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15 July 2013

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AGL submission — Regulation Impact Statement: Gas Transmission Pipeline Capacity Trading

Dear Sir/Madam,

AGL provides this submission in response to the SCER consultation around the issue of secondary pipeline capacity trading.

The executive summary to the Regulation Impact Statement (RIS) states that the purpose of the RIS is to test the case for possible changes to the way in which unused, but contracted, capacity is traded as well as to evaluate possible options that might enhance trading. The impetus for this consultation is that "access to unutilised pipeline capacity has been raised by a number of stakeholders as an important issue for improving the efficiency of infrastructure use and of gas markets."

Industry background

Gas has always been underwritten by long-term contracts for both commodity and haulage. The up-front capital costs of development require producers and pipeliners to have revenue certainty. Prior to full retail competition (FRC) being introduced in downstream markets, it was the case often that a foundation shipper would subscribe to all or most of a pipeline's capacity as there was assurance about market share. The introduction of FRC has meant that incumbent retailers were not looking at a franchised market arrangement any longer — the industry has witnessed some de-contracting by incumbents and the freed-up capacity has gone to new players. We have also witnessed the introduction of new pipelines to traditional demand centres.

But in all of this change to the structure of the industry, what has remained constant is the need for shippers and retailers to be able to offer firm gas to end-users, and this has been backed up by firm haulage and gas sales agreements. Opportunistic demand for gas is a very rare thing. End-users have to commit to investment in natural gas-burning technology and have to have connection arrangements with either gas distributors or with transmission companies. A decision to use gas is also a long-term commitment by an end-user. Gas-fired power generators (GPGs), particularly peakers, can be viewed as the most occasional users of gas. But even there, in order to secure project finance, GPGs would need to demonstrate security of supply through haulage agreements, at least for the levels of operation required to make the project financially viable. AGL struggles with the notion that there might be seekers of short-term firm capacity. Where are they sourcing their gas?

Spare capacity

It is generally known and understood that there is a peak period for pipeline usage, and contractual MDQs are configured around those peak requirements. Where there is a strong seasonal or weather-sensitive component to demand, we do see spare capacity outside of the peak period. However, it should not be concluded that this is therefore a gap that can be commercially exploited, for the following reasons:

- Off-peak is when pipeline operators conduct pigging and other maintenance activities, including compressor maintenance. This reduces any apparent spare capacity.
- Off-peak is also when producers plan their plant outages and maintenance, with consequences for capacity that could otherwise be considered spare.
- Shippers will retain some capacity for operational flexibility as well as to meet obligations to provide balancing services and MOS.
- Pipeliners may take the commercial decision to forego some forward haulage capacity to provide a park service.

Subtracting actual daily flows from the nominal or nameplate capacity of a pipeline does not necessarily mean that the difference is therefore available for on-selling. Apart from the above list, further factors impact the actual ability of a pipeline to haul gas. As a pipeline ages, and a lot of our major pipelines are getting on in years, there is an operational tendency to cut back on pressure. Where property development encroaches on pipeline easements, particularly around major urban centres, pipeliners have tended to reduce pressure as a precautionary public safety response. Compressors are also not used continuously, for a variety of good technical reasons — they are there to ensure delivery on peak days and peak hours but not necessarily to maintain higher year-round throughput.

Evaluation of options presented

Accepting that there may be some capacity available from time to time, we would still raise the question of the value of a capacity trade only. AGL does engage in a lot of comodity+capacity trades (i.e. delivered gas) and has arrangements in place with a large number of counterparties so that short-term deals can be effected on the strength of a term sheet. We have occasionally sold spare capacity and have been approached for some as well, but never on any large scale and for very short terms only. AGL is always interested in trading opportunities and we would be happy to consider selling capacity when we do not require it.

Industry players, in terms of producers, pipeline operators, and shippers, are well-known and it would be easy enough to phone around to enquire about spare capacity and/or spare gas. Even with our portfolio, we still do the phone-around from time to time when short-term gaps arise. It is intriguing that those stakeholders who claim to be experiencing difficulty accessing capacity have not approached the pipeline operators or some of the major shippers.

Whilst we are still trying to discern the specific shortcoming brought on by an apparent lack of access to capacity, we would, as a matter of principle, caution against any heavy-handed or intrusive approach until such time as the extent of the problem has been identified and scoped. A modest, low-cost approach which leaves property rights and pipeline operation systems intact is the recommended approach. This is the approach that has been approved for Wallumbilla. If a problem is subsequently confirmed, then consideration can be given to further solutions.

Transmission pipelines are highly capital intensive investments that require a substantial level of lead planning time and debt finance. Long-term foundation contracts are generally required to underwrite investment. Incremental demand growth may not always be met in the short term, partly also due to the lumpy nature of incremental capacity, but the model does not appear to have been a fundamental constraint on the development of the industry. Investment in pipeline capacity has generally been timely and efficient, with the current framework providing a reasonable balance of end-user protection with service provider protection and incentives. AGL would very much caution against any regulatory intrusion that would impair the investment incentive that underpins contract carriage. If anything, AGL's experience is that investment approval in the market carriage framework in Victoria has been more problematic.

Both shippers and pipeline operators face clear financial incentives to offer unutilised capacity where there is demand. There are contractual mechanisms currently available that enable both parties to freely trade this capacity. However, AGL cannot recall being approached, except for a few instances, for spare capacity that we might have on a pipeline.

In the absence of detailed analysis around the materiality of the issue, it is difficult to explicitly evaluate options at this stage of the consultation process. A decision to proceed with any form of regulatory intervention should ultimately be informed by independent cost/benefit analysis. We have nonetheless populated a matrix below which sets out the pros and cons of the four options presented in the RIS.

In the event that a material market failure is identified and confirmed through the RIS consultation process, the mechanisms available to address the failure must be carefully considered. If regulatory intervention is to be considered, a light-handed approach that has appropriate regard for existing contracts is likely to be most appropriate response. AGL considers there is merit exploring Options 2 (improved information) in the first instance. If experience shows that there is sufficient interest and take-up, then it may be appropriate to consider investing in a trading platform and a market services provider. As noted in the consultation RIS, a review of the voluntary trading platform for commodity and the capacity listing service to be implemented for the Wallumbilla Gas Supply Hub will provide a useful insight into the appetite for more flexible trading across the broader east coast gas market. Mandatory trading is only warranted where there is a sizeable and permanent demand for capacity trading and where it is demonstrated that there is clear market failure under current arrangements. A further cautionary note is that “spare” capacity and pipeline park services are still required by shippers for offering balancing gas and STTM MOS services — these downstream market balancing arrangements would need to be revisited as well.

Option	PRO	CON
Status Quo	• Preserves property rights of parties who have committed to long term investments • As-available haulage is available from pipeliners • Short-term deals, with or without commodity, can be executed with shippers • Not too difficult to ring around.	• Perception that gas transmission capacity is not being made available which can have adverse market impacts.

Option	PRO	CON
Information Provision	• Full control of capacity rights and associated revenues to shippers • Ability to source short term capacity • Ability to convert sunk cost into revenue • Added flexibility in portfolio • Save time looking for sellers/buyers	• There may still be mismatches in contract tenor • Could the participant provide enough information for commercial decision? • Lack of a standard contract to facilitate quick transactions
Voluntary Trading platform	• As per above • Standard transactional product / agreements • Quick transaction	• As per above: "market definition" • Cost of the platform (building), membership and trading • Limited or little take-up of released capacity
Mandatory Trading Obligations	• Standardised short-term trading contracts	• Inability to retain available/spare capacity for legitimate operational needs • Could impact shippers' ability to provide MOS offers • Insufficient operational risk buffer may leave participants exposed to market vagaries and reduce the ability to deliver firm to end-users • Investment in market systems, and who is to pay? • May impact willingness to commit to future investments • Limited or little take-up of released capacity

Conclusion

Committing to trading platforms may be high risk and expose industry to transaction costs with minimal benefits when the extent of the market and the take-up of listed spare capacity have not been demonstrated. The same cautionary principle is being applied to the Gas Supply Hub at Wallumbilla. The best way forward, and a prudent one, would be to take learnings from our experience at Wallumbilla with the voluntary listing service after a reasonable period of operation. AGL would caution against mandatory trading as this would impinge on the property rights of shippers and on the sovereignty of pipeline operators to manage their business. And in all of this, the size of the secondary capacity market is yet to be proved.

One final observation that AGL would like to offer is that the plethora of reviews into gas markets, including this RIS consultation, may have an unintended consequence on investment in future capacity. The sheer volume of reviews can tend to engender a sense or climate of policy and regulatory uncertainty. In view of that perspective, an early resolution from this RIS consultation would assist in providing assurance as to the way forward.

If you have any queries with respect to this submission, please contact me on (03) 8633 6239 or by email at gfoley@agl.com.au.

Yours sincerely,

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Manager Gas Market Development