



13 June 2013

Mr Daniel Hamel
The Australian Energy Market Commission
Via web submission

GAS MARKET SCOPING STUDY

Dear Commissioners,

The Australian Pipeline Industry Association (APIA) welcomes the opportunity to provide further comments on the Commission's Gas Market Scoping Study. Having met with the Commission and participated in the Sydney workshop, this submission will not repeat matters already discussed.

There is currently a high level of attention on Australia's gas markets, driven by the structural change underway with the development of east coast LNG export facilities. APIA welcomes this attention, but is concerned that potential responses to the structural change seem to focus on efficiency improvements to the current gas market frameworks rather than consider the bigger question of the policy establishing the market frameworks.

An effective, efficient market is one that responds to supply tightness with higher prices. The supply is allocated to the users that value it most. The higher price is also an incentive to increase supply, eventually – as supply begins to exceed demand – reducing prices. The demonstrated ability of the Australian gas market to adjust its prices according to supply availability appears to indicate the market is efficient and working.

Markets are designed within a policy framework. When there is perceived "unfairness" or failure within a market, often when there is a shortage of supply and prices rise, the point is usually made that "allowing the market to work" will eventually see the higher prices generate increased supply, so that prices then fall.

However, a focus on the actual policy framework for a market is often overlooked because this is a more difficult and substantive challenge.

Australia's east coast gas market is a case in point. The National Gas Objective is to:

'promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.'

Open, competitive markets will be able to ensure that price for a commodity reflects the supply/demand balance and that those value the commodity most highly will access it, but may be unable to give consideration to broader issues that form part of a market's purpose or objectives. Government policy, such as the intent embodied in the National Gas Objective, defines the purpose of a market and sets the boundaries in which competition should occur.

The gas market policy settings for Eastern Australia have been developed in an environment where producers were focussed on the domestic market and supplying large gas users in that market. The market environment has changed to one where the largest producers are focussed on export markets that are far bigger than the domestic market.

The policy settings framing the markets have not changed during this period of change and it might, therefore, be timely to revisit policy – not simply the operation of the market.

As mentioned, the policy framework for the Eastern Australian gas market was developed without consideration of exports. In fact, it was assumed that gas would be imported from PNG or from Western Australia. This was prior to the development of coal seam gas in Queensland, which has supplied the domestic Queensland market for many years. The early development of coal seam gas to supply the Eastern Australian market was not a challenge to the policy framework – it merely factored out imports from PNG or WA to address demand issues.

The policy framework, with no changes, allows producers to sell gas to the users that value it most highly. That is an appropriate market outcome when producers themselves do not have a major interest in downstream demand. With the establishment of an LNG export industry in Eastern Australia, major producers will now be the primary suppliers and the source of the largest gas demand – the LNG export facilities. It appears the gas market is soon to be faced with a situation where the three joint ventures committed to LNG facilities in Gladstone will control well over 2/3rds of east coast gas supply and be the source of approximately 2/3rds of east coast gas demand.

This presents a challenge to the existing policy framework. The *Energy White Paper* states on page 145 that a key objective of the gas market is to ensure timely and adequate domestic supply. If major gas producers have larger incentives, both price-driven and contractual, to pursue export markets it is possible that due consideration will not be given to providing timely and adequate domestic supply.

If there is a shortage of gas, producers may face a choice between the export and domestic markets. There is nothing in the policy framework for the Eastern Australian market that ensures Australian gas users (consumers/manufacturers/generators) will have access to that gas – even if they are prepared to pay the export equivalent price. This is particularly relevant in the event of a gas supply emergency disrupting domestic gas supplies.

Making efficiency and flexibility adjustments in the domestic gas market might be useful in improving the allocation of marginal gas, but will not address the fundamental question of how gas is to be allocated. While adjustments are being made to the domestic gas market, the gas being supplied to that market may be diminishing and the adjustments provide no solutions to this.

It is appropriate to revisit the policy framework governing wholesale gas markets to ensure the appropriate incentives are in place to ensure that the key objective of timely and adequate provision of domestic supply is achieved.

If you have any questions, please contact me on (02) 6273 0577 or at sdavies@apia.asn.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Steve Davies', with a small mark above the 'v'.

STEVE DAVIES
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