Australian Pipeline Limited
ACN 091 344 704

HSBC Building
Level 19
580 George Street
Sydney NSW 2000
PO Box R41
Royal Exchange NSW 1225
P: 61 2 9693 0000
F: 61 2 9693 0093
www.apa.com.au

15 October 2015

Submitted electronically through the AEMC's online lodgement facility at www.aemc.gov.au

AEMC project EMO0030: Strategic Priorities for Energy Market Development

APA Group comments on AEMC Discussion Paper

APA Group (APA) is a major participant in national energy markets as a gas pipeline owner and operator, as a provider of gas storage services, and as an owner and operator of electricity generation and transmission assets. APA appreciates this opportunity to comment on the strategic priorities which should guide the AEMC's work program for 2015 and 2016.

APA generally concurs with the priorities outlined in the AEMC's presentations at the Strategic Priorities forum held on 30 September, and in the Strategic Priorities discussion paper. We understand why the AEMC's three key strategic priorities have remained broadly unchanged from the period 2013-2014 and, in the paragraphs which follow, comment on some aspects of the changes in focus for 2015-2016.

Markets, networks and consumers

APA sees the ways in which innovations in energy supply technology and in the business of supplying energy are reshaping consumer participation in energy markets, and creating challenges and opportunities for distributors and retailers, particularly in the electricity sector.

Although the major changes seem to be in the way in which electricity can be generated and stored, and in the technologically assisted management of electricity use, these changes will have effects which flow through energy sector supply chains.

We think that, in these circumstances, it is entirely appropriate that the AEMC refocuses its markets and networks priority on market and network arrangements that encourage efficient investment and flexibility.

In circumstances of accelerated technological change, flexibility will be a key to facilitating new investment which can deliver outcomes which are in the long term interests of all energy consumers. Network service providers – including gas pipeline service providers – will need to be able to respond flexibly to the changes which they expect to occur by making the investments which they believe will be required to provide the services which will meet changed consumer preferences.

Service provider investment decisions will be made in conditions of greater uncertainty that has been the case during the last decade. In conditions of uncertainty, competitive markets play an important role in testing the viability of investment alternatives. That testing does not take place in regulated markets like those for network services. In regulated markets, the investments which proceed are those which are approved or agreed to by the regulator.

This, we believe, will create a major challenge for the AEMC in facilitating the development of market and network arrangements that are both flexible and conducive to efficient investment.

In Australia, the design of regulation, and the way in which regulation is applied, have been framed largely by a static view of markets and competition in which consumer demand, and the options available to meet that demand, are known with relative certainty. When they are not – when this static view of markets is no longer the appropriate one – regulators are not well placed to make judgements on investment decisions. Moreover, regulatory processes are slow. In circumstances of accelerated technological change, the technology may have changed again before a regulator has made a decision to approve an investment incorporating what was, at the time the investment was proposed, the most recent technological advances.

The discussion paper advises that regulation will need to evolve to permit innovation in new products and services to the benefit of consumers, without eroding the consumer outcomes that regulation intends. We are unsure about how this might be done. In conditions of uncertainty and change, application of the static views of markets and competition, and of efficiency, which have framed regulatory thinking may clearly allocate risks between businesses and consumers, but are unlikely to promote innovation and new business models.

In APA's view, if Australian energy markets are to be dynamic markets, in which service providers are actively seeking to understand changing consumer preferences, and responding to those changing preferences, then regulatory design will need to anticipate uncertainty, and facilitate technical innovation and innovation in business models. Regulatory design will need to be accommodative of new investment, and provide investors with a degree of confidence that, when making investment decisions, they are exposed to normal commercial risks and not to the significant risks of regulatory regimes which are frequently changing in a process of catching up with product and service innovation.

Regulatory design which is responsive to the anticipated changes will, in all likelihood, have a reduced scope for regulatory intervention, with regulators having little or no role in investment decision making. This may be at the expense of static efficiency, but it will be necessary for dynamic efficiency: it will be necessary if energy markets are to deliver outcomes which are in the long term interest of consumers.

Developing an efficient gas market

With a major review of the East Coast gas market (including the DWGM in Victoria) under way, with the ACCC inquiring into market operation, and with the prospect of further change as all of the Queensland LNG plants begin producing for the export market, gas should continue to be a priority for the AEMC.

The AEMC has identified three areas of specific focus within its gas strategic priority:

- How should wholesale gas trading markets be structured to maximize the efficiency of trade and minimise transaction costs?
- How should efficient investment in transmission pipeline capacity be promoted, and how should that capacity be allocated, to support trade in a wholesale gas market?
- What information is required for the effective functioning of a liquid wholesale gas market?

These are, in APA's view, all areas of focus which might now be of concern to energy policymakers. Whether they should be significant areas of concern, and requiring of major policy interventions, is less clear to us.

Buyers of gas see value in the further development of wholesale gas trading markets, and we agree that those markets should facilitate efficient trades at minimum transaction costs. We remain concerned about market designs, like the designs of the STTMs and the DWGM, which impose significant transaction costs on market participants.

Buyers of gas are already seeking from pipeline service providers greater flexibility in gas transportation arrangements than has been the case in the past. APA and other service providers have sought to anticipate their needs, and are offering the required flexibility in gas transportation agreements. APA has negotiated, and is continuing to negotiate, agreements which underpin provision of the infrastructure needed to support a more active trading market.

We are strongly of the view that, at the present time, the provision of greater flexibility in pipeline transportation should continue to be driven by market participants rather than by policy interventions.

The market for gas itself remains a market in which there are still relatively small numbers of sellers and buyers, and a market in which there is a small number of very large participants. The AEMC's restricting its focus to gas which has already been bought from producers, and to the pipeline transportation of that gas, will direct attention away from the issue of the structure of the primary market for gas. Furthermore, focusing on pipeline transportation, without addressing the gas market structure issue, may put at risk the emergence of institutional arrangements for the flexible use of pipeline capacity, and further development of the supporting pipeline infrastructure. In APA's view, the structuring of wholesale gas trading markets might be an area of focus but, if that focus cannot be directed to the fundamental issues of selling and buying gas, then little can be achieved.

The major buyers appear, to us, to operate in industries in which longer term contracts for gas provide certainty for the long term investments required in those industries. These buyers have some need to trade around their contractual positions, but that need may not be great, and may not be consistent with the requirements of others who see opportunities to profit from short term trading.

When those major buyers do not fully utilise the pipeline capacity to which they have committed, and appear to be unwilling to make it available to facilitate trading by others, the issue of "hoarding" is raised. It is typically raised by those who have not been prepared to make commitments to support pipeline investment, or investment in downstream industries.

Those claiming "hoarding" do not seem to be concerned that the measures which they, and others, then propose often amount to little more than the expropriation of the rights of market participants who have paid for investment in pipeline capacity.

"Hoarding" is, we believe, not an issue about the inefficiency which might result from some market participants holding pipeline capacity and not using it, while others cannot gain access to capacity for which they have immediate uses. Indeed, we are unsure whether there is such an issue. Little analysis appears to have been undertaken of market participants – of their drivers and their actual behaviours – and much of the discussion on "hoarding" remains hypothetical.

Rather, the issue is one of prematurely addressing a hypothetical problem of "hoarding", which will carry the risk that those who have supported capacity development in the past find that their property rights in that capacity are to be taken from them. If this risk is realised, it will act to deter further pipeline investment to support a more active trading market.

Much is being made of the opportunities for, and the gains potentially available from, trading around the newly developed Queensland LNG industry. APA is concerned about this focus, and the perceived need to be able to respond to rapid changes in supply/demand balance brought about by the operation of the industry.

Certainly, the ability to respond has the potential to benefit individual market participants and the economy more generally. However, most of the scenarios identified in the discussion paper consider temporary (LNG train commissioning) or uncertain events (unexpected tripping of LNG trains, requirements for unplanned maintenance).

Providing the flexibility for market participants to respond to these temporary and uncertain events is, in APA's view, highly desirable. But whether the provision of that flexibility extends to further investment in pipeline infrastructure is not clear. Some of those pursuing the opportunities to trade provided by Queensland LNG see only the gains, and not the costs of the required infrastructure. Whether the gains from trade might exceed the costs of providing any additional infrastructure required is a difficult and, as yet, only partially answered question.

The opportunity to access low priced gas offered into the domestic market as a result of the shutdown of an LNG train for unplanned maintenance may be highly desirable, but the costs of infrastructure provision may preclude that opportunity from being fully exploited, and may limit the extent of the opportunity to those who have been prepared to assess the risks and who have undertaken to fund required investment.

There may be unexploited – but uneconomic – opportunities to trade, and there may be some market participants who are unable to pursue the opportunities which are available. These unexploited opportunities, and the exclusion of some participants, will be indicators of the economic extent of the market rather than of market failure requiring policy intervention.

Investing, and funding the investment, in long lived, purpose-specific assets like transmission pipelines, in circumstances where demand is temporary or uncertain, are highly risky. They are not matters for regulators or for independent market operators. They are, in APA's view, best left to market participants who can assess the risks and take the actions necessary to mitigate them.

In APA's view, there is not yet a clear rationale for radical policy intervention to structure wholesale gas trading markets. Nor is there an obvious need to promote efficient investment in pipeline capacity. APA, and others, have responded to changed requirements for gas transportation services as the Queensland LNG production has commenced, and as existing market participants have identified new opportunities for the buying and selling of gas.

Through changes to commercial arrangements which APA has negotiated with pipeline users, Queensland gas has flowed into Victoria, and Victorian gas has flowed into Queensland. APA has also negotiated arrangements with users which have underpinned the investment required to permit bidirectional gas flows in its major pipelines, facilitating a wider range of trading opportunities across the East Coast gas market. These changes to commercial arrangements have been effected relatively quickly. The negotiation of arrangements to support new pipeline investment is more complex and has taken longer.

In APA's view, the AEMC's continued focus on gas as a strategic priority remains appropriate. Furthermore, to facilitate emergence of the liquid wholesale gas market envisaged by the Energy Council, we would expect the AEMC to be giving consideration to issues of market structure, investment in pipeline capacity and capacity allocation, and the information requirements for effective wholesale market functioning. However, the first steps toward the market envisaged by the Council have already been taken by market participants themselves.

It is the participants who are best placed to make assessments of the changes in the gas market and the responses required. They will need to assess the scale of any investment required, the risks of committing to undertake that investment, and the timing. APA sees the AEMC's role during the next two years as facilitating further activity of the type which the market participants have already initiated, and ensuring that institutional arrangements and regulatory design allow the market to operate.

We see significant risks in premature changes to those institutional arrangements and to regulation in pursuit of a vision of a market which is in the process of emerging. Changing those arrangements and the structure of regulation as information about the circumstances and the requirements of market participants is still being revealed risks prematurely curtailing market development. APA's major concern is that some of the changes which have recently been proposed would allow market participants greater flexibility in the short term, but would deter those participants, and others, from entering into the longer term gas transportation agreements needed to underpin the financing of pipeline investment.

Environmental and social policies

In setting the context for the consideration of energy sector strategic priorities, the discussion paper draws attention to the potential implications of environmental and social policies.

Current governance arrangements and regulatory design in the energy sector are the outcomes of policy processes which reduced the role of the state as an energy supplier, and which sought to rely, where possible, on competitive markets to deliver energy. These arrangements had their origins in, and are reflective of, the national competition policy reforms of the 1990s.

APA agrees that well designed energy markets, which rely wherever possible on competition, can mitigate some of the risks which arise from the implementation of new environmental and social policies, but we doubt whether energy and environmental and social policies can always be mutually reinforcing. As the discussion paper notes, environmental and social policies will be advanced which have the potential to directly affect the outcomes currently delivered by energy markets by changing the allocation of risk and the incentives for investment, and by adding to costs and raising prices. Trade-offs will be required, and these may involve changes to governance arrangements and regulatory design in the energy sector.

We see the AEMC as having a key role, within the governmental system, in explaining these trade-offs, and their implications for the continued operation of well-functioning energy markets which properly remunerate investors and businesses providing infrastructure and services in the long term interests of energy consumers.

APA would be pleased to elaborate further on any of the comments in the preceding paragraphs. APA's contact for this work is John Williams, who can be contacted on 08 6189 4594, or at john.williams@apa.com.au.

Peter Bolding
General Manager Strategy and Regulatory
APA Group