows). This becomes an effective barrier to entry for new producers in the gas market reducing competition in that market. Central welcomes the opportunity to comment on the Australian Energy Market Commission's ("AEMC") Pipeline Regulation and Capacity Trading Discussion Paper which forms part of AEMC's East Coast Wholesale Gas Market and Pipeline Frameworks Review ("Review").

Central is an oil and gas explorer and producer with an extensive onshore exploration and production portfolio located primarily in the Northern Territory's Amadeus Basin. Central's Amadeus Basin production assets, comprising the Mereenie, Palm Valley and Dingo gas fields, allow Central to be the Northern Territory's largest onshore producer of domestic gas with significant existing uncontracted reserves (200 – 300PJs) available for sale into the East Coast gas market. This continues to be one of Central's primary objectives.

The present structure of pipeline tariffs allocates the highest returns to the parties taking the least risk (owners of existing pipelines). Whilst it is clearly appropriate for new pipelines to be underwritten by bilateral arrangements with "most favoured nation" provisions there is little justification for these arrangements to continue beyond their underwriting functions. It is now widely accepted that there is going to be a domestic gas shortfall on the Eastern Seaboard commencing around 2018 with the primary impact being felt in the Sydney and Brisbane markets. The Moomba to Sydney line is already physically flowing towards Moomba. On present indications well over 50% of the notional gas sale price in Sydney in 2018 (assumed for this analysis to be $7.50/GJ at Wilton) will go to the owners of pipeline which are 20 years or older with roughly 45% of the sale price being paid for backhauls where there is no material costs actually being incurred. Given the dire predictions for the domestic market shortage and the fact that over 1 million direct jobs in the Eastern Seaboard are in manufacturing dependent on gas as gas (for which electricity is no substitute), it is imperative that risk capital be allocated to exploration and increasing supply and that the price paid by customers actually reflects the costs incurred to supply that gas. The extraordinary returns on existing (and often fully amortised) pipelines for services that require no investment is clearly blunting the price signal necessary to allocate the capital where it is needed most - exploration and production. Exploration for gas has dramatically decreased despite the continued increase in domestic gas prices.

The Review is of significant importance to Central given its exploration assets and significant existing uncontracted reserve base available which can be sold into the East Coast gas market via the recently proposed Northern Gas Pipeline ("NGP") connecting Tennant Creek to Mt Isa. The location of our production is ideal with respect to its efficiency within existing gas transportation infrastructure. Our southern flow from Mt Isa into NSW would all be backhaul and actually free up pipeline capacity from a physical flow perspective. With respect to selling existing and future gas reserves into the East Coast market, prices for transport along existing pipelines (many decades old) appear to be insurmountable. Specifically, there is currently no relationship between pipeline tariffs charged for transport services and the actual costs associated with providing those services. Central believes that major gas transmission pipelines (typically operating without competition) should set transport prices that are reasonable to the risked capital required, rather than being based on what burden it is believed gas suppliers and customers can ultimately bear particularly after the expiry of foundation contracts. Absent appropriate pricing regulation for major gas transmission networks, pipeline tariffs will serve to dislocate the pricing signals between customers and suppliers which is necessary for an efficient and functioning market. To this end, Central strongly supports the Commission's work to assist delivery of the COAG Energy Council's vision for a liquid and transparent East Coast gas market, but suggests it goes further in considering how current pipeline owners are setting their tariffs for various services.

In Central's case, gas reserves sold into the East Coast market need to be transported along the Amadeus Gas Pipeline (AGP), the newly announced NGP, and then down the Carpentaria Gas Pipeline (CGP). Whist tariffs for the NGP have been established and are clearly linked to actual costs and investments for a new build, the AGP and CGP are existing pipelines (of several decades) with previous gas transportation agreements having already underwritten the investment. As mentioned above, pipeline transportation tariffs, particularly in the case of mature existing pipelines, appear out of sync with actual operating costs and reasonable investment returns. This has a significant negative impact on the ability to raise risk capital for new gas exploration and development capital for proven reserves. The main areas of concern to Central include the following:

- No alternatives for major pipeline transmission networks create a monopoly;
- Lack of transparency in the calculation of pipeline tariffs offered;
- Reasonableness of tariffs offered with regards to a) actual costs incurred / capital at risk, b) previous investment returns and c) the cost of capital for infrastructure providers;
- Price signals between customer and supplier being "eaten" by pipeline owners leading to dysfunctional markets; and
- Lack of confidence in future tariff negotiations are a disincentive to undertake exploration activities

Central believes that an understanding of all of the above from a producer perspective is necessary and should be taken into consideration by the Commission when reviewing the feedback sought on the identified issues.

Yours Sincerely,

Richard Cottee
Managing Director and Chief Executive Officer .