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Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

19 October 2015

Dear Mr Pierce

Pipeline Regulation and Capacity Trading Discussion Paper

AGL welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) Pipeline Regulation and Capacity Trading Discussion Paper.

The comprehensive work being undertaken by the AEMC on East Coast gas market settings, coupled with the work being conducted by the Australian Competition and Consumer Commission (ACCC) and the Australian Energy Market Operator (AEMO), provides a substantive opportunity to assess existing market settings, as well as market outcomes, in order to ascertain whether the settings should be amended.

AGL is one of Australia's leading integrated energy companies, operating a retail business with over 3.7 million customers and a power generation portfolio of over 10,000MW, which consists of base, peaking and intermediate generation plants, spread across thermal and renewable energy sources.

As a gas producer, shipper, owner of gas storage facilities and being a gas retailer, AGL has a strong interest in the gas market settings currently being investigated by the AEMC. AGL notes that it supports reforms consistent with the Council of Australian Government Energy Council's vision of enhancing transparency and market liquidity. However, AGL urges caution in proposing significant reform while the market adjusts to the changing environment associated with the commencement of liquefied natural gas exports (LNG) in Queensland. Where reforms are proposed, AGL considers that the benefits should clearly outweigh the costs.

Framing comments

AGL has previously noted, in its submission to the AEMC East Coast Wholesale Gas Market and Pipeline Frameworks Review Stage 1 discussion paper, that it sees capacity trading as a key constraint in developing liquidity in the East Coast gas market, second only to addressing gas supply constraints, and it agrees with the AEMC's assertion that 'the ability of gas to flow easily across the pipeline system to where it most highly valued is a critical enabler of a liquid gas market'.

Fundamental to achieving the objective of enabling gas to flow to where it is most highly valued, AGL supports further examination of measures aimed at properly regulating pipeline transmission settings (Approach C – Improve the incentives of pipeline owners in facilitating access to capacity). AGL considers that such an approach would allow shippers to freely trade capacity (including flexibility with regards to delivery and receipt points) as needed, with minimal transaction costs, improving timeliness of trading and any other barriers to trade. This action would likely open up capacity trading, as shippers would have greater flexibility in offering any spare capacity they may have to market without any significant barriers impeding trade.

While AGL is supportive of a market carriage model, it notes the inherent difficulty of pursuing a market carriage model in order to free up access whilst also delivering the substantial benefits of a contract carriage model – that is private sector investment and private sector exposure to commercial risk. AGL would support further analysis on the part of the AEMC as to how investment signals, and investment in any new infrastructure, in a market carriage model will be delivered.

Approach A – Facilitate trading between parties

AGL notes the work that has previously been completed by AEMO, in relation to the National Gas Market Bulletin Board, and the work currently being completed by the AEMC on information provision.

Although AGL supports additional work being completed in relation to Approach A (as long as the solutions are voluntary, there are no increased reporting burdens and any commercial issues associated with reporting are addressed), it considers that any further benefits from facilitating trading between parties would largely be marginal given the efforts that have already been expended in this space.

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

On the issue of capacity holders and the provision of capacity, as the AEMC notes, foundation shippers underwrite transmission infrastructure investments 'for long-term firm access to that infrastructure's capacity'. From AGL's perspective, the AEMC has not sufficiently recognised a number of key elements associated with this investment on the shipper's part. Specifically, the actual purpose of the investment (to effectively manage risks and exposure in relation to end-use consumption, including the possibility of a one in ten year peak demand event) and adequately noting the opportunity cost of hoarding capacity.

In regards to shipper risk management strategies, AGL is concerned that the AEMC has not addressed this issue. Specifically, that shippers Gas Transportation Agreement's (GTA) contain sufficient contracted capacity to manage their own risks and exposure, including the possibility of a peak demand event. Accordingly, unutilised capacity does not directly correspond to capacity hoarding or contractual congestion. AGL suggests that should a regulator eventually invoke Use It Or Lose It (UIOLI) provisions, responsibility for security of supply should also rest with the regulator, including the possibility of compensation being paid to the shipper in the event that UIOLI provisions led to them incurring a financial loss. To the extent that existing property rights are also adversely impacted, this should be recognised and compensation, where necessary, provided in order to address sovereign risk issues and possible financial loss against investments made in good faith.

Furthermore, GTA's do not only reflect actual capacity contracted. They also contain reference to directly associated services such as storage in the form of linepack. Even though, at times, it may appear that a shipper is not utilising all of the contracted capacity, the shipper may actually be fully utilising the directly associated linepack park-and-loan tolerance as a means by which to balance and manage risks within its portfolio. Shippers need the capability to park or loan gas, UIOLI provisions may diminish shippers abilities to do this and hamstring their ability to effectively participate in the market.

Fundamentally, AGL considers that managing UIOLI provisions may require 'omnipotence' on the part of the regulator in order to correctly gauge what capacity is actually underutilised and should be made available against what capacity is actually required on the part of the shipper to manage its exposure. Finally, AGL is of the view that UIOLI provisions should only be considered after all other avenues have been pursued aimed at freeing up trading on pipelines.

In relation to the notion of capacity hoarding, where a shipper makes capacity available, a commercial rent will be earnt from doing so, by not facilitating such a trade an opportunity cost is incurred on the part of the shipper. From its perspective, AGL does not consider that capacity hoarding is a significant issue. AGL notes that the attractiveness of any capacity trade on the part of the purchasing shipper will be determined by a number of variables including, price, volume and importantly, the duration of access to the capacity. One of the reasons why foundation shippers enter into long term contracts is because of the fact that it is difficult to manage end use customer demand for gas through short term access arrangements. The fact that such long term carriage products are not routinely available minimises demand for capacity trading overall.

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

AGL strongly supports further work on the part of the AEMC aimed at introducing measures to ensure that any natural monopoly issues associated with pipeline ownership are appropriately and effectively addressed through regulation. Specifically, AGL supports steps that address limits on capacity trading on the part of shippers.

AGL considers that the extent to which issues regarding pipeline owners facilitating access to capacity and freeing any trade restrictions, may largely supersede issues raised and identified under Options A and B.

If you have any questions in relation to this matter please contact me on 03 8633 6967.

Yours sincerely

Simon Camroux
A/g Head of Regulatory Strategy