

16 October 2015

John Pierce
Australian Energy Markets Commission
PO Box A2449
Sydney South NSW 1235
Submitted via AEMC website - GPR0003

Dear John,

RE: Pipeline Regulation and Capacity Trading Discussion Paper

Thank you for the opportunity to provide comment on the Australian Energy Market Commission's (AEMC's) Pipeline Regulation and Capacity Trading Discussion Paper (Discussion Paper). We note the Discussion Paper is intended to stimulate discussion around the arrangements for pipeline regulation and capacity trading in light of the AEMC's concern that existing capacity may not be being held by the parties that value it the highest.

Stanwell's interest in the gas market is as a trader of gas and industrial buyer for the gas-fired Swanbank E and Mica Creek power stations. Swanbank E power station has a capacity of 385MW and is located 10km from Ipswich, QLD. Mica Creek power station is 218MW and is located near Mount Isa, QLD. Stanwell is an active participant in the Brisbane STTM and Wallumbilla hub.

Stanwell supports capacity trading

As stated in earlier submissions, Stanwell supports measures to improve capacity trading. Improved capacity trading will drive more efficient market outcomes where capacity is held by the parties that value it the highest. A more mature capacity trading market will also increase the options for the movement of gas to and from Stanwell's Swanbank E power station.

The way capacity is currently traded

With subdued electricity prices and higher prices for gas, Stanwell placed the gas fired Swanbank E power station into cold storage from December 2014 for up to three years. We have made commercial arrangements for a substantial portion of the gas and transport capacity that underpins this power station. We have not faced the "high search and transaction costs" associated with capacity trading as noted in the Discussion Paper.

The Discussion Paper states¹ that capacity trading can take the form of either:

1. a bare transfer where the contract holder remains responsible for the financial and operational obligations in the Gas Transport Agreement (GTA)
2. a novation which is a permanent transfer of the contract holder's rights and obligations under the GTA
3. an operational capacity transfer which is a temporary transfer of the contract holder's rights and obligations under the GTA

¹ Page 8

In Stanwell's experience capacity trading can also effectively occur by two additional methods

4. A locational swap - the exchange of gas at one location for the equivalent amount of gas at another location. Gas swaps are widely used in lieu of capacity trading and have been utilised by GLNG and APLNG in order to minimise gas movements and operational costs between their LNG facilities².
5. In-pipe trading - APA offers an in-pipe trade service where shippers can nominate to deliver or receipt gas at a non location-specific 'virtual' delivery/receipt point within the pipeline. From the shippers' point of view, this service negates the need to acquire capacity between the buyer and seller's location.

Of the five methods to trade capacity above, Stanwell has used locational swaps and in-pipe trading to reduce the cost of the firm capacity that is temporarily unused under our GTA. Stanwell prefers these approaches to capacity trading as they allow us to:

- negotiate flexible and commercial short term arrangements with counterparties
- retain our underlying firm transport capacity;
- manage the potential costs and risks associated with the transport contract (e.g. storage, imbalances etc)

Caution on some proposals

While Stanwell supports measures to improve capacity trading, the initiatives proposed must be appropriate considering:

1. Property rights - Stanwell does not support measures that encroach on the value or rights of existing GTAs without adequate compensation. GTAs are long term investments which in many cases have funded pipeline expansions. These contracts have been entered into in good faith by both the pipeline owner and shipper.
2. The number of participants and concentration of the market - While the AEMC must be forward looking, the current number of participants and the concentration of the market may mean that liquid capacity trading markets may take many years to eventuate.
3. The incentive for network expansion - AEMO's 2012 catalogue of existing Wallumbilla infrastructure³ reveals numerous examples of participants facilitating the construction of gas network infrastructure in exchange for long term agreements. Stanwell is concerned that development activity may be stifled under some of the approaches in the Discussion Paper.

² <http://www.platts.com/latest-news/natural-gas/sydney/santos-origin-to-cooperate-on-gas-swaps-pipelines-27558368>

³ AEMO, Gas Supply Hub - Cost and Scoping Report, May 2012, <http://www.scer.gov.au/files/2012/06/Gas-Supply-Hub-Cost-and-Scoping-Report-Final-for-SCER.pdf>

Feedback on Approach A - Facilitate trading between parties

Standardisation of capacity rights

Stanwell has negotiated a bespoke GTA with terms and conditions designed to meet our need to operate the Swanbank power station in a flexible manner. However we believe that the proposal to introduce some element of standardisation to capacity rights has some merit. A fungible product could increase liquidity and transparency and could reduce transaction costs.

The standardisation could take various forms, such as standardisation of a short term product only. Alternatively, standardisation could be on only certain terms and conditions with shippers able to enter additional contract/s with the pipeline owner for bespoke requirements. The latter approach appears to be how the United States (US) regulator has dealt with the change from bespoke to standard transport agreements⁴.

The proposal to standardise capacity rights should apply between pipeline owners and shippers as well as between two shippers.

Regulations requiring the standardisation of contracts should apply to new GTAs only. Shippers holding existing GTAs would have an incentive to novate their GTAs into standard agreements in order to facilitate trading however should not be obliged to do so if this decreases the value of their existing GTA. In addition, the standardisation and trading of contracts would provide a basis for the comparison and valuation of existing bespoke GTAs. The proposal could also include the ability for shippers to segment their existing GTAs in order to allow for the sale of only a component of their GTA (such as only a segment of the pipe or only a portion of the capacity or only a certain service).

Standardisation could be achieved by regulation. Alternatively the industry could work together through a body such as the Australian Financial Markets Association (AFMA) in order to develop a standard contract. This has worked successfully for the development of an electricity forward carbon clause as well as the environmental product contract.

Pipeline owners required to offer spare firm capacity in a transparent, open process

Stanwell considers this proposal to be unnecessary. The pool of prospective buyers is too small to support an auction, open season or other process. In addition, this proposal splits the market between pipeline owner firm capacity and shipper firm capacity. Pipelines should list their capacity, and compete with other sellers, through the same exchange-based trading platform.

Information about available capacity and trades to be published through a bulletin board

With standard contracts in place, additional information publication will facilitate further trading. This includes publication of price, duration, location and standard terms and conditions. It could also include the names of the parties involved. It should be published in near real-time in order to best inform the market.

⁴ Makhholm J.D, The political economy of pipelines, page 142

However, in attempting to negotiate a capacity trade with another participant, the information that is most relevant is

1. How much capacity does the participant have
2. How much aren't they using

It is unclear whether the information published in this proposal would answer these questions.

Voluntary surrender of capacity mechanism

Stanwell does not support this proposal. The regulations required to ensure that the resale of a participant's unwanted capacity are conducted in a timely and fair manner would outweigh the benefit of the proposal. The proposal would also split the market for capacity between the pipeline's voluntary surrender mechanism and the rest of the capacity market. Stanwell understands that participants can already negotiate directly with the pipeline owner to cancel unused capacity.

Approach B

Compulsory acquisition of capacity through 'oversell and buyback', 'firm day-ahead use-it-or-lose-it', 'long-term use-it-or-lose-it'

Stanwell does not support these initiatives as:

- They are a fundamental change to the way the market currently operates and appears to be complex and costly to implement.
- They are a significant incursion on existing property rights on contracts which have been used to underwrite sunk investments.
- They create a free-rider problem where prospective shippers have little incentive to enter into long term gas transport agreements. This has flow on effects for network investment.
- The initiatives appear to encourage a capacity holder to sell their capacity before it is compulsorily removed. However, it is unclear why a buyer would buy capacity before it can be obtained (possibly cheaper) through the compulsory mechanism.
- Implementation would create an additional regulatory burden.
- It is unclear how Stanwell could flexibly operate the Swanbank E power station with Stanwell's reserve capacity taken away on a daily basis. Stanwell's operation of the Swanbank E power station relies on our ability to change the generation profile during the gas day depending on electricity market conditions. This changes our profile of gas and capacity usage, possibly using more capacity than expected at the time of day-ahead nominations.
- The European Union gas market, where these types of initiatives have come from, is very different to our own. These initiatives may have been implemented to fix problems with European market design which are not applicable to the east coast gas market. Stanwell's last submission highlighted the deficiencies in the design of the European gas market.

Prohibit contractual provisions in GTAs which limit capacity trading by pipeline owners

This is a sensible initiative which should serve to reduce the barriers to capacity trading. This provision should apply to any new GTAs.

Reserving firm capacity to be traded in the short term

This proposal is likely to lead to foundation shippers being over charged for transport in order to subsidise the pipeline's reserve capacity. The pipeline owner is already free to over build facilities for reasons of economies of scale or to meet the needs of future shippers. This should remain a commercial decision by the pipeline owner rather than a mandatory arrangement.

Approach C

Changes to economic regulation of pipelines

Changes to the economic regulation of pipelines are designed to reduce the market power of pipelines in the provision of capacity. This may be unnecessary because if measures to increase capacity trading are successful, then shippers will act as competitors to the pipeline owner for secondary capacity sales. This could have a limiting effect on the pipelines' monopoly power without the need for further regulation.

If further regulation is required, Stanwell's preference is that it should be done on an 'incremental pricing' basis as currently applies in the United States. This means that pipeline companies must segregate the costs of new construction for the purpose of calculating distinct regulated charges for the new capacity⁵. This prevents the pipeline from subsidising the expansion from existing funds in order to inhibit competition in pipeline development.

Prohibit contractual provisions in GTAs which limit capacity trading by shippers

This is a sensible initiative which should serve to reduce the barriers to capacity trading. Consistent with our views above, this should apply to any new GTAs.

We note the measures the US regulator has taken to remove the barriers for capacity trading by shippers have included⁶:

- Eliminating scheduling disadvantages for released capacity relative to pipeline controlled capacity
- Allowing shippers to segment their capacity in order to keep some and sell the rest
- Revised imbalance and penalty provisions limiting penalties to only those cases which are needed to protect system reliability
- Evidence that any operational restrictions on a shipper's use of their capacity is necessary for safe and reliable system operation

Stanwell considers that some or all of these could be examined with respect to new GTAs in the east coast gas market.

⁵ Makhholm J.D, The political economy of pipelines, page 145

⁶ Makhholm J.D, The political economy of pipelines, page 143

Thank you for your consideration of Stanwell's response to the Discussion Paper. If you would like to discuss any aspect of this submission, please contact Jennifer Tarr on 07 3228 4546.

Regards

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