HSBC Building
Level 19
580 George Street
Sydney NSW 2000
PO Box R41
Royal Exchange NSW 1225

Phone 61 2 9693 0000
Fax 61 2 9693 0093
www.apa.com.au

APA Group

Australian Pipeline Ltd
ACN 091 344 704

Australian Pipeline Trust
ARSN 091 678 778

APT Investment Trust
ARSN 115 585 441

28 May 2013

Ms Skye d'Almeida
Australian Energy Market Commission
Level 5
201 Elizabeth Street
Sydney NSW 2000

AEMC Reference: EMO0025

Dear Ms d'Almeida

AEMC 2013 Strategic Priorities for Energy Market Development: APA Group submission

APA Group (APA) welcomes the opportunity to lodge the following submission in response to the Australian Energy Market Commission's (AEMC's) 2013 Strategic Priorities for Energy Market Development Discussion Paper.

APA is a major ASX-listed gas transportation business with interests in energy infrastructure across Australia, including over 14,000 km of natural gas pipelines, gas storage facilities and a wind farm. APA is Australia's largest transporter of natural gas, delivering about half of Australia's annual gas use through its infrastructure. APA owns and operates a diverse portfolio of energy infrastructure assets across Australia, with a value of approximately $12 billion. These assets also include investments in two interstate electricity interconnectors which operate in the National Electricity Market.

<u>AEMC proposed gas priority</u>

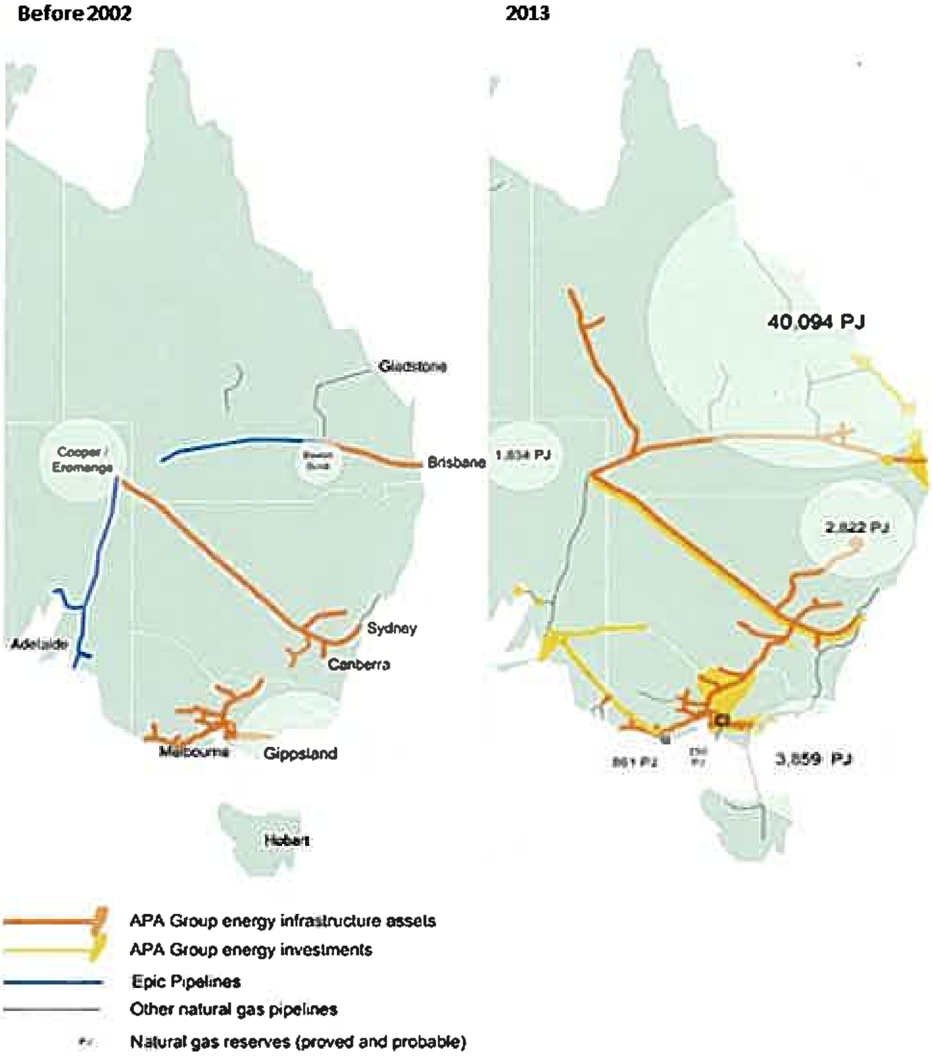
Development of gas market over last decade

The Australian gas market has developed significantly in the last decade. Starting from a fragmented market characterised by point-to-point (single basin to demand centre) gas supply, the south east Australian market is now highly interconnected with most major centres served by more than one pipeline, and gas able to be sourced from multiple basins to meet demand.

This development is shown in Figure 1 below, which compares the interconnectiveness of the south east Australian gas market prior to 2002 to that now. Of particular note, the construction of the Eastern Gas Pipeline and the Interconnect Pipeline have directly linked the Melbourne and Sydney markets, the SEAGas Pipeline has linked the Melbourne and Adelaide markets, and the BassGas and Moomba to Ballera pipelines have respectively linked the Tasmanian and the Queensland markets to the south eastern gas market.

This interconnectivity has created potential for basin-on-basin competition, providing scope for shippers to diversify their gas portfolios as existing long term contracts expire. In addition, new major gas production regions have emerged through the development of coal seam methane reserves in Queensland and New South Wales, further enhancing diversity in the south eastern gas grid. It is against this backdrop of investment and market development that the AEMC's strategic priorities must be considered.

Figure 1 – Gas pipelines and reserves before 2002 compared with 2013



AEMC's discussion of current issues

The discussion paper lists three characteristics that the AEMC considers are required of a gas market that promotes the efficient allocation of natural gas and capacity: information transparency, low transaction costs and flexibility. While these are important aspects of any market, it is also important that an assessment of the performance of a market against these characteristics is undertaken with reference to the size of the market and the nature of its players.

<u>Transparency</u>

The Australian gas market is characterised by a small number of large and highly informed participants. Due to the transactions involved, smaller (second tier) retailers and intending participants must also be of a sufficient size, with access to significant business and financial resources, as evidenced by the prudential requirements in place for all operating gas (and electricity) markets.

In respect of market transparency, these participants have access to or are able to access all the information they require to operate in the market. Existing public resources include the gas market bulletin board, the pipeline register of spare capacity, access arrangements and posted prices (for the availability of capacity and price of gas transportation) and the Short Term Trading Market (STTM) and Declared Wholesale Gas Market (DWGM) for the short-term price of gas. Users and potential users can also approach producers, retailers and transmission companies to uncover further detail as to available gas and capacity.

The transparency of the market must therefore be assessed against the availability and accessibility of information for existing and intended market participants. It is not necessary for there to be broad *public* knowledge of expected gas and transportation costs for the gas market to be considered transparent – it is only necessary that *market participants* have knowledge of expected gas and transportation costs, or be able to readily uncover those costs through enquiries.

APA considers that the gas transportation market performs well in this regard, with information readily available on the cost of gas transportation through a number of means, including but not limited to prices determined in full access arrangements.

Transaction costs

Similar to the discussion above, transaction costs must be considered in the context of the scope of the transactions involved. Multimillion dollar investments to facilitate substantial increases in capacity can be expected to involve detailed contractual negotiations, however the costs of those negotiations can be minor compared to the value of the contracts. Transaction costs must therefore be assessed by reference to the value of the transactions they support. Care must be taken that the cost of markets (including both its operation and the transaction costs of all players) do not exceed the value of those markets.

Flexibility

APA understands that shippers and end users are currently facing difficulties in securing longer term gas supply contracts at prices in line with historic trends. Gas supply contracts, where offered, also lack the flexibility often included in past contracts. When faced with potential higher prices (and profits) in the future if international trade does increase local gas prices, gas producers, and shippers who have supply contracts in place, are not willing to limit their future gains through long term contracts. This lack of flexibility at the producer level is being reflected in shippers only entering into transportation contracts to match their contracted supply.

A further issue impacting the availability of gas for domestic contracting is the lack of upstream competition, brought about by the aggregation of gas reserves amongst a few large players, sometimes also coupled with joint marketing arrangements. In the past, smaller gas producers have been willing to enter into long term contracts with domestic shippers as their gas reserves were not internationally marketable.

The lack of upstream competition from smaller players means that smaller parcels of gas are not being made available for domestic contracts. Instead, larger producers are holding back reserves until they achieve marketable quantities for international trade. The impact has been an effective five year hiatus on the availability of domestic gas contracts while Liquefied Natural Gas (LNG) projects are being developed.

The response of gas producers and shippers to this uncertainty has been to prefer shorter term transportation arrangements with greater flexibility as to capacity commitments and timing of offtake. As a result, these types of transportation contracts have been replacing existing longer term point-to-point transportation contracts for a number of years. It is therefore not accurate to assert that the gas market is still reliant on long term gas transportation contracts, or that these contracts are the only ones available in the market.

Pipeline capacity can be readily expanded on most pipelines in response to market needs with the addition of compression. Bilateral contracts are important to support this new investment, though it should be noted that the length of these types of contracts has also been falling.

APA's experience, however, is that where longer term gas supply contracts are available, shippers also prefer longer term transportation contracts. Under these contracts (both long and short term), flexibility is available through mechanisms for bare transfers that facilitate capacity trading where the shipper wishes.

Focus for future gas market development

There has been very significant investment in the gas transportation industry in the past decade which has facilitated the development of the south eastern gas market, including enhanced scope for basin-on-basin competition. Arguably, this potential has not been realised due to a lack of competition in the upstream sector, and the prospect of greater returns for gas in international markets.

Given these market conditions, it is not clear that the development of further market mechanisms for capacity trading in the transmission sector will assist in delivering more efficient market outcomes. The limiting factor for greater market flexibility appears to be the availability of gas supply contracts. APA is therefore disappointed that the AEMC appears to have assumed that further market regulation of the already heavily regulated transportation sector is required, without a comprehensive assessment of the current market and its limitations.

APA is particularly concerned at the notion that pipeline utilisation will increase should some form of capacity trading be implemented. Demand is the only driver of utilisation and given the current issues in obtaining the gas commodity at acceptable prices it is unlikely that any change in transportation arrangements will result in an increase in utilisation, particularly as shippers currently have the ability to trade unused capacity under contract.

<u>AEMC market priority</u>

APA supports the retention of the existing market priority as part of the AEMC's strategic priorities, however considers that the industry is best placed to implement effective market solutions. Government involvement should be considered only as a last resort if industry mechanisms are clearly identified as not meeting the National Gas Objectives.

APA considers that the AEMC is best placed to work with industry to undertake market development functions in the Australian energy market, reflecting the intention of policy makers in establishing a market development and rule making body separate from the regulator and market operator. This structure increases investor certainty that changes to rules and the development of the market will be undertaken by reference to evidence-based policy, ensuring that vested interests do not have undue influence on policy outcomes.

APA would be pleased to be involved in further discussions with the AEMC regarding the development of its strategic priorities. Please contact Alexandra Curran, Regulatory Manager on 02 92750020 if you would like further information on this submission.

Yours sincerely

Peter Bolding
General Manager Regulatory & Strategy