



27 August 2014

Kate Ryan
Independent Market Operator
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Cloisters Square, Perth, WA 6850

Submitted via email

Dear Kate,

GAS MARKET DEVELOPMENT IN WESTERN AUSTRALIA

Alinta Energy (Alinta) welcomes the opportunity to make a submission in response to the work recently completed by Market Reform (an independent consultant) to outline the structure of a potential capacity and wholesale gas spot market in Western Australia. This submission expands on previous discussions held between Alinta Energy and the Independent Market Operator (IMO) in early 2014.

Alinta is the incumbent gas retailer in Western Australia (WA) and offers gas at the mass market retail level in South Australia and Victoria. Alinta Energy is also active in the gas market in Queensland.

Alinta's portfolio includes three gas-fired generation units at the Braemar Power Station facility in the Queensland region, the Pinjarra and Wagerup Power Stations in the WA south-west interconnected system, and the Port Hedland Power Station and Newman Power Station in the Pilbara region.

Alinta supports a prudent approach to gas market development in Western Australia

Markets generally evolve overtime in response to industry need. When markets fail to evolve in an efficient manner, they can be facilitated by government policy. In either case, the objective is usually to improve transparency, remove barriers to entry and increase competitive pressure within the existing framework.

Alinta considers that to date the WA gas market has been developing effectively and efficiently, independent of any regulatory or government body direction. The success of the natural evolution of the WA gas market is evidenced through gas users' ease of access to reliable gas supplies, the growth and diversity of bilaterally offered products and the close interaction between gas and electricity markets.

To date no market failures which would necessitate government intervention have been identified. While there may be opportunities for further gas market development, any government/regulatory involvement should be targeted at areas where clear deficiencies and market failures have been identified and where it is clear these failures can only be resolved through intervention. The remainder of this submission should be framed within this context.

Evolution of proposed trading hub in WA

Existing Arrangements

Historically the gas market in WA was largely formed through the existence of large legacy contracts which operate for extended periods of time between gas producers and gas users. These contracts underpinned pipeline investment, as well as the contracts for transport with pipeline operators.

Evolution of the WA gas market has been largely led by industry to address the changing supply/demand balance in the market and the resultant need for an option to buy and sell short term volumes of gas. This is evident from the development of Gas Trading and Energy Access. In addition to this, more recent government policy has led to the establishment of the Gas Bulletin Board (GBB) and the Gas Statement of Opportunities (GSOO), which has resulted in further transparency in the WA gas market.

To date this evolution has successfully served investment and development of the WA gas market. A high level overview of the current WA gas market arrangements is provided below:

- The WA gas market is largely structured through long-term bilateral agreements with some short term trading activity occurring. The market currently satisfies its limited need for short term trading through standard business to business practises or existing trading platforms;
- The Mondarra gas storage facility has enabled a further physical and financial mechanism to trade short and long term gas;
- There have been no cited cases (to our knowledge) where participants have been unable to source gas or transport when required. Decisions to not acquire gas/transport have been made solely on commercial grounds;
- The ability to publish trading notices on the GBB has provided greater transparency of gas trading opportunities for new and existing participants;
- The GBB provides an overview of gas volumes in all aspects of the WA market and a detailed list of members along with their contact details. This creates further opportunities to trade wholesale gas and capacity and has significantly reduced the barriers to entry for new participants;
- Transparency of historical trading gas prices and volumes is openly available for users and non-users through the existing market platforms for trading. This pricing is specifically aligned to the volumes “traded” within the WA short term market; and
- The balancing mechanism, i.e. the Swing Service market administered by REMCo, has resulted in low cost balancing services being provided by Shippers and no major concerns being raised by participants.

Nonetheless, it is understood that there are some concerns that the existing market structure may be undermining further short term trading options from occurring due to a lack of transparency around short term gas pricing and other related concerns. Alinta does not share these views.

Under the existing market structure, there is no material difference for new or established participants by either trading bilaterally or through a potential gas trading hub. The selection of method of trade

should have little bearing on any trade decision as trade decisions are primarily determined on the basis of commercial incentives such as price risk and other physical realities such as guaranteeing commodity delivery through capacity contracts.

Given the above, whilst gas trading hubs may arguably be beneficial in facilitating short term trading markets, it is Alinta's view that they are not necessarily a precondition of greater gas market development and that it is most appropriate that further development of the market continues to naturally evolve in response to industry need.

Proposed WA Gas Supply Hub and Wallumbilla Supply Hub

Wallumbilla

In March 2014, the Wallumbilla supply hub first came online after 18 months of pre-production and development by the Australian Energy Market Operator, at a cost of approximately \$1.6 million¹. Alinta is currently a registered trading participant in the gas supply hub at Wallumbilla and was closely involved in its establishment as part of the Gas Supply Hub Reference Group. It is worth noting that several unique East Coast market dynamics made the facilitation of the Wallumbilla supply hub possible.

For example, Wallumbilla was a rational physical point for a gas supply hub given its intersection of three major pipelines and close proximity to production and export facilities. Additionally, gas demand in the South East Queensland region is expected to rise from 745PJ's to 2182PJ's over the next 20 years, largely because of substantial Liquefied Natural Gas (LNG) exports coming online. This strong linkage to export markets meant a gas supply hub was a possible development in enabling the large amount of industry participants in the region to better manage the financial risks accompanying exposure to variable gas prices.

In Alinta's experience the success of the Wallumbilla supply hub still requires further analysis. There has been some liquidity for on-the-day and day-ahead products to justify market participation; however, the uptake of weekly products appears limited with low liquidity, likely occurring due to recently subdued market prices in the region.

Whilst the Wallumbilla hub shares some similarities with the proposed WA hub, it is worth noting several different market conditions exist in WA and any potential hub should be viewed on its own merits. This is further discussed below.

Proposed WA Gas Supply Model

Alinta notes that Market Reform has developed two potential design options; a basic option and an extended option. These have been developed in accordance with a set of guiding principles that were prepared by the IMO.

The basic option would likely contain the features below:

- Physical hubs located around Carnarvon Basin gas fields and the Mondarra gas storage facility.
- Participation in the market would be voluntary.

¹ This excludes participant's costs.

- Market operator to implement and operate trading platform, settle transactions, monitor settlement exposures and hold credit support.
- Products for physical delivery of gas to hub (spot and short term forward delivery periods) traded on an exchange platform. Exchange matches buy and sell orders to form transactions continuously during trading hours. Services to support trading pipeline capacity included in platform with facility operator to be encouraged to provide transfer services to shipper to increase efficiency of secondary trading of pipeline capacity.
- Firm obligation for gas delivery with buyers and sellers responsible for the delivery of gas utilising their pipeline contracts.
- The legal framework would potentially be established through regulatory instruments or alternatively could be via contractual agreement between market operator and trading participants.
- Funding of the hub will be recovered on a “user pays” basis. Recognising uncertainty of transaction volumes any shortfall would likely be borne by the IMO and therefore ultimately market participants.

The extended market design option includes ideas such as potentially extending the definition of the hub, incorporating forward products and potentially combining prudential requirements across electricity and gas markets.

Alinta is broadly supportive of the basic model framework if a gas supply hub in WA is to eventuate, and appreciates the constructive contribution of the IMO and Market Reform in assisting the Gas Advisory Board in identifying the options for a spot gas trading market.

However Alinta holds some key concerns:

- Given the absence of clearly defined deficiencies in existing trading arrangements, introducing a gas trading hub at this time could introduce a level of complexity which is unnecessary in the existing WA market, and could impact on existing contractual relationships.
- The success of the Wallumbilla trading hub is yet to be fully measured. The effect large LNG projects in the Gladstone region (set to come online in 2015) will have on market liquidity and price outcomes at Wallumbilla is yet to be seen.
- A predominant reason for establishing Wallumbilla was to provide participants’ flexibility in managing daily balancing issues, given the limited gas volumes available in linepack on the pipelines surrounding Wallumbilla. The physical nature of several of the lengthy pipelines in the WA gas market, such as the Dampier to Bunbury pipeline (1530km) means daily balancing is not an issue that requires addressing.
- The WA Gas market is significantly different to that of the East in terms of size, demand and contractual arrangements. The establishment of a WA gas hub should not necessarily be linked to the success of the Wallumbilla hub.
- The costs of administering a gas supply hub in WA may not necessarily be recoverable from a variable charge applied to hub participants alone and may potentially need to be recovered

more broadly from shippers (consistent with the allocation of costs for the IMO's GBB and GSOO). This raises the question of whether participants whom are not actively participating in the hub should be subsidising its use.²

- Given the limited uptake of trading services provided by GasTrading and Energy Access, there appears little market demand for an additional short term trading market at this time.
- The Electricity Market Review includes a specific consideration of the market governance arrangements for Western Australia. This makes commenting on market operator arrangements challenging, given the IMO may undertake a reformed role.
- Further knowledge is required to determine whether short term gas trading markets in WA are currently constrained to the extent that it would be economic to progress with the development of a trading hub. Such an assessment metric would assist the development process and industry knowledge.

Given these concerns, it is clear the introduction of a gas market trading hub is unwarranted at this time. The absence of an identifiable market failure suggests there is no need for government/regulatory intervention at this time. However if the Gas Advisory Board, which represents industry, determines that a gas trading market would be desirable, Alinta suggests that the most efficient and effective solution would be for industry to lead the development of appropriate options. Such arrangements have worked well in overseas markets³, and historically have done so at least cost.

Conclusion

Alinta welcomes the IMO's Gas Market Development paper and supports further ongoing development of institutional understanding of WA gas market arrangements.

In the absence of clearly defined deficiencies in the existing trading arrangements, Alinta is supportive of industry working directly with Gas Trading and Energy Access to refine the existing short term markets. However, if industry consensus dictates that the establishment of a separate gas supply hub is a beneficial development, Alinta would be supportive of such a model being taken forward as part of an industry led solution.

Should you have any queries in relation to this submission please do not hesitate to contact me on 08 9486 3009, or Anders Sangkuhl on 02 9375 0962.

Yours sincerely

Fiona Edmonds

Wholesale Regulatory Manager

² Additionally Alinta would caution against any potential smearing of costs onto electricity market participants. It would be inappropriate to bill electricity users to recover the costs of a gas supply hub.

³ For example the Henry Hub is largely viewed as one of the most efficient and liquid trading hubs in the world. The Henry hub (along with the majority of trading hubs in North America) is privately owned and operated by Sabine Pipe Pty Ltd, a subsidiary of the Chevron Corporation.