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Gas Transmission Pipeline Capacity Trading – Consultation Regulation Impact Statement

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Standing Council on Energy and Resources (SCER) Secretariat on the Gas Transmission Capacity Trading Consultation Regulation Impact Statement (RIS).

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 36 electricity and downstream natural gas businesses. These businesses own and operate some $120 billion in assets, employ more than 51,000 people and contribute $16.5 billion directly to the nation's Gross Domestic Product.

Australia is naturally endowed with significant reserves and resources and has historically benefited from the provision of secure, reliable and reasonably priced gas supply – relative to global standards – for some time. While gas is poised to continue playing an important role in the future of Australia's energy supply industry, enhancing energy security in the face of reduced greenhouse emissions, the dynamics of the domestic gas market are changing. Most recently, the development of significant unconventional gas resources and the emergence of liquefied natural gas (LNG) capacity on the east coast has brought a new dimension to the domestic gas market.

In light of this, there is currently a heightened government focus on the east coast gas market, particularly with respect to enhancing transparency through an increasing role for markets. A prime example of this is SCER's Gas Market Development Plan, an element of which is supported by this RIS.

Flexible and transparent access to pipeline capacity is a key feature of well-developed gas markets globally and important for the development of liquid commodity markets. In such markets, the benefits of transparency and liquidity are interrelated and reinforcing. Transparency improves market efficiency and security of supply as market participants become increasingly aware of the value of gas at different locations and at different times, while liquidity facilitates competition and enhances efficiency by enabling markets to react to an increase in transparency.

The ability of the east coast gas market to efficiently respond to changing market dynamics will be dependent upon the access to, and flexibility of, gas supply agreements and wholesale trading market arrangements and settings. Though this is not necessarily inconsistent with improved market transparency, this is not in itself justification for mandating particular market outcomes. There are trade-offs associated with delivering transparency in any market, including increased compliance costs that will ultimately be passed on to end-users as well as commercial risks for those businesses that have underwritten current arrangements. Accordingly, the appropriateness of regulatory intervention should be guided by consideration of: the nature of any perceived market failure in the context of the east coast gas market; and how alternative arrangements considered more conducive to secondary trading will deliver net benefits for consumers over the long term.

Understanding the nature of any impediments to trade is essential

Transmission pipelines are highly capital intensive investments that require a substantial level of debt gearing. As such, long-term foundation contracts have generally been required to provide revenue certainty and to underpin investment in a transmission pipeline project. While this may frustrate incremental demand growth to some degree over the short-term, this does not appear to have been a fundamental constraint to the development of the industry. Rather, significant investment in pipeline capacity has occurred, with the current framework providing a reasonable balance of end-user protection with service provider protection and incentives.

The extent to which this framework may impede the flexible trade of unutilised pipeline capacity and thus, efficient utilisation of existing pipeline infrastructure, is not immediately evident. Both shippers and pipeline operators face clear financial incentives to offer unutilised capacity where there is demand and there are contractual mechanisms available that enable both parties to freely trade this capacity.

The consultation RIS notes there is anecdotal evidence suggesting market participants are unable to obtain access to unutilised capacity in some instances. Further, it is clear the east coast gas market has not developed a liquid and flexible market for secondary trading of transmission capacity. The absence of such a market does not necessarily imply there is a market failure or that investment has been inefficient. A lack of secondary trading could potentially be reflective of a number of factors, including the fact that gas pipeline capacity is not homogenous, with different terms and conditions and operating environments applying to each. Nonetheless, as discussed, flexible and transparent access to pipeline capacity is important for the development of a liquid and transparent commodity market. Where access to capacity is impeded, therefore, this creates the risk that incremental benefits of more flexible short-term trades are missed, the value of which may grow as market dynamics continue to evolve.

To inform discussion, it is important the RIS consultation process provides a more detailed assessment of potential impediments to trade (e.g. is it a lack of demand, administrative complexity, or simply differential timing with respect to the availability and demand for secondary capacity) as well as the materiality of the issue more broadly. Identifying and understanding the nature of any perceived market failure is a prudent first step that will guide the appropriateness of regulatory intervention in the evolving east coast gas market.

Regulatory intervention must be carefully considered

In the absence of detailed analysis around the cause and extent of any perceived market failure, it is difficult to explicitly evaluate options at this stage of the consultation process. Further, given the interrelationship between commodity and transportation arrangements, the esaa believes there is merit in taking a more holistic approach that considers the broader east coast gas market, rather than reviewing discrete aspects of the market in isolation. With this in mind, the Association has provided some general observations with respect to the direction of energy market reform and the degree of intervention that could be considered in the context of the east coast gas market.

The east coast gas market has historically been characterised by a limited number of market participants, a reliance on long-term bilateral contracts to underpin capital intensive investments (both for commodity and transport) and a modest level of domestic demand. The number of market participants has continued to grow in recent years and there is also evidence of a desire for more transparent and shorter-term price signals. Despite this, there are risks associated with governments seeking to accelerate market development through well-meaning regulation in such an environment.

There are sovereign risk issues to be considered where the rights of existing capacity holders – established under pre-existing long-term contracts – are potentially compromised. This creates significant regulatory risk, the implications of which could impact upon future levels of investment. Further, it is not clear that implementing some form of mandatory trading would deliver the efficiency gains necessary to justify such significant intervention. On this basis, the esaa does not support Option 4 (mandatory trading of unutilised capacity) at this time.

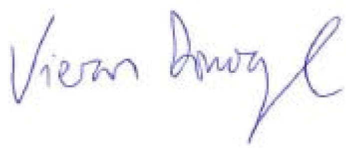
Where regulatory intervention is to be considered, a light-handed and incremental approach that has appropriate regard for existing contracts is likely to be the most appropriate response. To this end, the Association considers there is merit exploring Options 2 (improved information) and 3 (voluntary trading platform), which appear to provide a better balance of risks/benefits relative to some form of mandatory trading. An important consideration in this regard will be to understand how these options would interface with existing wholesale trading market platforms on the east coast.

As noted in the consultation RIS, a one year review of the voluntary trading platform to be established as part of the Wallumbilla Gas Supply Hub (the Supply Hub), has some merit. But the esaa would caution against using the outcomes of the Supply Hub review as the basis for regulatory intervention across the broader east coast gas market. In particular, to the extent trading activity at the Supply Hub is limited, this should not be used as justification for more heavy-handed reform elsewhere. While the Supply Hub arrangements will provide a useful insight into the impact of greater transparency and appetite for more flexible trading arrangements, it may not necessarily be reflective of the broader east coast gas market.

The decision to proceed with any form of regulatory intervention should ultimately be guided by industry and informed by independent cost/benefit analysis. There are trade-offs associated with pursuing particular market outcomes, including increased compliance costs that will ultimately be passed onto consumers and risks for market participants with pre-existing capacity rights. It is critical that any form of intervention does not impede future levels of investment and delivers society-wide benefits that outweigh these costs. The process is one of evolution and the Association welcomes further work in this regard.

Any questions about our submission should be addressed to Shaun Cole, by email to shaun.cole@esaa.com.au or by telephone on (03) 9205 3106.

Yours sincerely



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