the australian PIPELINE industry association Ltd

AEMC Strategic Priorities for Energy Market Development

Comments on the Discussion Paper

24/05/2013

APIA, the national peak body representing the Australian transmission pipeline industry, welcomes the opportunity to comment on the Australian Energy Market Commission's Discussion Paper on its 2013 review of strategic priorities for energy market development.

Australia's gas transmission industry provides transportation services to Australia's gas producers, retailers, users and markets. The transmission industry works with customers to deliver specific, contracted services designed to meet the unique needs of each customer. The highly specialised nature of the industry and the fundamental commercial framework of bi-lateral, long-term contracts, allows transmission business to attract lower cost debt than most other businesses. This in turns lowers the overall capital costs of pipeline infrastructure and enables the provision of transmission services to all customers at a lower cost.

The gas focussed strategic priority is of most interest to APIA and its members and this will be the section of the discussion paper on which comment is provided. At this time, APIA will make only brief comment on the discussion paper. APIA is also actively participating in the Commission's gas market scoping study, an important component of the Commission's activity in gas markets.

Structural shift in gas supply and demand

The Commission is aware of the structural shift in supply and demand underway in eastern gas markets and has adequately addressed this issue in the discussion paper. One aspect of the shift that does not seem to be reflected in the discussion paper is the permanent, fundamental adjustment the domestic gas markets in eastern Australia are faced with. On page 26, the Commission characterises the tightening supply/demand balance as providing short-term leverage to gas sellers, but that it is reasonable to anticipate a supply response to high prices will occur in due course.

In the short term, sellers may have leverage in negotiations over buyers as existing domestic contracts expire or are reopened for price negotiation concurrently with the tightening of the supply/demand balance. The expected response to this tightening is an upward pressure on gas prices, which should signal to producers to invest in bringing additional supplies of gas to market. For Australia, this may mean bringing forward investment in technologies to enable the large-scale economic development of unconventional gas resources, such as shale gas.

A response of the kind seen in the United States to rising gas prices has the potential to substantially increase the supply of gas to the Australian economy.

APIA is concerned that the Commission and other policy makers appear to hold the view, based on accepted economic theory, that the market will facilitate a supply side response and tight supply will resolve itself. The Australian gas market and current circumstances have two key features that may limit the effectiveness of a supply side response.

1. The structural change in eastern markets is unprecedented. The LNG export facilities under construction in Queensland will have more than double the gas demand of the entire eastern market. The price for gas in eastern markets will now and into the future be set by the prices achievable in the larger export market rather than the domestic market. Given the potential for further expansion in export facilities, it is more likely that the domestic market decreases in size relative to the export market, further cementing the export market's role as the price setter for natural gas in Australia.

2. The high prices in US gas markets were more a symptom of high international oil prices than one of tight US supply. Importantly, the high prices of the period 2003-2008 were not driven by massive new demand. The US petroleum industry is much larger than the Australian industry and was not resource or capacity constrained at the time, enabling it to respond rapidly and effectively to high prices. By contrast, a significant contributor to current supply tightness is the fact the capacity of the Australian gas production industry is being severely tested in meeting the new demand of the export facilities under construction in Queensland. Unlike conventional gas wells, CSG gas wells are relatively low flowing and short lived. There will be a more intensive, ongoing gas production development program required to continue to serve the export facilities once construction is complete. There is limited opportunity to increase exploration and production activity in response to high prices.

APIA urges the Commission and other not to be complacent regarding the structural shift in supply and demand and to develop and implement market improvements that will genuinely assist market participants managing the issues arising from the changes underway.

Transparency, Flexibility and Transaction Costs

The issues of transparency, flexibility and transaction costs are often discussed when contemplating gas market development. APIA supports initiatives where the benefits outweigh the costs, that have the ability to improve transaction efficiency for all gas market participants and that compensate those parties that incur costs to achieve change that benefits the whole gas market or certain classes of market participant.

Recent market developments such as the establishment of the Gas Bulletin Board, Gas Statement of Opportunities and Short Term Trading Market hubs in Adelaide, Brisbane and Sydney mean that eastern gas markets have the greatest transparency and flexibility they have ever had. Proposed changes to the Gas Bulletin Board and the establishment of a gas supply hub at Wallumbilla will further enhance transparency and flexibility. The utility of these initiatives in assisting market participants manage current issues arising from supply tightness appears limited.

APIA notes that, prior to the establishment of the STTM, the Gas Bulletin Board facilitated flexibility and trading through a voluntary central platform for market participants to transparently signal trading opportunities. To APIA's knowledge, this platform was never used by either buyers or sellers of gas.

Before considering any new initiatives in this area it is appropriate to assess the costs and benefits of those initiatives in place. APIA considers there is sufficient data available on the STTM hubs, including:

- the number of unique market participants;
- the AEMO costs which are recovered from market participants;
- participant's estimates of incurred costs;
- pipeline operator MOS costs (and unrecovered costs);
- and volume of gas traded in hubs

to make a reasonable assessment as to whether the STTM has been cost effective. APIA recommends that the Commission's gas market scoping study conduct such an analysis as part of its assessment of gas markets.

Finally, the National Gas Law, the National Gas Rules and the National Gas Objective they both work to achieve apply only to Australia's downstream gas markets. Increased transparency and flexibility in downstream market is only genuinely useful if there is corresponding increases in transparency and flexibility in upstream markets. APIA does not advocate unnecessary or ineffective change in either upstream or downstream markets. In particular, it is not appropriate or efficient to seek increased flexibility and/or transparency in downstream markets to compensate for a lack of these qualities in upstream markets.

To discuss any elements of this submission please contact APIA's Policy Adviser, Steve Davies, on (02) 6273 0577 or sdavies@apia.asn.au.