29 October 2015

Mr John Pierce
Chairman, Australian Energy Market Commission
Level 6, 201 Elizabeth Street
Sydney NSW 2000

Lodged via www.aemc.gov.au

Dear Mr Pierce,

RE: Pipeline Regulation and Capacity Trading Discussion Paper (Ref GPR0003)

GDF SUEZ Australian Energy (GDFSAE) appreciates the opportunity to make a submission in response to the Australian Energy Market Commission's (AEMC) *Pipeline Regulation and Capacity Trading Discussion Paper* (Discussion Paper).

GDFSAE supports the Council of Australian Government's Energy Council vision for the establishment of liquid wholesale gas markets, with transparently traded gas prices which are suitably liquid and robust, and which allow participants to manage risk in an environment where long-term bilateral contracts are supplemented by shorter term trading.

As noted in the AEMC discussion paper, a critical enabler of a liquid gas market is the ability for gas to flow across the pipeline network to where it is most highly valued. Therefore, artificial mechanisms that prevent participant access to transportation services will inhibit the ability to trade gas, and hence reduce the liquidity of the gas markets. Efficient utilisation of pipeline capacity is therefore a key requirement in achieving the Energy Council's vision.

The gas industry infrastructure in Australia has largely been financed through long term bilateral contracts between pipeline and other infrastructure owners, and gas users. This arrangement has been successful to date in ensuring that gas supply and transport has met the needs of gas users, both domestic and industrial.

The changing dynamics in the east coast of Australia with the rapid growth in liquid natural gas (LNG) exports from the Gladstone terminal in Queensland, and the growth in unconventional gas sources has significantly changed the nature of the gas industry. These changes are creating new challenges for gas supply and transport, with the volumes and direction of gas flows now subject to quite dramatic change and relatively short notice.

Another factor that is contributing to the need for more dynamic gas supply and transport arrangements is the changes that are occurring in the electricity sector which are impacting on gas power generation. The growth in intermittent renewable generation and the withdrawal of some older baseload generation plant is seeing a need for intermediate and peaking gas powered generation to be able to quickly and with short notice, change its generation output to balance changes in the intermittent generation. As a result, gas

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power generation is finding that it is being called upon at short notice, but its long term gas requirements are less certain. This is creating a need for the operators of gas power generation to have flexible, short term options available for purchasing gas supply and transport.

The current arrangements available to respond to these changes in gas dynamics are somewhat limited, with shippers able to obtain pre-existing pipeline capacity from:

- a shipper which already holds spare capacity (bare transfer, novation or operational capacity transfer);
- a pipeline owner who has spare unallocated capacity; or
- a pipeline owner who sells capacity not being used that has already been allocated to a shipper.

Both APA and Jemena have established capacity trading websites which allow participants to ascertain the amount of spare capacity available on the listed pipelines, the delivery and receipt points and the price. GDFSAE understands that volume of trading on these sites has been quite limited to date, with the APA site indicating that only the Roma to Brisbane pipeline has attracted any trades in recent months. GDFSAE understands that factors that are contributing to the limited number of trades are high prices and restrictive receipt and delivery points.

Furthermore, there is a general perspective that pipeline interests may not fully support the level of flexibility required by participants who looking to trade. In this regard, an ongoing complaint is the ability of market participants to trade bi-laterally to reach commercial outcomes that best meet their objectives without facing a form of hold up risk.

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Potential reforms

The discussion paper identifies three broad approaches that could potentially address the issues identified:

- Approach A – Facilitate trading between parties, which primarily addresses transaction cost issues;
- Approach B – Improve the incentives of capacity holders in the provision of capacity; and
- Approach C – Improve the incentives of pipeline owners in facilitating access to capacity.

The AEMC have asked in the discussion paper whether participants believe that the market will respond in a timely manner to address the issues relating to transaction costs, or whether regulatory intervention, such as Approach A, is warranted.

GDFSAE believes that although it is feasible that over time, the market could potentially evolve to more dynamic trading arrangements, the changes in the gas and electricity markets are of vital importance to the Australian economy and society in general, and their ongoing success should not be left to chance. On the other hand, GDFSAE would not support an overly heavy-handed regulatory approach that was not justified.

On balance, GDFSAE believes that the Australian gas and electricity markets are currently at an important point of change which justify the introduction of cost effective measures aimed at facilitating trading between parties and reducing transaction costs. Whether additional steps such as those proposed in Approaches B and C are necessary is perhaps less clear at this stage, although GDFSAE is of the view that these options should be further examined.

Below are some specific comments on the three approaches outlined in the discussion paper.

Approach A – Facilitate trading between parties

Facilitating pipeline capacity trading by participants is supported by GDFSAE as reducing transaction costs and other barriers should provide additional encouragement for trade. Although the proposed options to facilitate trade are unlikely to directly change the incentives of shippers or pipeline operators in providing capacity for trade, it is possible that increased demand encouraged by facilitated trade will in turn create incentives for pipeline operators and shippers to support such trade.

As noted in the discussion paper, there is a range of potential measures that could be introduced to facilitate trading between parties, and some of these would overlap.

GDFSAE agrees that standardisation of capacity trading terms and conditions would likely contribute to the facilitation of trading as this would enable participants to more readily compare options on a like for like basis, and quickly assess their value. It would also streamline the need for participants to review contractual terms, leading to faster decisions.

There is a difficulty in establishing how such standardisation would impact on existing long term agreements between shippers and pipeline operators. Consideration could be given to an arrangement where the underlying long-term agreement terms and conditions are unchanged, but standardised terms and conditions are established and applied to any short term trading that sits on top of the long term agreement.

GDFSAE agrees that pipelines should on the face of it, have an incentive to offer any spare capacity for sale as this would increase the pipeline operators revenue. Given that, apparently, not all pipeline capacity is being offered suggests that either the costs to facilitate the sale are too high, including contractual impediments, or there are insufficient prospective purchasers. A standardised approach should act to reduce the costs associated with offering excess pipeline capacity for purchase, and should also make it easier and more attractive for potential purchasers to participate.

Once a standardised approach to capacity trading has been established, it should become more feasible to consolidate information about available capacity trades on a central bulletin board, which would reduce the cost and complexity for participants seeking to trade.

Approach B – Improve the incentives of capacity holders in the provision of capacity

This approach focuses on options to overcome the issue of pipeline capacity holders, who would mainly be shippers, from holding onto pipeline capacity even though they are not using that capacity. This practice is referred to as hoarding, a somewhat pejorative term, and although the shipper that hoards capacity might have legitimate reasons to decide not to offer its spare capacity for sale, this potentially leads to inefficient utilisation of pipelines as there are potentially other shippers that place a higher value on capacity that are unable to access that capacity.

The discussion paper outlines a number of options to improve the incentives for shippers to make their spare capacity available for trade listed below.

- Compulsory acquisition and reallocation of capacity via:
    - oversell and buyback;
    - day ahead use-it-or-lose-it; or
    - long term use-it-or-lose-it.
- Reserving capacity for trade.
- Remove GTA provisions which confer monopoly power with the shipper.

All of these options could involve relatively significant changes to existing regulatory and contractual arrangements, and introduce issues such as how to protect the rights of existing contract counter parties and free rifer issues.

As a minimum, GDFSAE would support a process which seeks to remove any provisions in gas transportation agreements which provide the shipper with an ability to limit trade. This step would be the least intrusive of all the options presented in the discussion paper, and should act to remove some of the tendency for shippers to hoard capacity.

GDFSAE supports the objective of these options in ensuring that shippers are sufficiently incentivised to offer their spare capacity for trade, and not hoard capacity. The question that follows is: whether the issue of shippers hoarding their spare capacity is sufficiently prevalent to warrant the un-costed impact of regulatory intrusion of compulsory acquisition of capacity reserve; and how if such options are supported they can be implemented in the least disruptive manner?

Of the options discussion, GDFSAE suggests that the long term use-it-or-lose-it would be the least intrusive option, and would therefore represent a more practical first step down the path of compulsory acquisition. The settings for measuring under-utilisation of pipeline capacity by a shipper would need to be carefully considered to ensure an appropriate balance is struck between allowing shippers some flexibility in their utilisation of the contracted capacity, including holding for future use and selling use in the interim, and hoarding that capacity over the longer term period for the sole purpose of impeding the market.

Importantly, two key issues will be how existing holders are compensated under any possible model and ensuring that there are no financial imbalances. GDFSAE in earlier submissions has covered these issues and remains of the view that holders of capacity, whether through a regulated scheme or a bi-lateral trade, will remain economically incentivised where they are compensated at the appropriate market rate and where that rate is above the value they themselves place on that capacity for said period of time. Secondly, where any scheme creates a trading mechanism or creates financial flows and exposures, all positions must be closed out at an agreed point in time. The market will not function effectively if there are financial imbalances or where trade creates more uncertainty, and further where holders are not compensated for their (efficient) short-term loss of capacity it will undermine pipeline investment incentives.

Approach C – Improve the incentives of pipeline owners in facilitating access to capacity

The regulatory framework for gas pipelines on the Australian east coast is an important issue in relation to the overall gas market arrangements. This matter is likely to come into consideration by the ACCC as part of their inquiry into the level of competition in gas supply.

GDFSAE agrees with the general points raised in the AEMC discussion paper that the conditions that are used to assess whether a pipeline should be regulated, are not directly related to the ability of the pipeline to exercise market power. The regulatory decision is instead primarily based on the assessed impact on upstream or downstream markets. This has proven to be a very high threshold, with the result that very few pipelines are regulated on the Australian east coast.

GDFSAE suggests that pipeline regulatory arrangements have been reasonably effective to date, but believes that if some of the reforms for pipeline capacity trading that are being discussed are to be successfully implemented, it is likely that a stricter regulatory framework will be required to ensure that all participants are provided with access to pipeline services on an equal terms.

Similar to points noted above in consideration of options under Approach B, GDFSAE suggests that as a minimum, measures should be introduced that prohibit contractual provisions in GTAs which limit capacity trading by shippers, with a focus on those provisions which confer market power to pipeline owners.

GDFSAE trusts that the comments provided in this response are of assistance to the AEMC in its deliberations. Should you wish to discuss any aspects of this submission, please do not hesitate to contact me on, telephone, 03 9617 8331.

Yours sincerely,

Chris Deague
Wholesale Regulations Manager