

## **APIA Position on the Development of the Australian Wholesale Gas Market**

### **A Response to the Draft Report “Options For the Development of the Australian Wholesale Gas market” released by Allen Consulting Group March 2005**

#### **1. Introduction**

The Australian Pipeline Industry Association (APIA) has a strong view that a light-handed regulatory regime is needed in Australian gas pipeline markets and wholesale gas markets. APIA is opposed to regulatory change for its own sake. Regulatory change should only be considered if it demonstrably and unequivocally adds to industry efficiency and effectiveness.

To date there has been no demonstration that legislated regulatory change such as the options suggested by the Draft Report (the Paper) will fundamentally enhance efficiency beyond what will be achieved by the ongoing maturing of the Australian wholesale gas market.

APIA is opposed to any forced removal or renegotiation of current market arrangements and contracts. Apart from issues relating to deprivation of rights, this would add considerably to regulatory risk and uncertainty, negatively impacting on infrastructure investment and consequently halting the maturing of the Australian wholesale gas market.

APIA supports a regulatory environment that encourages the construction of sustainable additional pipeline infrastructure and greater connectivity between pipelines. This will assist in developing efficient wholesale markets, as additional infrastructure will allow increased numbers of producers and purchasers to trade.

APIA does not support any move to subject uncovered pipelines to any non-price Code obligations. Even if regulatory action is taken to introduce changes any regulatory requirements relating to the outcomes of this process should be introduced via amendments to pipeline licence conditions rather than the Gas Code. APIA has a strong view that the Code is concerned with third party access; it is not a general instrument to impose regulation on pipelines.

#### **2. General Wholesale Gas Market Development**

The Australian wholesale gas market consists of several large gas producers that sell to several large gas purchasers (retailers or large industrial gas users) via bilateral contracts for relatively long time frames (typically months or years).

Pipelines generally act in this market as carriers of gas; they are typically not producers or purchasers. As carriers of gas, pipeliners receive revenue by selling transport capacity. Pipeliners have a strong commercial incentive to sell all available capacity. The commercial incentive to sell capacity has been reinforced by the construction of new pipelines serving markets already served by existing pipelines, thus creating spare capacity for the foreseeable future in many instances. Artificial incentives to sell capacity, through regulation, are therefore unnecessary.

Alteration of pipeline contracts and operation would not address issues of market concentration amongst producers and purchasers and so would not be a successful driver of wholesale gas market reform. The focus of any intended wholesale gas market reform should be on producers and purchasers, not on already heavily regulated pipelines.

In a thin wholesale gas market with long term bilateral contracts any spot market will largely be a simple means of addressing balancing, overruns or spot opportunities for shippers or customers with peaky load profiles, it will not lead to a long term sustained change in the wholesale market. Under the contract carriage model:

- balancing and overruns are already addressed by contract terms and conditions
- over-contracted shippers can and do trade capacity; and
- spot opportunities are addressed by pipeline spare capacity registers (Code 5.9) and shipper/pipeliner and shipper/shipper discussions.

APIA acknowledges that the use of electronic bulletin boards could marginally add to the realisation of spot opportunities as information may be more widely disseminated but we note that, to date, usage of existing bulletin boards is minimal. There is currently no evidence that the benefits of any compulsory bulletin board system will outweigh the costs of regulatory intervention.

### **3. Response to the Options Contained in the Paper**

#### ***3.1 Response to Option 1***

*Option 1 is maintaining the current market structure and regulation with ongoing development.*

APIA strongly supports this option for reasons outlined in Sections 1 and 2 above.

The gas transmission market is evolving, reflecting the influence of market forces and the developing maturity of market participants.

This option has no implementation costs; it is practical and simple and does not add to regulatory uncertainty or complexity.

APIA believes the market should be allowed to evolve organically. Recent pipeline developments in Australia such as SEAGas have led to increased interconnection and there is potential for other pipelines such as the mooted PNG or Timor Sea pipelines to add further to this interconnection. In addition, recent exploration and production developments include the Moomba- South West Queensland swap and the development of new gas fields and coal seam methane fields.

**Option 1 Preferred Outcome:** APIA strongly supports maintaining the current market structure and regulation with ongoing development as its preferred option.

#### ***3.2 Response to Option 2***

*Option 2 is maintaining the current market structure as per Option 1 with the added feature of contract trading bulletin boards. These boards would allow the voluntary*

*posting of bids and offers for trades of surplus or deficit levels of gas or pipeline capacity (these trades would not necessarily be standardised). Price outcomes of these trades would be published on the bulletin board.*

*All pipelines, pipeline users and producers would be required to be a party to at least one bulletin board.*

*There is also a suggestion that uncovered pipelines be covered by the non-price obligations of the Code (ie. trading policy, ring fencing and information disclosure). The implication is that this coverage may be needed to ensure these pipelines are involved in bulletin boards.*

Contract carriage does not prevent capacity trading, and APIA has no issue with pipeliners and/or shippers voluntarily posting information to facilitate capacity trading or entering commercial arrangements to trade capacity.

The Code (Section 5.9) requires pipeliners to maintain a public register of spare and developable capacity. Consequently, covered pipeliners currently keep registers of this capacity.

APIA acknowledges one view that improvements in information systems may allow shippers to take greater advantage of spot opportunities. However, APIA is aware of at least two pipelines (Dampier-Bunbury natural gas pipeline and the Eastern Gas pipeline) where shippers have expressed a preference to undertake bilateral trading without recourse to established bulletin board services established by pipeline owners.

Notwithstanding this, APIA has no objection to a non-mandated bulletin board service advising of available capacity. Without the regulatory proscription of bulletin boards, the proposed bulletin boards of Option 2 are effectively a potential variation on Option 1 where the market establishes the bulletin boards in response to a market need.

APIA's concern with Option 2 is that the usage and content of bulletin board systems would be proscribed by regulation. Rather than having these systems proscribed by regulation, APIA would be willing to work with government to facilitate improvements in current systems rather than have pipeliners incur additional costs in establishing and operating new systems for little or no benefit.

APIA's position is that the market should be allowed to develop bulletin boards on different pipelines at a time when the market requires it. The usage, content and format of bulletin boards should not be proscribed by specific regulation but should be developed by market participants in response to market needs. APIA notes that, to date, experience with pipeline bulletin boards indicates there is limited interest.

Issues with bulletin boards include

- practical issues such as costs, veracity of information, definition of information provided, confidentiality implications of information provided (particularly in a thin market) etc. These issues are better addressed in more specialist forums.

- benchmark issues (eg in a thin market with long term contracts bulletin board spot prices may be volatile and may be capable of being manipulated – these prices should not be viewed as market benchmark prices).

**Option 2 Preferred Outcome:** APIA prefers Option 1 but could support Option 2 if it was consistent with Option 1.

APIA supports mechanisms such as bulletin boards to the extent that they will enhance pipeline capacity trading opportunities, provided:

- these mechanisms are consistent with the framework of the contract carriage model or, in the case of the GasNet system, with the market carriage model applicable to that system
- involvement in bulletin boards is voluntary
- provision of content to bulletin boards is voluntary

The introduction and development of bulletin boards is best managed by the industry rather than external regulatory proscription.

### **3.2 Response to Option 3**

*Option 3 is a spot market at a transmission node (eg city gate) that*

- *allows shippers to bids and offer for delivered gas one day ahead,*
- *increases standardisation*
- *sets clearing prices for imbalances and compulsorily clears imbalances at these prices*
- *publishes information relating to impending shortages in production or transmission capability*
- *manages market response to emergency shortfalls of supply*
- *possibly publishes information annually on market performance and emerging transmission and supply constraints.*

*A city gate scheme would be regulator approved and managed by an independent market management entity.*

*Under this option all pipelines must provide a city gate scheme which all relevant users must join. The Option (pp42-44) is silent on producer involvement but comments (pp52-54) imply some producer involvement.*

*There is also a suggestion that uncovered pipelines be covered by the non-price obligations of the Code.*

APIA does not support this option; it increases regulatory uncertainty and imposes additional layers of regulation.

It is stated that the proposed scheme would clear imbalances via a spot price. APIA notes that pipeline imbalances are currently cleared via contractual arrangements. Any clearing of imbalances via spot prices in thin markets may be subject to price volatility concerns. This point is evidenced by the current situation at the Culcairn

interconnect (EAPL and GasNet). Vencorp generates a daily spot market price, but at Culcairn a balancing agreement overrides this spot price. If balancing was managed at Culcairn by the spot price set in a thin market, managing system co-ordination may be problematic. Using a daily spot price is valid when there is little linepack, but in pipelines where there is substantial linepack a daily spot price set in a thin market may send spurious market signals and compromise system management.

The provision of information on transmission and supply constraints under the proposed scheme presupposes that the publisher of the information can provide better signals than the current market. This has the potential to replace multiple infrastructure investors with investment via a central-planning regime, resulting in less efficient outcomes.

To the extent the option is silent on producer involvement it does not adequately address its outlined features:

- emergency response
- management of shortages in production capability emergency
- provision of a statement of supply constraints.

In regard to the suggestion under this Option that uncovered pipelines be covered by the Code for non-price obligations, this implies that uncovered pipelines be subject to city gate schemes. Uncovered pipelines serve remote users or are already competing with other pipeline alternatives. The imposition of a spot market requirement on pipelines supplying remote sites or pipelines in head-to-head competition with each other is unnecessary.

**Option 3 Preferred Outcome:** APIA would strongly oppose the introduction of the city gate scheme model as the model for the Australian wholesale gas market.

### ***3.4 Response to Option 4***

*In the Paper Option 4 is effectively an extension of the Victorian market carriage model to other major pipeline systems. It would be extended to cover all pipelines, including uncovered pipelines.*

APIA does not support this option; it increases regulatory uncertainty and complexity and imposes substantial additional layers of regulation. The Paper (p55) raises concerns about sovereign risk in relation to this option – APIA broadly concurs with these concerns.

This option would replace head-to-head pipeline competition with a form of central coordination. APIA believes that head-to-head competition is more likely to result in efficient outcomes than central coordination.

The majority of Australian pipelines and jurisdictions use a contract carriage pipeline model. The most recent Australian jurisdiction to be supplied with natural gas, Tasmania, uses the contract carriage model. Even in Victoria, the jurisdiction associated with market carriage, the most recent major pipeline constructed, is a contract carriage pipeline.

The contract carriage model relies on bilateral contracting of capacity between pipeliners and shippers. These bilateral contracts assist in establishing certainty required for investment. The recent major pipeline investments have been developed outside the Code and as contract carriage pipelines, for example, the planned Dampier to Bunbury Natural Gas Pipeline capacity expansion. The paper (p55) claims that the market carriage model has been “very successful”, however on the criterion of infrastructure investment APIA contends that the market carriage model is not particularly successful.

Other benefits of contract carriage are:

- contract carriage operating cost is lower than market carriage operating cost (based on regulatory decisions)
- contract carriage allows tailoring of non-price terms and conditions to the needs of the shipper (market carriage requires a “one-size fits all” contract)

The Gas Code reflects the underlying presumption of Government and industry that contract carriage is the accepted general form of carriage. This is demonstrated by the prohibition in section 3.8 against a regulator accepting a market carriage access arrangement unless the relevant Minister has permitted the pipeline to be a market carriage pipeline. This reflects industry as it was in 1997 and as it is in 2005. There is no evidence that this should be changed. All new pipelines, including pipelines in Victoria, are contract carriage pipelines.

APIA has concerns that changes to Australian wholesale gas markets suggested in the Paper attempt to steer the wholesale gas market towards the electricity market model (ie NEMMCO model). Workable market solutions in the electricity wholesale market are not directly translatable to the wholesale gas market.

Gas and electricity are sufficiently different energy forms to require different market structures

- Gas can be stored in transmission line-pack, underground storage and LNG – electricity is instantaneous and requires continuous price signals to ensure sufficient supply.
- Gas is discovered via an exploration process that may not be successful, electricity is generated on demand using known technology that operates with a high degree of certainty.

In addition the gas and electricity wholesale markets have very different histories. The wholesale gas market has a of long-term bilateral contracts with at least one party being a privately owned company. This basis of contracting history and private company involvement, dating from the 1960s, has allowed the wholesale gas market to evolve towards a more competitive market. In contrast, state governments centrally planned the electricity industry until the 1990s, the introduction of competition into wholesale electricity markets required market coordination functions to be moved to a single coordinating body (NEMMCO).

These differences between gas and electricity require different wholesale market structures for gas and electricity. In particular the gas wholesale market does not require a single coordinating market-company. Market coordination is achieved via

bilateral contracting. The market will continue to introduce additional mechanisms as it matures.

**Option 4 Preferred Outcome:** APIA would strongly oppose the introduction of the market carriage model as the default pipeline model for the Australian wholesale gas market.

APIA has no comment on the suitability of contract carriage versus market carriage in the case of the Vencorp / GasNet system in Victoria.

#### **4. Conclusion**

APIA strongly supports Option one - maintaining the current market structure and regulation with ongoing development - as its preferred option. This option has no implementation costs, it is practical and simple and does not add to regulatory uncertainty or complexity.

In time APIA envisages the market will voluntarily move towards option two as it further evolves and matures. APIA supports mechanisms that enhance market trading provided:

- these mechanisms are consistent with the framework of the contract carriage model
- involvement is voluntary
- provision of content to bulletin boards or similar schemes is voluntary

The introduction and development of bulletin boards is best managed by the industry rather than external regulatory proscription.