12 April 2010

Dr John Tamblyn
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By electronic submission: www.aemc.gov.

Dear John,

RE: GRC0001 – Prioritisation of Tied Controlled Withdrawal Bids, Draft Determination

Origin Energy Limited (Origin) appreciates the opportunity to provide a submission in response to the draft determination.

We note the AEMO rule change proposal forming the basis of the AEMC decision has already benefited from considerable consultation through the Gas Market Consultative Forum (GMCF). In this regard, it has significant industry support that reflects the perceived commercial benefits of the proposal. However, we also acknowledge that the AEMC must assess the proposal against the National Gas Objective (NGO); efficient investment and pricing of gas and pipeline capacity are germane to this objective.

In this regard, we consider that providing a consistent framework for allocating access at times of constraint for both injecting and withdrawing gas on the Principal Transmission System (PTS) contributes to the NEO. In particular, we consider this will enhance the ability of participants to manage their risks and, subsequently, improve commercial incentives to invest in pipeline capacity.

Further, we consider that any market power concerns associated with holding or selling Authorised Maximum Daily Quantity (AMDQ) rights are capably managed by the general economy wide competition law provisions of the Trade Practices Act (TPA). We therefore ask the AEMC to reconsider its draft decision not to make this Rule change proposal.

We discuss these issues in more detail below.

AEMO proposal

AEMO on behalf of gas market participants outlined a number of important reasons for linking tied withdrawal bids to AMDQ rights:

- Ensures consistency with approach used for injection bids
- Promotes incentives for market driven investment in pipelines

- Increases predictability over dispatch outcomes in the event of a constraint, and therefore enhances management of risk in the Victorian gas market

The AEMC rejected these purported benefits in its draft report, essentially for the following reasons:

- Most investment in pipeline capacity is likely to proceed through a regulatory process, which does not consider AMDQ rights in its assessment process.
- AMDQ rights are not sufficiently firm for them to be a factor in encouraging market driven pipeline investment.
- A lack of liquidity could lead to the exercise of market power in markets for AMDQ rights, which in turn could lead to an inefficient allocation of gas during times of market stress (that is, gas will not flow to the party that values/or needs it most on the gas day)

Investment incentives and risk mitigation

One concern we have with the conclusions of the AEMC regarding the value of AMDQ rights is that it appears to be backward looking. Origin certainly agrees that AMDQ rights to date have not played a significant role in driving new investment in pipeline capacity; however, this may not continue to be the case. Pipeline capacity on the PTS to date has been more than sufficient to meet demand requirements. The subsequent lack of pipeline congestion means that the benefits of holding AMDQ have been limited. However, this could well change in a future environment dominated by the need to constrain carbon emissions, which is expected to significantly expand gas fired generation (GFG) capacity and demand for gas more generally. In an environment of increasing pipeline congestion AMDQ rights will become more valuable.

In this context, linking withdrawal of gas to such rights in the same way as injection of gas will improve the overall firmness of AMDQ as a transportation right, particularly given that in many cases participants are responsible for both the injection and withdrawal of gas on behalf of their customers. For example, because of the lack of gas supply in NSW Origin is required to meet its significant GFG load requirements in NSW from upstream sources in other states. In this regard we have made arrangements with off-shore producers in the Bass Strait to inject gas into the South West Pipeline (SWP) and we withdraw this gas at Culcairn for subsequent delivery into NSW. Already there are multiple injection sources contracted to a variety of shippers and retailers, competing for access to SWP pipeline capacity and congestion is becoming an increasing issue.

AMDQ injection rights in respect of the SWP provide a critical level of certainty in this environment for bringing our gas to market. We do not unfortunately have similar level of certainty for withdrawing our injected gas from the market at Culcairn during constrained conditions. This undermines the overall value of AMDQ rights as an investment incentive. A more complete AMDQ transport right would increase future certainty of access to market, in turn enhancing commercial incentives to invest in pipeline capacity in an environment where such capacity is anticipated to become an increasingly scarce commodity.

In this regard we disagree with the AEMC that the potential for free-riding effectively removes any incentive participants might have to fund new pipeline capacity in return for AMDQ rights. Free-riding only occurs during unconstrained conditions, when capacity is plentiful, it is not an issue when capacity becomes constrained which is precisely when AMDQ rights have their most value for those that hold them. In these circumstances non-rights holders would face the congestion costs and are the first to be constrained off the network.

The real value of AMDQ or any other kind of infrastructure access right is that they can provide a level of certainty around future access to market; however such value only manifests during constrained conditions. Therefore, by focusing on unconstrained conditions which have been a feature of the Victorian market to date, we consider the AEMC may be undervaluing AMDQ rights as an investment incentive, particularly in the context of a future environment where pipeline constraints are likely to become an increasing risk for participants.

Market power

Origin recognises that the AEMC is required to assess the potential for any rule change proposal to enhance market power and therefore undermine achievement of the NGO.

The AEMC's key concern appears to be that the proposal to link withdrawal priority to AMDQ rights in the event of a tie-break will exacerbate market power during pipeline constraints (with gas subsequently not flowing to the party that values it most). However, we consider this concern should be relatively minor, for the following reasons.

First, we note that priority of AMDQ rights for scheduling has been a feature of injection bids for some time (in many cases representing the same participants who are responsible for withdrawing the gas at the other end). There is little evidence that this has been exploited in any way or has led to any misuse of market power.

Second, while trading in AMDQ rights has to date been relatively muted, this is more a consequence of the excess capacity in the network to date (or the lack of pipeline congestion) rather than any exercise of market power or lack of value inherent in those rights. If overall capacity tightens, any spare capacity will become more valuable, and therefore incentives to trade unused spare capacity should increase.

Third, participants may have good reasons for holding onto some spare capacity inherent in their AMDQ rights; this may reflect a prudent risk measure for dealing with uncertain future demand rather than any express intention to exclude others from the market (forgoing revenues from trading AMDQ rights purely deterring new entry is a high risk strategy). If some withholding of AMDQ rights leads to an excess demand for them, this should be reflected in their value or pricing and subsequently strengthen incentives for pipeline investment to release more such rights (or the threat of investment by new entrants may be enough for existing participants to release some excess AMDQ capacity).

From a competition policy perspective, the role of AMDQ rights in enhancing market power is only of concern if there are barriers to new entrants undertaking pipeline investment. However, given the status of Gasnet as an independently regulated monopoly with no ties to particular participants, it is not evident that this is the case.

Finally, if any misuse of market power becomes an issue (such as withholding AMDQ rights with the express purpose of preventing a new entrant from entering the market), Section 46 of Part IV of the TPA would appear to be able to address this concern directly.

Next steps

If you would like to discuss any aspect of this letter, please do not hesitate to contact, in the first instance, Con Van Kemenade on 02 8345 5278.

Regards,

Phil Moody
Group Manager - Wholesale Risk, Finance and Regulation