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22 October 2015

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Lodged (by online): www.aemc.gov.au/Contact-Us/Lodge-a-submission

East Coast Wholesale Gas Market and Pipeline Frameworks Review – Pipeline Regulation and Capacity Trading Discussion Paper

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Australian Energy Market Commission's (AEMC) Pipeline Regulation and Capacity Trading Discussion Paper.

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 34 electricity and downstream natural gas businesses. These businesses own and operate some $120 billion in assets, employ more than 59,000 people and contribute $24.1 billion directly to the nation's Gross Domestic Product.

Flexible and transparent access to pipeline capacity is a key feature of well-developed gas markets globally and important for the development of liquid commodity markets. As noted by the AEMC, the ability of gas to flow to where it is most valued is inextricably linked to conditions in the transmission segment of the supply chain. While the Association considers current pipeline transportation arrangements have generally worked as intended, it is important to understand whether these arrangements remain fit-for-purpose in the context of changing east coast gas market dynamics.

The Association believes the original objectives of the gas access regime are still broadly relevant and compatible with the COAG Energy Council's Australian gas market vision. The current regulatory framework has delivered significant investment in pipeline capacity and provided a reasonable balance of end-user protection with service provider protection and incentives. But it is recognised changes underway in the market are likely to test the efficacy of current arrangements, particularly as they relate to facilitating access to short-term capacity trades. Where access to capacity is impeded, this creates the risk that the incremental benefits of more flexible short-term trades are missed, the value of which may grow as market dynamics continue to evolve.

The extent to which the current framework may impede the flexible trade of pipeline capacity and thus, the efficiency of the gas market more broadly, is difficult to assess. Limited trading of secondary pipeline capacity does not necessarily imply there is a market failure or that investment has been inefficient. Both shippers and pipeline operators face clear financial incentives to offer unutilised capacity where there is demand and there are contractual mechanisms available that enable both parties to trade this capacity.

But the AEMC has identified a range of potential impediments associated with the current framework that do warrant further consideration. Outside of search and transaction costs, these potential impediments primarily stem from the fact that gas pipeline capacity is not homogenous, with different terms and conditions and operating environments. In particular, there is a complexity associated with customised long-term bilateral agreements for gas transportation that may limit the ease and willingness with which secondary trading can be conducted.

A high level of specificity around key contractual provisions (e.g. delivery/receipt points and nomination cut off times) assists with managing contractual and physical flows and minimising operational costs for pipeline owners, and ultimately minimising the contribution of transportation charges to the end price of gas. Specific terms and conditions also provide foundations shippers with the security to underwrite pipeline investment. Despite these benefits, such a level of prescription can also limit trading between shippers that do not share the same requirements, particularly where a shipper's ability to address contractual inconsistencies is constrained in some way (e.g. through the costs associated with renegotiating contractual provisions).

Understanding the materiality of these impediments is essential

Addressing these potential issues in an established but evolving market is challenging. As identified by the AEMC, there are trade-offs associated with pursuing particular regulatory options. While alternate regulatory arrangements could potentially achieve more efficient allocation of pipeline capacity, the resultant impact on incentives for investment, pre-existing property rights and overall compliance costs must also be considered.

The Association is supportive of examining opportunities to facilitate more flexible and transparent access to gas supply and transportation capacity. To inform discussion and guide the appropriateness of any response, it will be important to further investigate the materiality of the challenges experienced in finding and executing capacity trades.

This assessment should give consideration to the potential barriers to trade identified by the AEMC, as well as other factors relating to the demand for, and availability of, secondary pipeline capacity. This includes: the volumes, durations and times of the day and year that participants are seeking capacity for; the search and negotiation process; and transaction costs and prices. The Australian Competition and Consumer Council's (ACCC) east coast gas inquiry may offer some useful insights in this regard.

Regulatory intervention to facilitate capacity trading must be carefully considered

In the absence of detailed analysis around the materiality of the potential barriers identified, it is difficult to explicitly evaluate options at this stage of the consultation process. Potential reforms to wholesale gas market arrangements will also have ramifications for the appropriateness of future pipeline transportation arrangements. But at a high-level, the Association is broadly supportive of an incremental approach to reform that reduces barriers to trade. Such an approach provides a better balance of risks/benefits relative to more heavy-handed reform options and would likely be consistent with supporting industry-led reform.

The 'trade facilitator' model recently developed and implemented across a range of gas transmission pipelines is an important initiative in this regard. It demonstrates the ability of industry to respond to changing market needs in a targeted and light-handed manner, a key benefit of which is avoided regulatory intervention and unnecessary costs. While utilisation is currently limited, there is scope for initiatives such as this to continue to evolve, potentially encompassing more pipelines and providing more standardised products to assist with efficient identification and execution of capacity trading opportunities.

The COAG Energy Council's agreement to pursue enhancements to information provision and standardisation of contractual terms and conditions for secondary capacity trading is also highly relevant. These reforms were informed by extensive stakeholder consultation and an assessment of the costs/benefits of a suite of different options. Collectively, they will assist with improving market participants' awareness of capacity trading opportunities and reduce the transaction and coordination costs associated with their execution. Given changes to information provision requirements are still in the process of being implemented, this reform should be given adequate time to take effect and for its impacts to be assessed.

Of the reform options presented by the AEMC, Approach A is most consistent with an industry-led approach to reform. While pipeline owners have developed standard contract terms and conditions to enable shippers to trade short-term capacity more readily, it is important to consider whether there are further opportunities to reduce the transaction costs associated with capacity trading.

The potentially restrictive transportation agreement provisions identified in section 2.2.1 of the Discussion Paper are highly relevant in this regard. Greater flexibility around these contractual provisions could assist with reducing transaction costs and facilitating more opportunistic trade amongst shippers. But it is important to note that any mandated reforms in this space represent a potentially significant change from the status quo, particularly where they would necessitate changes to existing long-term contractual agreements or interfere with property rights. Further, there are trade-offs to be considered where changes could result in higher operational costs for pipeline owners.

To this end, it is essential that revised transportation arrangements protect existing property rights and continue to incentivise efficient investment in the gas industry. Any move away from long-term foundation contracts to underwrite investment would therefore need to provide a robust model for funding future capacity. It should also ensure continuity of gas supply for end-use customers at volumes and on terms equivalent to current contractual arrangements.

In developing and pursuing work in this space, continued industry engagement is essential. Further, any decision to proceed with fundamental changes to current market arrangements must be informed by robust cost-benefits analysis.

Any questions about our submission should be addressed to Shaun Cole, by email to shaun.cole@esaa.com.au or by telephone on (03) 9205 3106.

Yours sincerely

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