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19 April 2005

Manager Energy Market Reform Team  
National Energy Market Branch  
Department of Industry, Tourism and Resources  
GPO Box 9839  
Canberra ACT 2601

Dear Sir/Madam,

## **RE: MCE - Options for the Development of Australian Wholesale Gas Markets**

### **Introduction**

Alinta is the owner and manager of various gas transmission pipelines, gas and electricity distribution networks and power stations throughout Australia and New Zealand, as well as retailing gas and electricity to more than 500,000 customers. As such, Alinta has several different perspectives on gas market development and is able to consider the MCE options in the context of what is best for the industry as a whole rather than what benefits a particular sector.

### **Gas market principles**

The gas market principles agreed and stated in the options paper are:

- publicly available information on market and system operations and capabilities at all stages in the supply chain;
- gas market structure to facilitate a competitive market in all sectors;
- market participants should be able to freely trade between pipelines, regions and basins;
- regulatory certainty and consistency across jurisdictions; and
- market design and institutional requirements responsive to and reflective of the needs of the market and market participants.

Alinta supports these principles, although with a couple of qualifications:

- information should be provided only where it is relevant to the market and the benefit to market participants outweighs the cost of provision and preserving existing contractual rights; and
- "jurisdictional consistency" should still allow variations to reflect and suit local conditions.

In this submission, Alinta focuses in particular on the last two principles: regulatory certainty and a market design which reflects participants' needs. The former principle means that government should refrain from imposing a new market design on the industry, whereas the latter principle means it shouldn't need to. By definition, market participants should be willing and eager to participate in a market which meets their needs. On the other hand, if they have to be coerced into participating then the last principle has obviously not been met.

### **Mandated reform**

Alinta is philosophically opposed, therefore, to any government attempt to regulate or mandate participation in a new market structure. This would be inconsistent with the gas market principles. It is also inconsistent with the approach to government intervention described in the Options Paper<sup>1</sup> which states that governments should only intervene to correct a market failure and, even then, only if there is a public benefit.

The Options Paper fails to demonstrate any such market failure – for example by citing a service desired by a market participant that is unable to be obtained on reasonable terms. It lists some potential areas of market failure, such as market power, but does not evaluate its market options against their ability to mitigate such potential problems. Rather it employs criteria such as transparency and practicability which, whilst nice to have, do not in themselves justify government intervention and new regulation.

In summary, the Options Paper does not demonstrate the need for government intervention, nor does it evaluate its options against the benefits that they would bring to the industry and its customers.

### **Option 1 - Let the market evolve**

This option is effectively the status quo, and is a benchmark against which the other options are compared. It leaves industry participants to develop the markets which they need.

Alinta considers option 1 to be the only acceptable option of the four described in the paper, because it is the only one that does not involve government mandating new obligations on the industry. This is not to say that the status quo is ideal, or that the government has no role to play in promoting and facilitating market development. Indeed, Alinta can see that some aspects of the other options may be attractive, but only if they are made available to the industry on a *voluntary* basis.

Alinta considers that the current operations of all the market sectors meets the principles. The sectors of the gas market include supply, transmission, distribution and retail. The gas market has developed substantially in recent years with the:

- New areas of supply in Victoria, NSW and Queensland with offshore additions, onshore discoveries and coal seam methane supplies;
- New transmission lines have been constructed including the Eastern Gas Pipeline, The Tasmanian Gas Pipeline, the SEAGAS Pipeline and other small pipelines; and
- There has been a substantial rise in the number of retailers servicing all state markets that have introduced full market contestability.

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<sup>1</sup> Pages 32-33

In terms of whether this market is developing according to the above principles we can also consider the views of other participants. For example the Queensland Government has argued that:

“There has been positive evidence of the development of upstream competition in Queensland, where the rapidly developing coal seam industry is providing field on field competition. The development of this industry has directly benefited from the capacity of pipelines such as the Wallumbilla-Gladstone pipeline.”<sup>2</sup>

Similarly the ACCC noted:

“There are long lead times for development of new gas fields and pipelines. Nevertheless, new pipelines are now bringing gas supplies to markets. We are starting to see the potential for a more competitive gas supply industry – but there is still some way to go.”<sup>3</sup>

Given these and other views of gas market developments there is no evidence of market failure and hence there is no need for governments to implement regulatory options. The essential point to note is that there are long lead times in the industry that are there because of the capital investment required. Nevertheless as the ACCC notes the industry is moving in the right direction.

In summary, the government *should* let the market evolve and can assist in this evolution by ensuring a stable regulatory environment which facilitates and promotes market development.

## **Option 2 – Voluntary participation in bulletin boards**

This option involves:

- a bulletin board for shippers, pipeline operators, producers and retailers to voluntarily post bids and offers of surplus or deficit levels of gas and transmission capacity.
- AEMC potentially mandating participation if it considers that more liquidity, transparency is required
- a possible “sub-option”, which would require that all transmission pipeline operators are subject to the non price obligations of the National Gas Code (eg trading policy, ring-fencing and information disclosure); and
- the AEMC establishing the rules and the AER administering the bulletin board and monitoring market behaviour and outcomes.

An Electronic Bulletin Board (EBB) is one particular type of trading “platform” upon which many markets in other industries and countries have become established. It may or may not be appropriate for the gas market in Australia.

There are a number of potential commercial providers of trading platforms who are generally keen to expand into new markets where this will be made profitable to them. Such service providers have entered the Australian electricity market, for example, providing a variety of services to electricity traders. Some trading platforms have been successful (eg the brokered “over-the-counter” market), some less so (eg the electricity futures market).

<sup>2</sup> Submission no. 63 to the Productivity Commission Review of the Gas Access Regime, June 2004, p.9.

<sup>3</sup> Submission no. 48 to the Productivity Commission Review of the Gas Access Regime, June 2004, p.11-12.

In the absence of any obvious entry barriers in the gas market, the fact that such trading services have not been offered suggests that there is little demand for them. Conversely, if the government believes that there is a latent demand for such services, then it should identify the barriers to their development and find ways for these barriers to be dismantled.

Instead, this option proposes to mandate that all market participants become “party to” an EBB, although it is not entirely clear what being a “party” would entail. It even suggests that, should trading on these EBBs fail to become established then the government could mandate participation. This idea is unacceptable and somewhat ridiculous. Would it mean that trades executed outside of the EBB would need to be posted on the EBB, or even that such “external” trading would be prohibited? Such a proposal seems to conflict with at least 3 of the market principles<sup>4</sup>.

Alinta agrees with the Options Paper that the availability of relevant information is important in ensuring an informed and orderly market. Much information is already in the public domain: some of this (for covered pipelines) pursuant to the information disclosure requirements of the Gas Code, the rest made available voluntarily as part of the marketing and customer support activities of producers, pipeline operators and traders. One might expect that a provider of trading services would gather this information and make it available to their clients

Mandating disclosure of information is only necessary, then, where such information is vital to an informed market and would not otherwise be willingly provided. Even then, mandatory disclosure would be subject to commercial confidentiality and cost-benefit tests within the participating jurisdictions<sup>5</sup>.

Alinta, as operator of both covered and uncovered pipelines, objects to the suggestion that uncovered pipelines could become subject to the “non-price” provisions of the Gas Code in order to enforce information disclosure, for a number of reasons:

- it would contradict and re-open the decision not to cover the pipeline and effectively re-introduces (partial) coverage through another route;
- information disclosure requirements in the Code are not designed to support gas markets, and may force the disclosure of much irrelevant information whilst not providing the information that is needed;
- it would be imposed on all uncovered pipelines, irrespective of whether they were already providing the information needed by the market.

In summary, Alinta supports the development of EBBs or other trading platforms which adhere to the gas market principles listed above and, in particular, reflect the needs of the market. It does not oppose any government involvement that would facilitate or promote such development. However, participation in such markets should be voluntary and disclosure of information to these markets should only be mandated where absolutely necessary and where no voluntary alternatives exist.

### **Option 3 – City gate Scheme**

This option involves:

- the establishment of day-ahead “spot” markets at the city gates of Sydney, Adelaide and potentially Wallumbilla in Qld;

<sup>4</sup> It would prevent participants “trading freely”, create regulatory uncertainty and impose a market design which does not reflect the market’s needs.

<sup>5</sup> Note that, in Victoria, although a large amount of information is made available, trading outside of the VENCORP market is nevertheless highly illiquid

- as with option 2, a possible “sub-option” requiring that all transmission pipeline operators are subject to the non price obligations of the National Gas Code;
- an independent market management company to develop and administer the detailed market rules and to establish and operate the city gate markets;
- publication of information to assist participants in ascertaining any existing or impending shortfalls in upstream gas or transportation capacity; and
- a possible “Statement of Opportunities” for the gas industry.

This scheme was developed and proposed by the ERAA with a focus on gas-fired generation and its systems impacts. Alinta supports the discovery of real value of marginal gas at various points of the eastern gas system within defined trading periods and across pipelines at day intervals, as long as participation was voluntary.

Alinta supports the further development of option 3 by industry with the option for industry to seek government input when and only if required in order to assist in the establishment of the framework.

Alinta recognises that the scheme may provide significant benefits if, as the ERAA contends, the scheme enables the market to respond more effectively to emergency shortfalls of supply. However, for such benefit to be realised, governments must allow the market to work and should only intervene when absolutely necessary.

### ***Third party network connection, access and pricing***

The paper suggests a sub-option for options 2 and 3 could be that all transmission pipeline operators could be required to be subject to the non-price obligations of the National Gas Code – in relation to having a trading policy, ring-fencing, and information disclosure.

Alinta is concerned that the scope of these obligations has not been well developed at this stage. For example, whilst aspects of the national gas access regime are discussed at pages 26 – 30, there is no discussion of how the information disclosure provisions of the Code may promote wholesale markets for transportation capacity and gas. Alinta cannot see how the current Code obligations would be appropriate because they are specific to regulators conducting access arrangement reviews - whilst some rules relating to information disclosure may be necessary for a wholesale gas market, those rules would not be those currently in the Code.

In addition, some rules relating to the facilitation of capacity trading may be necessary but the current Code obligations have not been developed with a view to a wholesale gas market and may not be appropriate. It would be crucial that the commercial position of unregulated pipelines not be diminished by the introduction of trading rules and, for example, even if the concepts of a trading policy were introduced the current protections (ie: pipeline operator approval if the trade affects the contractual obligations of the first shipper) should be preserved.

Again, ring fencing as a concept may be reasonable but there would need to be an examination of the detail of the Code provisions to make sure they were compatible with the scope of the obligations needed to meet the objectives of a wholesale gas market. Once again, the current obligations have been drafted against the background of regulated pricing arrangements, including allocation of costs, and these obligations should not be imposed on unregulated pipelines where they do not meet the needs of developing the wholesale gas market. For example, the Code makes specific reference to the use of the ring fencing provisions in relation to the verification of the calculation of Reference Tariffs which could simply not be appropriate.

Finally, the paper is ambiguous about the other non-price obligations in the Code not specifically mentioned, for example dispute resolution and associate contract approvals.

Alinta assumes the paper intends to do no more than highlight that some new regulatory arrangements may be required for non-covered pipelines and that the current Code provisions may be a good starting point for developing those obligations. The lack of any detailed analysis or discussion of the obligations leads Alinta to this assumption. As a response to the Options Paper, it would be inappropriate for the MCE to commit to anything other than a review of obligations on uncovered pipelines as part of the detailed development and consultation of the regulatory framework to implement the preferred model in due course.

#### **Option 4 – Extension of the Victorian model**

This option:

- extends the Victorian model to cover some or all of the other major transmission pipeline systems;
- operates the interconnected gas transmission system as a single “market carriage” market;
- may also establish market carriage in WA and NT, but only if suitable; and
- would require all pipelines (including those currently uncovered) to be regulated.

The Victorian model has been developed in the context of the particular physical characteristics of the Gasnet system, and was established in the absence of pre-existing transportation contracts. In this respect, it is highly unlikely to be appropriate for other pipeline systems. As far as we are aware, nobody in the market – including VENCORP – has suggested that the market carriage system should be used outside Victoria.

Furthermore, VENCORP and Victorian market participants have recognised certain shortcomings in the Victorian market design and are currently addressing these in their Gas Market Project. In this respect, it is not even clear what the long-term design of the market carriage system should be.

As with Options 2 and 3, this option suffers from a centralist tendency to impose a particular market design on the industry rather than help the market identify and develop markets which suit their own needs. This approach is inconsistent with the gas market principles.

However, the cost to impose such a model across other jurisdictions is significantly more than all of the other proposed options. Furthermore, it is unclear what impacts such a move would have on jurisdictions currently operating a contract carriage model.

In summary, the Victorian market was developed for Victoria. If government has a role to play it is to identify suitable market designs for other jurisdictions, not to arbitrarily impose an existing but unsuitable design.

#### **Summary**

If a gas market is to be successful, it must satisfy the needs of all market participants. An unsuccessful market will not deliver transparency and efficiency, no matter what the designers intended.

The Options Paper describes a number of different market designs and trading platforms. The absence of these in the gas industry does not in itself demonstrate any failure of the market

The various options propose to promote market development and competition by extending regulation. The Productivity Commission has found the opposite to be the case; that to promote competition, regulation needs to be as light-handed as possible. Therefore, the MCE's approach seems to be out of step with regulatory good practice.

Alinta supports industry development of a market to improve transparency and allow it to truly reflect the value of gas and associated services.

Alinta recognises that this is an Options Paper and appreciates the opportunity to critique a variety of potential market designs at this early stage. Alinta hopes that, out of this process, the industry will be able to better understand the market designs that would suit its needs and the MCE will recognise that successful markets cannot be built through regulation.

Should you require any further information on the above please contact Verity Watson on (03) 9265 7738.

Yours sincerely

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