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Regulation Impact Statement – Gas Transmission Pipeline Capacity Trading Consultation Paper – July 2013

EnergyAustralia welcomes the opportunity to comment on the Standing Council on Energy and Resources Officials Regulation Impact Statement (RIS) – Gas Transmission Pipeline Capacity Trading Consultation Paper.

EnergyAustralia is one of Australia's largest energy companies, providing gas and electricity to over 2.7 million residential and business customers. EnergyAustralia owns and operates a multi-billion dollar portfolio of energy generation and storage facilities across Australia including coal, gas and wind assets with control of over 5,600 MW of generation in the National Electricity Market (NEM) and gas sales in excess of 100 PJ per annum.

As a part of our day-to-day gas operations, we nominate and transport gas throughout the east coast gas market, through transmission and distribution pipelines to generation facilities and customers. In 2012 EnergyAustralia sold over 75 PJ of gas to large and small customers, supplied almost 20 PJ of gas to its own generation facilities and provided additional volumes to the wholesale market and other generators in the NEM. Customers are at the core of our business, ensuring energy markets are both efficient and sustainable is of key importance to meeting the long term interests of consumers.

Delivering efficient outcomes

Historically the east coast gas market has been relatively stable and predictable with operations under the current market design delivering investment and supporting competition. However **over the coming years the market dynamics are likely to transform for many reasons**, in part due to the tripling of gas market volumes due to LNG, expected increases in price and potentially shortages due to delayed resource development. The consequences of any inefficiency in the past were minimal; however through the expected transformation **ensuring that the market design provides adequate short term and long term signals is crucial**.

EnergyAustralia supports the intent of the current consultation to identify opportunities to improve efficiency in the gas transportation market. We recognise that concerns about the efficient use of gas transmission infrastructure have been raised during consultation for this RIS and similar views have also been expressed in other forums, including during industry consultation surrounding the Wallumbilla Gas Supply Hub. However **EnergyAustralia believes that a holistic approach to reviewing efficiency in the east coast gas market is required.**

Given the crucial importance to customers and the industry of ensuring gas markets are efficient we support this broader review of the east coast gas markets. This review should draw on the contributions to the range of reviews that are currently being conducted but also conduct a cost/benefit analysis of changes that are required to existing or alternative market structures for gas and transportation that will deliver the required levels of transparency and liquidity and support more efficient outcomes in the market. EnergyAustralia attaches the following paper that it has recently prepared, *Global Gas Market Reform: Implications for Gas Market Development in Australia,* which examines the history of reform in Australia and a global context for future reform.

Gas market reform in a global context

Australia's east coast gas market has undergone significant transformation over the past 20 years since the need for change was envisaged in 1991 as a part of the Industry Commission report on *Energy Generation and Distribution*. While subsequent Australian reforms have arguably delivered greater transparency through short term balancing markets and increased disclosure on some physical aspects of the market, increased liquidity has failed to emerge.

Global experience shows that both transparency and liquidity will deliver the greatest benefit to consumers and that transparency does not necessarily result in liquidity. While transparency alone can play an important role in improving the visibility of the market – which drives efficiency and security of supply – it is crucial for liquidity to emerge as well. Liquidity is the key to facilitating competition and enabling markets to react efficiently to the increased transparency.

Our observations from the major global gas markets suggest that the key to success in achieving transparency and liquidity of gas commodity markets is **competitive and transparent markets for transportation** and critically, a **diminishing role for long-term contracts**.

It is important to note that despite limited transparency and a lack of liquidity in the east coast gas market investment has occurred, though arguably this is likely to have been delivered in a less efficient way than could have otherwise been achieved. The operation of transportation agreements in this market has been adequate and the consequences of any inefficiency in the market are likely to have been minimal given the size of the market and the historical level of gas prices.

As noted above, the gas market in eastern Australia is about to change profoundly, the ramifications and cost of future inefficiency is likely to be much higher. Without increased transparency and liquidity, Australia reduces the likelihood of having the right investment, at the right time, in the right place going forward.

Experience in east coast secondary pipeline capacity markets

Our experience to date suggests that the market for unused but contracted transmission capacity in Australia's eastern gas market has been small but sufficient.

In general we source capacity to meet our portfolio requirements under a range of scenarios. This means at times our portfolio will have a limited amount of surplus capacity, which is held to mitigate broader portfolio risks or can be on sold if it becomes surplus to our requirements. Equally there are times when the need arises to buy additional capacity, to date we have not experienced any problems in sourcing additional firm and 'as available' capacity either directly through the pipeliners or in secondary markets. Our approach to secondary market transactions for capacity is either through a bare transfer or a novated contract.

The east coast gas market has a relatively small number of market participants and the expected size and direction of gas flows has been relatively stable and predictable which limits the complexity in identifying the right parties to approach in relation to negotiating secondary contracts for transportation. In the future as the east coast gas market undergoes significant change as new sources of production are developed and the demands for LNG have an uncertain influence on flows, greater complexity is likely to emerge.

Increased utilisation would be desirable, however achieving this relates more to changing usage patterns than through greater facilitation of trade.

In theory increased utilisation of pipeline capacity would be advantageous, as it would result in a more productive use of the existing infrastructure. The average cost of gas transportation would reduce as fixed costs are smeared. However in practise achieving this goal is challenging as the major reasons for spare capacity on existing pipelines relates to seasonal fluctuations in end use and for managing portfolio uncertainty by the shippers who have contracted firm capacity on the pipeline.

Increasing utilisation at the times when shippers carry spare capacity for portfolio reasons is possible through the use of 'as available' contracting or through existing frameworks for selling spare capacity. Encouraging greater use in periods outside of seasonal peaks could also be supported through consideration of alternative ways to encourage different pricing structures than currently used.

Contracting in the primary and secondary markets for firm and 'as available' gas transportation agreements is typically dominated by vanilla, calendar year structures that provide little incentive to encourage usage away from seasonal peaks. While this suggests a potential inefficiency, it may also be evidence of a lack of demand for that kind of structure.

EnergyAustralia does not support the introduction of mandatory operational and contractual transfers in Australia's eastern gas market

There are no legal or regulatory impediments that would prevent the adoption of operational transfer and/or contractual transfer in the trade of secondary pipeline capacity. The small size of the market and the number of transactions in part are likely to be the driver behind the lack of uptake in this area. Adopting a mandatory approach to requiring operational or contractual transfer could increase the burdens and costs of secondary trading in the market and as a consequence reduce the likelihood of activity.

Encouraging transparency and liquidity in capacity markets

A liquid market for secondary trading of transmission capacity has failed to emerge due to the dominance of long term contracts and a historically stable and predictable market for gas. As the east coast gas market evolves greater flexibility and shorter term contracts are likely to become desirable.

Over time the likelihood of industry participating in a voluntary pipeline capacity trading platform may emerge as portfolio requirements become less predictable. This platform could facilitate transacting as the market becomes more dynamic; however this may take time and may not guarantee success initially. A well structured voluntary trading platform could potentially provide a strong incentive for parties to trade capacity on the secondary market over the longer term.

Equally success in promoting a secondary market for pipeline capacity could be supported by a more liquid and transparent primary market. While the majority of capacity is contracted in the long term, satisfactory levels of liquidity in both the commodity and transportation markets are unlikely to emerge. Observation of the global gas markets highlights that via differing mechanisms transparent markets for capacity have emerged in both the UK and North America.

In North America industry led initiatives, as a result of significant reforms, has resulted in liquid commodity and transportation markets; consequently there has been a reduction in the perceived need for and benefits from long term contracts. In the United Kingdom centralised entry and exit capacity auctions, which cater for long and short term availability to firm access, have provided a framework that is similarly conducive to supporting liquidity in the gas market.

EnergyAustralia believes the key to delivering transparent and liquid capacity markets on the east coast of Australia involves:

a) Promoting transparency via mandatory publishing of available firm and non firm volumes and prices on the gas market bulletin board, and

b) Introducing centralised auctioning as a required contracting mechanism for all future capacity sales and augmentations; potentially along the lines of the capacity model used for the National Balancing Point in the UK. It is important to note that our proposal does not support Government intervention where it would materially affect existing contractual rights to pipeline capacity.

Proposed options to encourage secondary trading in pipeline capacity

EnergyAustralia believes that the way forward must involve a holistic review of the east coast gas markets. However in relation to a broader review EnergyAustralia provides the following guidance in relation the options for change presented in the RIS.

Over the coming years the market dynamics are likely to transform for many reasons. Ensuring that the market design provides adequate short term and long term signals is crucial, as previously, the consequence of an inefficient market were small. EnergyAustralia believes that a holistic approach to reviewing efficiency in the east coast gas market is required and global experience should help inform this review. For this reason we do not support the status quo (Option 1).

EnergyAustralia believes that increased transparency and access to voluntary markets can only serve to benefit liquidity. However success will be contingent on many factors which require a broader review (Options 2 & 3).

EnergyAustralia believes an altered version of Option 4a as presented in the RIS, is the closest to its vision for a transparent and liquid capacity market (as discussed above). The 'use it or lose it' approach as proposed in Option 4a of the RIS is unlikely to provide a material addition to the 'as available' volumes currently in the market. We do not support Option 4b as this proposal is likely to materially affect existing contractual rights.

The development of future reform in the east coast gas transportation market is a complex debate that is difficult to conduct in isolation of many factors. As the industry changes and the consequences of inefficiency increase it is important to identify reforms that will benefit consumers through increased efficiency and support investment through better signals about timing and location. Despite the variety of reviews currently proposed or being conducted, EnergyAustralia supports a holistic review of the east coast gas markets which draws on these reviews but also conducts a cost/benefit analysis of changes that are required to existing or alternative market structures for gas and transportation.

If you would like to further discuss this submission, please contact me on (07) 3360 0814.

Yours sincerely

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