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

21 June 2013

Mr Daniel Hamel
Australian Energy Market Commission
Level 5
201 Elizabeth Street
Sydney NSW 2000

AEMC Reference: GPR0001

Dear Hr Hamel

AEMC Gas Market Scoping Study: APA Group submission

APA Group (APA) welcomes the opportunity to lodge the following submission to the Australian Energy Market Commission (AEMC) in respect of its gas market scoping study.

APA is a major ASX-listed gas transportation business with interests in energy infrastructure across Australia, including over 14,000 km of natural gas transmission 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.

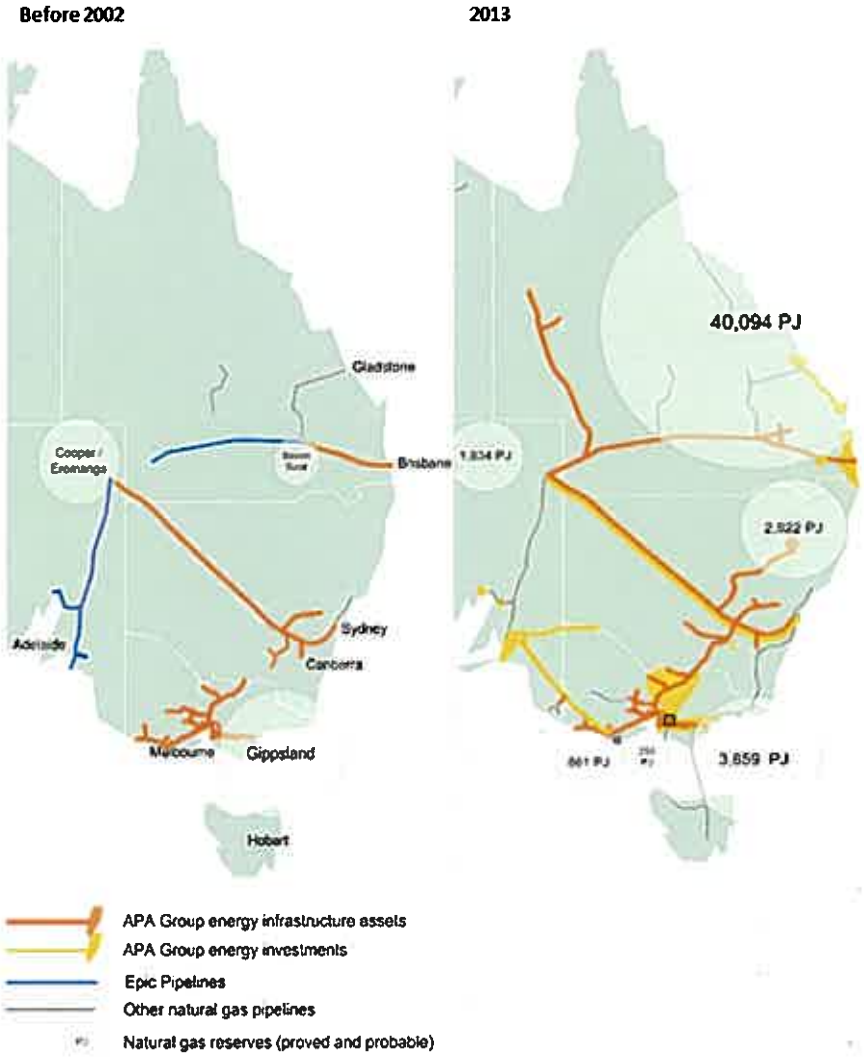
Development of gas market over last decade

The Australian gas market has experienced significant development 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 interconnectedness 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 South West Queensland pipelines have respectively linked the Tasmanian and the Queensland markets to the south eastern gas market.

This interconnectivity has created the 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 potential for similar development in New South Wales, further enhancing diversity in the south eastern gas grid.

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



Scoping study terms of reference

While APA notes that the AEMC's scoping study is limited to the downstream sector, APA considers that it is critical that the AEMC investigate and understand the current dynamics of the upstream sector in conducting its review.

Without consideration of the upstream sector and how it is impacting the market as a whole, it will be impossible for the AEMC to distinguish between issues that may be related to the upstream sector, and those that may be driven by downstream issues. The risk is that issues that are identified downstream are not linked to their upstream drivers, and ultimately, policy interventions to address those issues fail. There is a significant risk that the current push for a government facilitated capacity trading market proves to be one such example. APA discusses this further below.

Recent trends in the upstream sector

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. 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 producers, 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 producers means that smaller parcels of gas are not being made available for domestic contracts. Third party access to upstream processing facilities on appropriate terms is a key issue for smaller producers to facilitate the development of small fields and provide access to the market. Instead, in the absence of greater transparency, larger producers appear to be holding back reserves (or not spending the capital to move resources to reserves classification) until they achieve marketable quantities for international trade.

Implications of upstream factors for downstream gas market development

The response of gas producers and shippers to uncertainty over future gas prices 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.

While pipeline capacity can be readily expanded in response to market needs with the addition of compression or looping, bilateral contracts are important to support this new investment, and the length of these types of contracts has also been falling. This trend can have an impact on pipeline investment, particularly in respect of regulated pipelines if the additional risk taken on by the pipeline business through shorter contracts is not recognised by the regulator in setting regulated tariffs.

APA's experience 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 or assignment that facilitate capacity trading where the shipper wishes. In addition 'as available' services and authorised overruns are offered on most pipelines which provide a firm transportation service once scheduled.

These observations are important when considering the need and drivers for a government facilitated capacity trading market. Shippers currently have the ability to trade their capacity bilaterally via bare transfers. While a business-hosted capacity trading facility may improve the visibility of available capacity for trading (thereby assisting those interested in trades to find each other), it is not clear that it will lead to a significant increase in trading, or in more efficient asset utilisation. Asset utilisation is predominantly driven by seasonal demand factors rather than access to capacity.

The fundamentals of the gas market are supply and demand. APA is not aware of any evidence that there is a large unmet demand for gas that would be unlocked through capacity trading. The limiting factors to further gas usage instead appear to be the cost of gas compared to competitors (eg electricity), and the pace of general economic growth. Expected increases in gas supply costs (as existing lower cost supply contracts expire and are replaced with new contracts) will not assist this situation. It should also be noted that APA has an incentive to increase utilisation of its existing pipeline capacity as this leads to increased revenue for the business.

As a result of these market fundamentals, capacity trading is likely to be only at the margin, involving small volumes traded over a short term. This is only evident, however, by looking at the whole market, including the upstream sector. It is therefore very important that any capacity trading facility does not impose unnecessary administrative costs on the entire downstream market to the benefit of a very small number of participants as is the case with the Short term Trading Market (STTM). Doing so risks further burdening the downstream gas sector as a whole by imposing administrative and market costs that increase the cost of gas, thereby reducing the competitiveness of gas compared to other fuels, and ultimately leading to an overall reduction in gas consumption.

Impact of recent and anticipated gas market interventions

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.

There have been a number of recent interventions in the downstream gas market intended to improve market transparency, asset utilisation, and the ability for smaller users to enter the market. In particular, the Short Term Trading Markets (STTMs) in Sydney and Adelaide commenced on 1 September 2010, and the Brisbane STTM started on 1 December 2011.

In the context of a gas market characterised by longer term supply and transmission contracts, these new markets have been in place for a relatively short period. Further, the new Wallumbilla gas supply hub, which is based on a different market structure to the STTM, is not expected to start until 20 March 2014. APA also understands that there is a forthcoming rule change proposal from the Australian Energy Market Operator intended to facilitate trading in Authorised Maximum Daily Quantity (AMDQ) holdings between shippers within the Victorian Declared Transmission System.

Given how recent these developments have been (and that some are yet to even start), APA considers that it would be premature to conclude that the downstream gas market is not working and requires further government-led intervention. It should also be noted that interventions to date have not targeted issues in the upstream gas sector.

The downstream market must be given sufficient time to develop and mature under the existing arrangements before additional external mechanisms are imposed, potentially at significant further cost to market participants and ultimately consumers. APA considers that this approach will allow the downstream market to develop its own solutions and services to ensure efficient pipeline utilisation driven by demand.

By contrast, the threat of early and unwarranted government intervention has the potential to undermine any market-led processes. This is a particular threat in relation to pipeline capacity trading, where the option of pipeline-facilitated trading is under active consideration by APA. The spectre of a government facilitated capacity market that would erode any value from a market participant-led solution undermines this work and the associated business case, most likely leading to less efficient market outcomes being imposed through regulatory intervention.

APA would be pleased to be involved in further discussions with the AEMC regarding its gas market scoping study. 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