

Manager, SCER Secretariat  
Department of Resources, Energy and Tourism  
GPO Box 1564  
Canberra ACT 2601  
Lodged via email: [scer@ret.gov.au](mailto:scer@ret.gov.au)

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Dear Secretariat,

### **Regulation Impact Statement – Gas Transmission Pipeline Capacity Trading**

GDF SUEZ Australian Energy (GDFSAE), formerly International Power-GDF SUEZ Australia, appreciates the opportunity to provide this submission to the SCER Regulation Impact Statement on Gas Transmission Pipeline Capacity Trading (RIS). GDFSAE is wholly owned by GDF SUEZ S.A. and a business line of GDF SUEZ Energy International. In Australia, the company owns and operates 3,500MW (gross) of renewable, gas-fired and brown coal-fired plants in Victoria, South Australia and Western Australia. Our retail business, Simply Energy, has more than 320,000 electricity and gas accounts in Victoria, South Australia, New South Wales and Queensland.

GDFSAE welcomes the SCER initiative in carrying out this study into options for pipeline capacity trading in the Australian gas industry. GDFSAE supports the objectives of improving the tradability of pipeline capacity across Australia, and of providing better and more transparent market signals to allow participants to more effectively manage their operational and financial risks.

In summary, GDFSAE supports:

- developments that will increase competition and participation in the buying and selling of gas in both the short and long term
- transparent, efficient and open allocation of gas transport capacity including gas storage, and
- removal of barriers to intrastate and interstate trade in gas and reforms for third party access to gas transmission

GDFSAE has identified a number of gas market issues with the current arrangements in Australia, and key elements for consideration in the development of that industry. We have therefore set out below some general observations on the current gas market arrangements. The submission then includes specific responses to the questions raised in the RIS.

### **Multiple Gas Market Designs**

The key deficiencies associated with the current multiple gas market designs are:

- Multiple market designs that make market trading complex and inefficient for national participants:
  - three Short Term Trading Markets (STTM) based on a contract carriage model in South Australia, New South Wales and Queensland
  - the Declared Wholesale Gas Market in Victoria, and

- the pending supply hub market at Wallumbilla
- Non uniform gas days, trading periods and “within day” price signals across each market
- Limited ability to transact gas over short periods and forward trading is highly illiquid
- Mismatch of firmness of contractual supply between gas and electricity<sup>1</sup>
- No forward price signals to support long term trading
- Lack of secondary market trading activity
- Inadequate market data provision, with fragmented information systems and some data not available at all
- Predominately only retailers participate in the gas markets. Gas producers and pipelines are outside of the market arrangements, and intermediaries choose not to participate
- No framework to enable key decisions of producers and pipelines to respond economically to market processes. For example, decisions by pipeline businesses to undertake maintenance impacts the market, but the pipeline business is not impacted by market outcomes

In order to address these deficiencies, GDFSAE recommends:

- A single market design with consistent rules across the east coast of Australia. This will assist businesses operating in multiple jurisdictions and ensure optimal economic use of gas across the interconnected market. GDFSAE considers that the STTM model should be pursued nationally, because this provides the closest fit to market principles that GDFSAE believe are desirable
- A mechanism to deliver clear market price signals for both the short term and the longer term, which facilitate competition and efficient market outcomes
- Market pricing and settlement arrangements which facilitate secondary markets. The secondary market should, however, be developed by participants, not central agencies
- Transparent information on all significant market data, including supply, transport and demand, available freely through the market operator
- Market arrangements that encourage the participation of a wider range of market entities, including producers and pipelines

## Gas supply

GDFSAE considers the key issues to be:

- Lack of competition – particularly in Victoria. (The largest source of supply in Victoria has over 65% of gas sales). This level of concentration would not be acceptable in electricity supply
- Uneven supplier playing field with legacy value<sup>2</sup> favouring contracts with Longford
- Processing facilities are typically highly concentrated geographically (e.g. Longford and Moomba)
- Contracts are typically long term and inflexible to meet the needs of the dominant supplier, which results in uneconomic pricing and does not support market evolution
- Contract price reviews are very costly and disruptive to the market and typical dispute resolution processes are highly intrusive, and reveal commercially sensitive data to market participants and advisors
- No contract standardisation which impedes liquidity and the emergence of a forward market

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<sup>1</sup> Electricity financial contracts are “firm” and operate notwithstanding spot market outcomes. Gas contracts are generally physical, and as a result of concentration in upstream supply, contain force majeure provisions for non-delivery.

<sup>2</sup> For example, Victorian retailers are allocated a share of Longford pipeline capacity, whereas rights to other pipelines need to be purchased.

In order to address these deficiencies, GDFSAE recommends:

- Remove unnecessary barriers to entry to encourage new entrant on East coast to improve competition
- Develop consistent market terms and contract standardisation
- Gas producers and pipelines to be more closely aligned with gas market outcomes

## Gas Transmission

GDFSAE considers the key issues to be:

- Different transmission regulatory regimes across the market – open access and contract carriage; covered and un-covered - creating uncertainty and inefficiency
- Open access gas transportation arrangements in Victoria act as a disincentive to pipeline augmentation
- Insufficient gas transmission interconnection between the states
- Virtually no short term capacity trading is occurring

In order to address these deficiencies, GDFSAE recommends:

- Development of a consistent gas transport regulatory regime for all major east coast gas transmission
- Progression towards firm transmission access arrangements, with tradeable rights

## Australian Regulation

GDFSAE considers the key issues to be:

- Continually changing regulatory environment acts as impediment to investment and market participation
- Uncertainty over the Clean Energy Future and related legislation including the Renewable Energy Target recommendations

In order to address these deficiencies, GDFSAE recommends:

- Continued promotion of a nationally consistent regulatory regime, delivering a stable “light-handed” approach, and balance between the needs of investors and consumers

## Specific response to RIS questions

### 1. *Are there reasons why fuller pipeline capacity utilisation may be either advantageous or not desirable?*

The main specific indicators that pipeline capacity may be underutilised are available within information published on the Gas Bulletin Board. Another indicator is the level of discontent expressed by parties who have found it difficult to obtain pipeline capacity on acceptable terms and conditions.

However these sources of information don't give a true picture of the available capacity that could be traded. For example, the Gas Bulletin Board displays a pipeline's aggregate nominations and registered capacity. The difference between these two numbers could be construed to be available pipeline capacity for secondary trading. This is misleading however, as shippers may hold more sophisticated products, ordered via different processes to that agreed to by Gas Bulletin Board's aggregate nomination process (for example GDFSAE's Synergen Services).

GDFSAE do not believe that pipelines holding back surplus capacity are limiting pipeline capacity trading. Pipeline capacity trading is being limited by the current regulatory regime on pipeline owners and shippers. Solving these limitations will improve secondary trading of pipeline capacity and therefore benefit the gas industry.

2. *In Australia, how easy is it to organise and execute novation and/or bare transfer of pipeline capacity?*

GDFSAE has experience in both forms of pipeline trading over the last decade and has found the processes to be complex and time consuming. A novation from one party to GDFSAE completed in 2012 was a long and legalistic process that involved three direct parties, (shipper, transporter and GDFSAE) with the final agreement being in the form of a deed. This deed then required multiple business owners to be signatories that brought in a number of other corporations, not all located in Australia, so the logistics in signing this deed were challenging.

Bare transfers are much simpler to conclude mainly due to the transfer being a right under the main gas transportation agreement. This in itself removes the transporter from the negotiation but as an agreement between the two shippers is required, this generally is a legalistic and time consuming process. The final limitation on a bare transfer is parties to that capacity transfer must be shippers on that pipeline.

3. *What is the likely size of the benefits, if any, associated with adopting operational transfer and/or contractual transfer for the trade of secondary pipeline capacity in Australia?*

Adopting both the operational and contractual transfer mechanisms should improve the liquidity of secondary pipeline trading capacity. Both these proposals need to be standardised and open to a wider audience than currently exists. If this can be achieved and traded on a centralised platform where buyers and sellers can be matched, it would provide an efficient allocation of pipeline capacity.

4. *What operational/system changes would be necessary to allow operational transfer and/or contractual transfer to be used in Australia and what would the likely costs be to making these changes?*

A new legal contracting framework incorporating a high level of standardisation which allocates risk to the party best placed to manage it, and meets the needs of the transporters, particularly new secondary shippers that are introduced to that pipeline through that capacity trade.

GDFSAE's expectation of the cost to establish this new operational / contractual secondary model would not be dissimilar to the cost for establishing the trading and contracting platform for the Wallumbilla Gas Supply Hub project.

5. *Have you engaged in capacity trading in Australia and if so: how regularly do you undertake such transactions; what volumes and types of capacity (i.e. firm or 'as available') have you typically traded; and what pipelines have you traded capacity on?*

GDFSAE has participated in a small number of firm capacity trades with the first occurring in 2001 on the Moomba to Adelaide pipeline (MAP). More recently, a number of parties have been adjusting their portfolios to better prepare for the commitments to the various LNG projects in Queensland. This has created and interest in moving gas from Victoria where the SeaGas and MAP pipelines are intrinsic to that success and further investment are now contemplated. This has opened up interest in pipeline capacity trading with new parties requesting access to these pipelines. As previously discussed, a novation of Dampier to Brumby Pipeline in Western Australia in to the GDFSAE portfolio was a particularly difficult and time consuming process that took 12 months to complete.

6. *If you have experienced difficulties when undertaking capacity trading what specific barriers have you experienced on what particular pipelines and/or what were the particular circumstances?*

Capacity negotiation activity has been what would generally be expected under the current arrangements. The process typically commences with the initial navigation through the array of issues raised during the bilateral negotiation to an agreement, subsequently modifying company IT systems to both manage the operations, reporting and settle financials.

7. *Are there any improvements that could be made to ease the transfer of pipeline capacity?*

GDFSAE believe this is not about what difficulties we have experienced in trading pipeline capacity but about how these transactions can be improved to lower transaction costs and complete transactions in a timelier manner. This can be achieved by standardisation which would significantly reduce legal costs and speed up transaction time.

8. *What factors, including market or regulatory factors (that may include the identified factors above) may be limiting secondary capacity trading in Australia?*

The current pipeline regulatory model inhibits transporters from participating in the gas markets, and incentivises them to contract over longer terms to secure their revenue. Shippers on those pipelines are typically the only parties in a position to trade pipeline capacity.

Under a market carriage model where there are no participant rights to pipeline capacity, there is no pipeline capacity to trade in a secondary trading market. This is the model adopted in the Victorian Declared Wholesale Gas Market which has introduced AMDQ credits to assign some capacity rights to participants. The pipeline owner is compelled to auction those AMDQ Credits every 2 to 3 years.

There is a very small secondary market for these products limited to a small number of participants and having a pre-prepared agreement ready. The problems with the contract carriage that applies to the rest of Australia are discussed in some detail within this submission.

9. *What types of transportation services would stakeholders be most interested in accessing?*

The secondary pipeline trading market design needs to be simple, an excess of products and rules will stifle market liquidity. GDFSFAE would recommend commencing with a point to point firm pipeline trade that means receiving gas into the pipeline and subsequently delivering that gas to a point further along that pipeline. Other products could be developed over time based on buyer's demands. E.G. forward or back haul on either firm or non-firm basis.

10. *Would stakeholders be interested in accessing short-term 'as available' interruptible gas transportation capacity?*

This type of product is likely to be used by the more mature market players as the risk and ability to deal with the interruption does require a participant to adjust their position accordingly should that interruption occur.

11. *What duration of capacity trades would stakeholders be most interested in seeking?*

GDFSFAE recommends following other standardised financial markets where a single contract with a predetermined volume is the basis of a trade. For example the Gas Supply Hub uses 1 TJ/day while Electricity Futures adopted the 1 MWh unit. The term then sets the contract volume where the Gas Supply hub uses one day or week as the case may be, while Electricity Futures use one month.

With an agenda to standardise pipeline capacity trades and the desire to align these trades with gas markets in general, GDFSFAE suggest a monthly term with a 1TJ/day forming the basic pipeline capacity standard contract.

12. *What pipelines and indicative annual capacity volumes would stakeholders be most interested in accessing?*

GDFSFAE has positions on both the MAP and SeaGas pipelines and seeks to be able to move the commodity to wherever it gets the best value. This includes moving gas to the Sydney or Brisbane STTM or supporting the demand in other areas not covered by those gas markets including the LNG projects in Queensland. There is no business case to enter into long term pipeline contracts to support these ambitions unless GDFSFAE has a physical asset to service which would underpin pipeline investment. A pipeline capacity trading arrangement that has sufficient information transparency would facilitate investment, and allow flexibility for participants.

13. *What specific additional volumes of gas would producers be willing to supply into which specific markets?*

GDFSFAE volumes are relatively small in comparison to the producers and LNG proponents as we are balancing the portfolio between power station requirements, retail demand and the amount of gas we have in surplus to the portfolio requirements. Similarly, if our portfolio is short we would seek to purchase gas on the best terms, which requires having the ability to access any of the gas markets.

14. *Is there a problem with the way in which unused pipeline capacity is currently being traded in Australia and, if so, what are the key issues that have prevented/made difficult access to unused transportation capacity?*

As previously mentioned, capacity trades are problematic and any new contracting model should primarily reduce the cost of transactions and minimise the time to put the agreement into place

15. *What aspects of the current capacity trading arrangements work well?*

It is possible to execute a capacity trade today. However as mentioned previously, the complexity and timeliness of the current arrangements make such trades inefficient.

16. *Is adequate market information available so that pipeline capacity can be effectively traded? If not, what specific additional information is required?*

The current level of market information is insufficient to support effective capacity trading. To be effective, the information should include a forward estimate of the available capacity on a pipeline, similar to the PASA process in the national electricity market. A further issue is that the nomination on a pipeline reflects the aggregated commodity nominated by a shipper for transport through that pipeline. This does not include the other more sophisticated products participant may have, including imbalance regimes.

GDFSAE recommends that parties be required to list the pipeline capacity that they have available to be traded.

17. *Would the provision of improved market information be adequate to facilitate an increase in secondary capacity trading activity and, if not, what other tools/processes could be developed/pursued?*

Improved information, on its own, would only yield a marginal improvement in the trading of pipeline capacity. There has to be an improvement in the model to achieve a high level of participation in trading pipeline capacity.

18. *What are the likely advantages, disadvantages, costs, benefits and risks associated with the provision of additional information such as close to real-time data/ex-post data, preferably supported by quantitative evidence?*

An efficient market requires timely and transparent information; this has been of great benefit for the national electricity market. Gas markets have made good progress toward these objectives over recent years but still fall short of what is required.

19. *What is the likelihood of industry participating in a voluntary pipeline capacity trading platform? If you consider the likelihood to be low, what are the key issues that could prevent incumbents from releasing unused capacity to the market?*

For a voluntary model to work the market has to provide sufficient incentive to encourage involvement. This can be achieved in two ways:

- Have sufficient participants participating in that market to provide a deep liquid trading environment to a level where participants have comfort that they can execute a trade irrespective of the time of day, week, month or season. The difficulty for the Australian market is the relatively small number of participants that limits the effectiveness of a voluntary market
- Participants can see that the market is offering a lower transaction cost, faster execution times and/or better choice of products than are currently available.

20. *What are the types of incentives that would most likely encourage industry to participate in a voluntary pipeline capacity trading platform?*

As discussed above, a capacity trading market needs to have much lower costs per transaction, shorter transaction time frames and standardised but flexible product terms.

21. *What would be your likely costs to establish, operate and/or participate in a voluntary pipeline capacity trading platform?*

GDFSAE setup costs would include development of policies, setting up a trading platform including software interface and settlements processes. In broad terms, GDFSAE would expect this would not exceed \$100k of company investment.

22. *What are the likely advantages, disadvantages, benefits and risks associated with the establishment of voluntary pipeline capacity trading platform, preferably supported by quantitative evidence?*

The benefits and difficulties are discussed in other parts of this submission

23. *Under a mandatory pipeline capacity trading regime, would it be appropriate to mandate incumbents releasing all unused capacity or just a portion of unused capacity?*

This proposal is the least appealing to GDFSAE. As an alternative, GDFSAE suggests a capacity auction or "open season" as it is referred to in the USA. The current long-term bilateral pipeline agreements to underpin the initial investment would remain. After a long-term agreement expires, a capacity-trading model could be adopted where 25% of the available capacity is auctioned off for say a two-year period. This could be repeated every 6 months where 25% capacity is sold creating a rolling process not unlike that experienced in the Settlement Residue Auctions in the national electricity market. An auction every 6 months provides the market with information on the value of that capacity at six monthly intervals.

24. *Under a mandatory pipeline capacity trading regime, would it be appropriate to regulate the price (including floor and/or ceiling prices) of capacity?*

GDFSAE would not support price regulation, as this will inhibit the real value of the capacity to the market at that time. The price should be left to the market to determine based on supply and demand fundamentals.

25. *What would be appropriate mechanisms to clear the market under a mandatory pipeline capacity trading regime?*

If the auction model were adopted then the market would clear based on the prices bid.

26. *What would be other practicalities of introducing a mandatory pipeline capacity trading regime?*

A capacity auction would need a structural / regulatory change to the current access regime. New rules are needed to foster the transfer from the long-term bilateral agreements that support investment to build or augment the pipeline, to the pipeline capacity auction model.

27. *What would your likely costs be to establish, operate or comply with a mandatory pipeline capacity trading regime?*

This cost should be very little to participants but expect the legal changes in access regimes, possible NGL and NGR to facilitate pipeline capacity auction model may be costly but goes a long way toward meeting GDFSAE ideals discussed above.

28. *What are the likely advantages, disadvantages, benefits and risks associated with the establishment of mandatory pipeline capacity trading regime, preferably supported by quantitative evidence?*

The main advantage is attaching the correct market value to the capacity at the time the capacity bid was received. A public process such as this greatly improves the price and capacity information transparency to the market. Two year auction cycles also align better with the contracting cycle of the gas supply where typical deals are for terms ranging from two to four years.

The main disadvantage is the pipeline will not have long term revenue certainty but only a two year horizon with the risk of both selling all the capacity and the price they achieve for that capacity. This arrangement is not unlike the generators in the NEM who have little revenue certainty past two years.

29. *What are the practical issues associated with mandatory UIOSI, UIOLI and auction mechanisms?*

Both these concepts are undesirable for the reason of economic hardship to the shippers who hold that capacity and completely ignore the other service that shippers may hold on that pipeline. GDFSAE has a foundation shipper agreement with SeaGas where we agree to a 15-year deal to ensure SeaGas was built. That agreement was sized for our needs based on a load factor for our generator in South

Australia. The variance in the wholesale electricity price has resulted in the positions both in excess and short of pipeline capacity. As a business we have managed this to some degree through secondary sales and UIOSA or UIOLI will do nothing to bring additional pipeline capacity to the market by GDFSAE.

*30. What entity would be the most appropriate to operate a trading platform or auction process?*

As the South Eastern Australian Energy Sector has allocated the management of both the electricity and gas markets to AEMO, GDFSAE believes that AEMO should also be charged with the pipeline capacity market responsibilities. This would centralise market functions which assists in gas market consolidation.

GDFSAE trusts that these comments will assist the SCER in considering pipeline capacity trading in this Regulatory Impact Statement. Please feel free to contact me on 03 9617 8410 if you would like to further discuss our views on these issues.

Yours sincerely,

Mike Downey  
Senior Trading Originator & Gas Regulatory Specialist