

A few
words.

Mr Rod Sims
Chairman
Australian Competition and Consumer Commission
GPO Box 520
Melbourne Vic 3001
1 July 2015



Dear Mr Sims,

ACCC East Coast Gas Inquiry

AGL welcomes the opportunity to provide information to the ACCC East Coast Gas Inquiry (the Inquiry). AGL notes the overarching aim of the Inquiry is to assess the competitiveness of wholesale gas prices and the structure of the upstream, processing, transportation, storage and marketing segments of the gas industry.

AGL has a long history of involvement in Eastern Australian gas markets and currently supplies gas and electricity to over 3.7 million customers on the east coast. Additionally, AGL utilises gas in power generation, is involved in gas extraction activities and has also recently completed the construction of a gas storage facility in Hexham, New South Wales. The responses provided by AGL to the Inquiry, against each of the main subheadings, leverage this experience.

Changes affecting the domestic gas industry

The gas market in Eastern Australia is experiencing a period of uncertainty while the Queensland Liquefied Natural Gas (LNG) plants enter their production phases.

This period of uncertainty is likely to be overcome in the next few years and it is expected that the market will re-calibrate in response to the changing market conditions. ACCC should exercise caution in recommending wholesale changes to a market that is in transition.

However, there may be merit in focussing on the following areas to allow the market to transition smoothly and efficiently to a new equilibrium, these are: onshore gas extraction, pipeline capacity trading and joint marketing.

AGL notes that fundamentally, this is not a market that is broken but a market that is in a transition phase and which will, over a period of time, reach a new equilibrium point. Any changes that are eventually proposed by the ACCC should be framed against this context.

Access to new gas resources

AGL considers that increasing the quantity of gas available in the Eastern Australian gas market should be a primary focus for government reforms.

AGL considers that removing existing obstacles to the supply of gas will assist the gas market in Eastern Australia transition more smoothly to a new equilibrium, potentially at a lower price point.

Access to processing facilities

Gas processing facilities are an integral component to the supply of gas to the market. AGL considers that increasing competitively priced access to gas processing facilities would likely increase the supply of gas overall and ensure that any improvements to upstream markets translated into lower prices for consumers.

Accordingly, AGL supports further investigation by the ACCC as to whether existing third party access settings for gas processing facilities are appropriate.

Negotiation of new gas supply agreements¹

AGL is both a buyer and seller of gas in the Eastern Australian gas market and has therefore experienced negotiations with gas producers, end use customers and other wholesale buyers and sellers of gas.

AGL considers that the environment for negotiating new gas supply agreements has been challenging, due to the changing market dynamics and the need for producers, on sellers and consumers to adjust their expectations.

As an on seller of gas, AGL notes that there have recently been short periods where uncertainty, as to the terms of future gas acquisition contracts, limited the terms on which AGL was willing to offer to supply some end use customers. This limitation has diminished over time as gas acquisition contracts, for example AGL's recent Gippsland Basin Joint Venture agreement, have been entered into.

Rising domestic gas prices

We are currently witnessing a significant transformation in the Eastern Australia gas market due to a profound increase in demand arising from LNG export facilities.

Demand from LNG may, on the basis of existing production levels and policy settings, exceed the current pace of supply, which will inevitably impact the price of gas. Furthermore, changes in demand are being combined with stringent restrictions on upstream supply.

AGL considers that domestic gas prices are forecast to reach export parity levels as LNG production reaches full capacity. AGL notes that new supplies in a tight supply and demand environment would be expected to place downward pressure on end user prices.

¹ This section covers the Inquiry sub-headings: negotiation of new gas supply agreements; and changes in non-price terms and conditions of gas supply agreements.

Availability of information and trading liquidity

AGL considers that gas customers are best served by efficient and effective markets, characterised by information transparency, liquidity and light-handed regulation. AGL does not consider that information in its own right will build liquidity and transparency and that information resources should not be developed and mandated at the cost of light handed regulation and market development.

Joint marketing

AGL notes that joint marketing arrangements previously sought to support the development of the Eastern Australian oil and gas industry in the 1960s and 1970s.

AGL considers that joint marketing has served its purpose and that a review of joint marketing arrangements is now warranted. AGL considers that it is likely that breaking up joint marketing arrangements will, all else being equal, eventually lead to increased competition amongst gas producers with benefits being passed on to domestic gas consumers.

Pipelines and pipeline services²

Second only to increasing onshore gas supply, AGL considers that access to economic and tradeable transmission capacity is fundamental to an efficient gas market and ensuring supply is maximised.

The contract carriage model has delivered substantial private sector investment in gas transmission infrastructure in the Eastern Australian gas market (outside of the Declared Wholesale Gas Market). AGL recognises that concerns are now being raised that contractual terms associated with these investments is limiting transparency and liquidity in the trading of capacity on these assets. Accordingly, AGL considers there is merit in investigating whether the contract carriage model remains appropriate. Further investigation could include assessment of the relative costs and benefits of:

- secondary capacity trading;
- moving from 'contract carriage' to 'market carriage'; and
- adjusting pipeline settings to support new trading hubs.

AGL recognises that, as changes to existing arrangements may have adverse implications for current and future investment in gas transmission assets, these implications will need to be addressed as part of the policy development process. For example, it will be important to have a phased transition which recognises existing property rights.

² This section covers the Inquiry sub-headings: ownership and regulation of transmission pipelines; pipeline services; terms and conditions in gas transportation agreements; and pipeline capacity trading.

In considering the appropriate market design, AGL highlights that contract carriage instils a responsibility for security of supply with the capacity owner, which makes capacity owners risk averse and less willing to trade spare capacity – this issue would be expected to be addressed by a move to ‘market carriage’.

Further, a key principle to secondary capacity trading should be to ensure that it is the capacity owners that become the agents who buy and sell capacity rights, as opposed to the pipeline owner – this is likely to require the introduction of a market operator function to enable capacity trades to occur without the involvement of the pipeline owner.

The role of storage

Storage facilities situated close to gas market demand centres enhance the ability of energy retailers and wholesalers to manage increasing household and business peak demand requirements. AGL considers that the market currently provides adequate locational and investment signals for storage facilities.

Coordination requirements

AGL supports harmonisation of the short term trading markets and the Declared Wholesale Gas Market where benefits of doing so outweigh the costs. AGL also considers that pipeline capacity trading arrangements in the Eastern Australian gas market would benefit from coordination, subject to further analysis to ensure that investment signals remain robust.

In conclusion, AGL considers that the gas market in Eastern Australia will reach an appropriate equilibrium point following a period of transition and that reform may be warranted in key areas such as pipeline capacity trading, joint marketing and onshore gas extraction to ensure a smooth transition.

Should you have any questions in relation to this submission please contact Kirsten Hall, Wholesale Market Adviser, on (03) 8633 6688 or at khall@agl.com.au.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Simon Camroux', written in a cursive style.

Simon Camroux
Manager, Wholesale Regulation