



1 June 2015

Mr John Pierce
Chair
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Pierce

EAST COAST WHOLESALE GAS MARKET AND PIPELINE FRAMEWORKS REVIEW

The Australian Pipelines and Gas Association (APGA) is an active participant in gas market reform in Australia and offers the following comments and observations on the Commission's Stage 1 Draft Report of the East Coast Wholesale Gas Market and Pipeline Frameworks Review (the Review).

In short, APGA broadly supports the directions and recommendations for both stages of the Review set out in section 3.4. The Commission has identified a number of issues that can be progressed in the short term and set an appropriate direction for the consideration of medium to long-term issues in the second stage of the Review.

The key points raised in APGA's submission include:

- APGA supports the assessment framework set out by the Commission.
- The commercial arrangements entered into under the gas access framework have been highly successful in delivering investment and primary capacity.
- The current framework encourages service innovation and competition, resulting in the new services being offered to the market in responses to issues such as access to secondary capacity.
- The secondary pipeline capacity market is for the reallocation of primary capacity from its holders to third parties. Options to enhance the market for secondary capacity should only be explored once any barriers to trading have been identified and fully articulated.
- The rule change determination process already allows participants and the Commission ample opportunity to consider alternatives to the data detailed in the



Transmission Pipeline Capacity Trading: Enhanced Information rule change proposal.

- Quantitative analysis of actual gas flows and gas availability in facilitated markets should be conducted before conclusions about current regulatory and market arrangements can be reached.

APGA would like to provide more detailed comments in regard to Chapters 2, 3 and 4 of the Stage 1 Draft Report, concentrating on the assessment framework; the directions and recommendations; and the Commission's analysis and findings concerning transmission pipeline framework.

Assessment framework

APGA supports the assessment framework set out in Chapter 2 of the Stage 1 Draft Report. It is appropriate and suited to the task of reviewing wholesale markets and pipeline frameworks. In particular, APGA considers that a focus on reforms aimed at enhancing the six identified characteristics of a well-functioning gas market will deliver a suitable suite of recommendations in each stage of the Commission's review.

With regard to the Commission's commentary on the National Gas Objective (NGO) and the desired outcomes in allocative, productive and dynamic efficiency on page 12:

The NGO is structured to encourage energy market development in a way that supports the:

- 1. efficient allocation of natural gas and transportation services to market participants who value them the most, typically through price signals that reflect underlying costs;*
- 2. provision of, and investment in, physical gas and transportation services at lowest possible cost through employing the least-cost combination of inputs; and*
- 3. ability of the market to readily adapt to changing supply and demand conditions over the long-term by achieving outcomes 1 and 2 over time.*

APGA believes it would be useful and informative for the Commission to provide some analysis of the contributing factors to concepts such as, underlying costs of natural gas and transportation services. Such terms are highly relevant to the facilitated markets and pipeline frameworks under review and stakeholders may have differing views as to the nature of underlying costs of natural gas and transportation services and how it and similar concepts are to be used in the context of the NGO.



The East Coast gas grid

On page 24 the Commission states:

Over the period since the start of the reform process, the gas market environment has changed significantly. Many new pipelines have been constructed, most recently the LNG pipelines in Queensland and, prior to that, the Eastern Gas Pipeline, the SEA Gas Pipeline and QSNLink, amongst others. As a result, the market in eastern and southern Australia is now fully integrated, with transmission pipelines beginning to form an interconnected grid, as can be seen in Figure 3.6.

The investment in gas transmission pipelines that has occurred since the Hilmer Review in 1993 has enabled the development and integration of the gas market. APGA agrees with the Commission that 'transmission pipelines are beginning to form an interconnected grid'. The grid is not completely interconnected; there are few points that have multiple transportation options between the same source and demand centres. It is important that commentary, from the Commission and elsewhere, acknowledge that the level of interconnectivity, whilst having developed substantially over the last two decades, is not at the stage where each supply and demand centre has multiple transportation options to most other centres.

On page 25 the Commission states:

It is no longer clear that the objective underpinning the initial development of the access regime – to provide access to individual gas pipelines – remains relevant in the context of an interconnected network and the changing market dynamics discussed earlier in this chapter.

APGA considers that due credit should be given to the access framework that has facilitated the negotiated, bi-lateral contract arrangements enabling the investment that has increased the level of interconnectivity in the Eastern Australia gas market. It is these contracts that have been highly effective at allocating primary firm capacity to those that value it most highly. The access regime remains highly relevant to supporting the timely investment that will increase the level of interconnectivity.

Additional structure may have to be provided to facilitate secondary capacity and gas trading so that market participants are able to commercially exploit network interconnectivity. However, APGA does not see that structure being provided through changes to the access regime.

Costs of the facilitated markets

In APGA's submission to the Commission's Discussion Paper, it was noted that the costs of facilitated markets are recovered from gross volumes of gas passing through them and



that if these costs were allocated solely to the volumes being transacted (the net gas) the cost would be much greater.

On page 26 the Commission notes that:

However, in practice, the vast majority of trades – between 80 per cent in Victoria and 95 per cent in Brisbane⁵⁴ – occur between the same entities.

In this light, the costs of the facilitated markets are even greater and passive participants are paying the fixed costs of the market to the direct benefit of active participants. These costs cannot be considered efficient and thus are unlikely to be consistent with the NGO.

Issues that can be addressed in the shorter term

As noted above, APGA broadly supports the Commission's assessment of issues that can be addressed in the short term.

With regard to the action to address additional information gaps, APGA questions whether this Review can add additional value to the process.

The Gas Transmission Pipeline Capacity Trading: Enhanced Information rule change proposal developed and submitted to the Commission by the CoAG Energy Council is itself the result of an extensive process initiated in 2012. Much of the work already undertaken by CoAG will also be relevant to the Commission's consideration of capacity trading in Stage 2 of the Review.

Once it was determined to facilitate trading through enhanced information provision, the process canvassed a range of data options before arriving on that detailed in the rule change proposal. It is highly unlikely that any new information would be identified through the Review.

Further, the rule change proposal consideration process will allow market participants to suggest changes to the detail of the proposal and the Commission itself can make a preferred rule change determination.

APGA considers the best use of resources for all involved in this Review would be if the rule change process is allowed to consider and address the immediate information requirements relevant to the rule change proposal, and the Review acknowledges this process as the appropriate forum to do so.

The Commission has also suggested there may be possible improvements to medium-term capacity information. Medium-term capacity information was the subject of its own 2014 rule change process, resulting from extensive analysis undertaken by AEMO, and brought into effect at the start of 2015. APGA believes it is not appropriate to review further



changes to medium-term capacity information until the existing reforms have been given a chance to operate. As has been observed in relation to most gas market reforms, it takes a period of two years or more for market participants to respond to changes in capability and information.

Transmission Pipeline Frameworks

On page 40 the Commission observes:

The ability of gas to flow to where it is most valued is inextricably linked to the conditions prevailing in the transmission segment of the supply chain. It is relevant therefore to consider whether the current regulatory and market arrangements are enabling gas to flow to where it is valued most.

APGA agrees with these statements that the ability of gas to flow where it is most valued is inextricably linked to the transmission segment of the supply chain. The transmission segment provides the physical infrastructure required for gas flow. However, this does not imply that further consideration of current regulatory and market arrangements is especially relevant.

The work which the AEMC has already carried out has identified a number of potential barriers to secondary capacity trading. These potential barriers seem to be in the incentives primary capacity holders have to release that capacity, and in the search and transaction costs associated with secondary trading. APGA supports further work being done in Stage 2 to fully articulate these barriers to entry before proposing solutions. Those solutions may well lie outside current regulatory and market arrangements.

To inform this work, it is appropriate to undertake a quantitative assessment of where gas is currently flowing and how it responds to changes in value, particularly around the Wallumbilla Supply Hub. Whilst there has been significant discussion regarding the ability of gas to flow to its highest value, as part of the consultation process for this Review and elsewhere, APGA is not aware of any public analysis that has utilised Bulletin Board or other data to document trends of gas flows and the relationship between gas flows and availability of gas in facilitated markets. It is difficult to see how the utility of current arrangements and barriers to trading can be assessed in the absence of such analysis.

Secondary capacity

There has been a focus throughout the Review consultation on secondary capacity trading and it is clear there is a need for the Commission to focus on this issue during Stage 2 of the Review. A strong market for secondary capacity supports competition and growth for gas markets and allows shippers to better manage volume risk. The ability to trade capacity in a secondary market provides benefits to pipeline businesses by potentially increasing throughput, as well as giving shippers the ability to trade out of firm contractual positions, making it more likely for them to enter into those positions in the first place.



APGA is concerned that sufficient clarity might not have been provided to all participants regarding the definition of secondary capacity and its market. On page 50 the Commission states:

If a firm capacity holder on a pipeline (primary capacity holder) has any spare pipeline capacity, it may decide to on-sell it to another shipper that is in a position to utilise the pipeline capacity.

From this statement, it is apparent:

- Secondary capacity is the reallocation of primary firm capacity; and
- It is traded in a market between firm capacity holders and other market participants seeking to use that capacity.

APGA believes this is an accurate description of secondary capacity trading. However, given the link between secondary capacity trading and increased flexibility, the discussion regarding access to secondary capacity often draws in flexible arrangements including interruptible and as available services offered by pipeline operators. These flexible services are offered by pipeline operators and are not strictly 'secondary capacity arrangements', they do not provide market participants the opportunity to acquire firm capacity. Short-term flexibility is available to market participants both through pipeline operator services and the secondary market, however short-term firm options such as weekly or monthly firm capacity are more likely to be available through the secondary market.

As noted above, the gas access regime has been highly effective at allocating primary firm capacity and achieving investment. APGA supports the development of a strong market for secondary capacity but cautions against changes to the access regime in order to achieve it.

Operational capacity transfers

In response to market participants' desire for increased flexibility, the gas transmission industry has developed and offered the new service of 'operational capacity transfers'. APGA developed and published a guideline on the offering of this service in 2013.

This service offers a third form for secondary trades, the other two being those identified by the Commission on page 50 – bare transfer and novation. Operational capacity transfers offer reduced transaction costs to traders and allow the temporary transfer of rights and obligations.

As such, operational capacity transfers can be seen as combining the temporary rights transfers of bare transfers with the obligation transfer of novation. They are an important innovation and it would be useful to have them recognised in the Stage 1 Final Report.



APGA is happy to discuss these issues and any others of interest to the Commission in more detail throughout the review process. For more information, please contact me on (02) 6273 0577 or at sdavies@apga.org.au.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Steve Davies", written in a cursive style.

STEVE DAVIES
National Policy Manager