epicenergy

27 March 2015

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

Dear Mr Pierce

RE: Wholesale Gas Markets and Pipelines Framework Review

Thank you for the opportunity to respond to the Wholesale Gas Markets and Pipelines Framework Review.

Epic Energy South Australia Pty Ltd (EESA) is the owner the Moomba to Adelaide Pipeline System (MAPS) and the South East Australian Pipeline System (SEPS) and is a member of The Australian Pipelines and Gas Association (APGA). Through its position on the APGA Policy Committee EESA, together with other transmission pipeline operators, has actively participated in the development of the APGA submission to this Review.

APGA Submission Summary

EESA supports the APGA position reflected in its submission and will not revisit the issues raised in that submission apart from to highlight EESA's strong support the following:

- The supply-demand balance in the gas market is the key driver for prices, not the efficiency and transparency of secondary pipeline capacity trading markets. Secondary capacity trading, now occurs and the benefits of market reform are therefore likely to be limited (especially in the absence of new market participants). This is demonstrated by the results of the NERA study for the Capacity Trading RIS referred to in the APGA submission, where the cost benefit analysis supported the provision of greater data and with lack of access not raised as a significant issue;
- If capacity utilization is used as the proxy for market efficiency, then the data quoted in the APGA submission on utilization percentages in Australia, North America and Europe suggests that the Australian system is more efficient in utilizing capacity. This further

supports the conclusion that the benefits to be gained from market reform in the absence of addressing supply issues are limited;

- The development, expansion and connection of the broader east coast market has occurred in response to the demands of the market; the efficiency and timeliness of which response is a direct result of the Contract Carriage system. This also includes the financing of the existing infrastructure, a critical element to the efficiency of the market;
- The STTMs and DWGM are balancing markets introduced to support retail market competition and cannot be considered wholesale markets. The clearing price set in these markets, especially in the STTM's, reflect the value of imbalance in the retail market not the value of gas for the region. The exclusion of power generation loads from the Adelaide STTM highlights the inability to use the Adelaide STTM clearing price as a wholesale gas price in SA.

Contract Carriage and Bespoke Arrangements

EESA firmly believes that overarching benefit of the Contract Carriage model is that it allows for the development of bespoke arrangements between Shippers and Pipeliners to best suit the needs of the market. The ability to develop bespoke arrangements is critical given the variability in demand and supply profiles across the major demand centres in eastern Australia. This arrangement encourages and supports long term investment needed for the capital intensive nature of pipelines where the market demand requires it.

Market Segments

The natural gas market in South Australia supplied by EESSA compromises 3 diverse segments, with substantially different characteristics:

- Regional markets underpinned by large industrial load connected to one supply source;
- Adelaide metropolitan retail market connected to 2 pipelines and underpinned by the STTM;
- Power generation market with the majority of generation load connected to 2 pipelines

The Power Generation market, in particular, exhibits extreme swings in load requirements reflecting the power market scheduling requirements at 5 minute intervals. Retail markets have seasonal swing and load variation across the day driven by domestic demand as well as the presence of cold fronts, whilst industrial load tends to be more constant in nature both within day and across the year.

Given these disparities in requirements to meet demand, shippers seek a range of services and flexibilities to meet their specific requirements. These requirements can only be met through the development of bespoke contracts which reflect appropriate risk allocation between the parties.

Gas Transportation Agreement Value

Having markets which reflect appropriate risk allocations is critical to the functioning of the energy markets overall; where risk should sit with the party best able to manage it. From a pipeliner's perspective, one key risk is in the capital investment of its asset which underpinned by the contracting profile of its customers, with term of contract and security of revenue source critical.

The value of a Gas Transmission Agreement from a customer's perspective is the certainty it receives from that contract on its ability to access capacity when it is required, and the contractual guarantee that the gas it schedules will be delivered. The capacity charge the customer pays for that guaranteed access, can therefore be considered an option fee, for the right to utilize that capacity on any day in the term of the GTA; where utilization includes the right to trade that capacity if it chooses.

The value of the capacity option is therefore a function of the value that the access provides to the Shipper, whilst the premium must cover the Pipeliner's costs to meet its obligations to deliver the gas. This value is therefore a function of potential substitutes, including other sources of gas, as well as the scarcity of capacity. Furthermore, Pipeliners are constrained by the National Gas Law and the potential for regulation which remain open to customers to consider is desired.

Excess Capacity and Secondary Markets

In an environment where there is excess capacity available on a pipeline, the scarcity value is limited as a non-firm service (for which there is no option fee payable) presents no risk of interruption. A non-firm service, in an excess capacity environment, therefore gives a Shipper effectively a free option and transfers its access, or security of supply, risk to the pipeliner, who now has significant revenue risk which it is unable to effectively manage. This revenue risk impacts on capital returns and therefore becomes an overall business risk and, in the extreme has the potential to impact on the future viability of the business.

In this excess capacity environment, As Available services, if offered, therefore need to be priced at a level which reflect the economic costs associated with such a service. This price will be at a substantial premium to the firm service as it has substantially higher costs to the Pipeliner (and at much greater risk) in providing it. Contract carriage has allowed these services to be negotiated on a bespoke basis as the negotiation process allows a reasonable allocation of the inherent risks between the contracting parties which are common in the industry and have been so for many years.

Trading on the MAPS

In this excess capacity scenario, secondary capacity traded between Shippers competes with both Firm and As Available Services offered by the Pipeliner. This is certainly the MAPS experience and whilst the arrangements between Shippers are not transparent, and EESA is unaware of the terms of the trades, it is aware through the nominations process that such trades occur. The fact that there is an active secondary market on the MAPS between Shippers in the absence of any formal platform, suggests that the gains from a formal trading platform would be marginal; supporting the NERA study conclusions referred to above.

The MAPS also provides an imbalance trading service between shippers which allows them to trade positive and negative imbalances on the pipeline; providing alternative sources of supply (and demand) for gas wholesalers downstream of production facilities. These trades occur and are effectively the same as providing a virtual settlement point for a Moomba Trading hub; but without the transparency of the wholesale hub market.

Given that EESA is aware of substantial wholesale trading activity, for both capacity and imbalances, in and around its pipeline, it sees the value benefit from more formal arrangements as limited to the incremental benefits of transparency. These are considered limited in the absence of substantial new entrants bringing significant increases in liquidity to the trading markets. However, as these trades take place, provided that the costs of developing the platforms are recovered, the development of those platforms will not negatively impact the market.

This support, however, is subject to a significant provision, which is that any trading platform developed deals with available secondary capacity and does not impact on the value of primary capacity. **For this reason, capacity trading markets, if developed, must only reflect trades between shippers in respect of their unutilized firm capacity and provide no compulsion on Shippers to offer its uncontracted capacity into the market.**

In respect of the opportunities for further connection between the markets, EESA would again highlight the benefits of contract carriage in delivering bespoke arrangements that meet the needs of the market.

Should there be a Moomba Hub?

As above, the presence of imbalance trading on the MAPS indicates a trading market for gas supply on the MAPS already exists, and is valued by Shippers on the pipeline. A Moomba trading location would provide a more transparent market place and deliver value to market participants who operate in non-Queensland markets.

The fact these trades already occur on the MAPS, highlights the need to ensure that any Moomba trading location includes MAPS as specific point. The complexities of a single Moomba location are many, and EESA believes that the optimal approach would be to establish separate MAPS and APA trading locations and, once established, a single location can be assessed in time when the specific technical issues arising from the changing functionality at Moomba are better understood and can be addressed appropriately.

What opportunities are there for improved integration between the markets?

From mid 2015, MAPS will be connected to the SEA Gas pipeline and provide services flowing gas north from Adelaide to Moomba. This connection and the associated work to allow flow reversal of the pipeline was driven by customer requests and the ability to agree a bespoke contract with Shippers interested in the service.

The existing market framework has allowed this investment to proceed, promoting a more flexible and interconnected market.

EESA understands there are difficulties in delivering gas across the Victorian system to allow full access for gas developed in the Gippsland and Bass Basins to deliver into SEA Gas and then into the MAPS; however this issue is addressed in the APGA submission and no further detail will be provided in this submission.

Conclusion

In conclusion, EESA would like to highlight the following key issues:

- The contract carriage market structure has allowed the development of bespoke agreements which provide acceptable transfers of risks between Shippers and the Pipeliner to meet the increasing needs for flexibility in a changing market;
- The value of Primary firm capacity is a function of the scarcity of that capacity and the value derived from its use. Any formal secondary market arrangements must not alter the balance of value drivers in the Primary capacity market to ensure all participants can manage their risks appropriately;
- Significant capacity and imbalance trading already occurs on the MAPS so the benefit of a more formal trading platform are likely limited;
- The cost of development of any formal secondary trading platforms must be able to be recovered from the market;
- A trading location for the Wholesale Gas Supply Hub at Moomba would benefit the market, but a separate MAPS location in the initial design is imperative

Thank you for the opportunity to comment on this Framework Review and should you require any further information, please do not hesitate to contact me on the numbers below.

Yours sincerely

Jonathan Teubner
Manager, Commercial