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Mr Chris Pattas
General Manager, Network Regulation South
Australian Competition and Consumer Commission
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Via email: chris.pattas@accc.gov.au

Friday, 21 December 2007

Dear Mr Pattas

GASNET ACCESS ARRANGEMENT REVISIONS 2008 – DRAFT DECISION

Thank you for the opportunity to comment on the Commission's Draft Decision relating to GasNet's Access Arrangement Revisions.

International Power (IP) is Australia's largest private generator of electricity. IP owns and operates 3,654MW (gross) of renewable, gas-fired and brown coal-fired generating plants in Victoria, South Australia and Western Australia.

IP also has an electricity and gas retail operation in Victoria and South Australia trading under the name Simply Energy. Simply Energy is the largest non–incumbent retailer in Victoria for gas and electricity. Two IP entities, International Power (Energy) Pty Ltd and Simply Energy, are market participants in the Victorian gas market.

Authorised MDQ (AMDQ) and AMDQ Credits

IP agrees with the position of the ACCC in regard to treating the revenue from the sale of AMDQ Credits as part of the reference tariff.

IP has significant concerns with the treatment of AMDQ and AMDQ Credits in the Victorian wholesale gas market. IP acknowledges that this concern relates primarily to the Victorian wholesale gas market design rather than GasNet's Access Arrangements; however, IP believes that the issues are closely linked and should be considered together.

AMDQ and AMDQ Credits were designed to provide a system augmentation signal. Under the market and system rules, AMDQ and AMDQ credits are now both linked to gas injections from the relevant supply sources. The purpose of the linkage was to replicate a contract carriage model to provide system augmentation signals.

This means that if a retailer wishes to secure a hedge against congestion uplift payments, it has to ensure it has AMDQ and/or AMDQ Credits, and that it injects gas from the related supply source. To access AMDQ a participant is required to inject Longford gas. To access AMDQ Credits a participant has to purchase the Credits and ensure that gas is either injected into the South West Pipeline or at Culcairn.

The significant difference between AMDQ and AMDQ Credits is that retailers receive 'gifted' AMDQ from Longford by acquiring customers, but have to purchase AMDQ Credits.

IP does not believe that the original objective of providing a signal for system augmentation has been achieved. For example, the expansion of the South West Pipeline (Corio loop) announced prior to winter 2008 did not result from pricing signals, but from VENCorp assessment of participant supply and demand information the Annual Planning Review process.

In winter 2007 there were approximately $55 million (net) of uplift payments, primarily from the injection of LNG into the gas market. LNG price peaked above $700/GJ, creating an unprecedented level of volatility. LNG is predominately fully contracted up to 2010 with the exception of 1500 tonnes coming onto the market in 2008 (IP welcomes the ACCC involvement in the sale of this LNG to ensure that a larger number of retailers can access this product).

As a result of the market arrangements, and the initial settings in the gas market, smaller retailers have been exposed to substantial market risk from congestion ancillary payments without the capacity to hedge this risk. LNG has been fully contracted, and sourcing additional volumes of gas from Longford in order to access an AMDQ hedge has been highly problematic because the majority of Longford capacity is under contract to the incumbent retailers. For those injecting gas from Western Victoria into the South West Pipeline, securing AMDQ Credits has been difficult because of limited supply.

In the event that a participant could not source gas from the relevant supply source to access their AMDQ or AMDQ Credits hedge, an Agency Hedge arrangement has been allowed for in the market design. However, this requires a smaller retailer to seek a risk mitigation product from their larger competitors. This places a smaller retailer in a high risk position and raises a market power concern. In winter 2007 the Agency Hedge arrangement was also shown to be an ineffective trading tool, as it is non-firm and complex.

The issue is compounded by a recent Essential Services Commission (ESC) ruling that prevents retailers effectively passing through the costs of congestion uplift payments to end users. The ESC ruled that Simply Energy was not permitted to pass through the costs of uplift payments to its customers, claiming that they are incorporated in the retail customer tariff. While IP does not believe that the Victorian retail customer tariff incorporates the substantial cost and risk of uplift payments, the ruling impacts the potential for pass-through.

This potentially creates an unsustainable business model for smaller retailers. On one hand, they are exposed to high and volatile uplift payments in the wholesale market, but on the other are unable to effectively hedge this risk compared to their larger competitors because of market illiquidity and concentration, and following the ESC ruling cannot pass on this cost to customers.

IP also believes that the AMDQ and AMDQ Credits rules in the Victorian wholesale gas market could distort the upstream gas contracting arrangements as they create an incentive for market participants to source gas where they have the AMDQ or AMDQ Credits. For example, because Longford AMDQ is 'gifted', market participants have an incentive to source gas from Longford rather than sourcing gas from Western Victoria for injection into the South West Pipeline, as this alternative requires them to incur the additional cost of purchasing AMDQ Credits.

For the above reasons, IP believes that the linkage of AMDQ and AMDQ Credits to a supply source needs to be removed prior to winter 2008 to ensure that all participants can have access to risk mitigation options in a highly volatile, concentrated and illiquid market.

System Security and Pipeline Augmentation

IP notes the reluctance of the ACCC to accept the proposed augmentation of the Principal Transmission System (PTS) as the submission made by GasNet does not fall within the requirements of the Code.

GasNet relies heavily on the VENCorp Gas Annual Planning Report to support system augmentation. IP is concerned that this report could be understating the demand from gas-fired power generation and the capacity of the system to meet peak gas demand.

In its Gas Annual Planning Report 2007, VENCorp it states that there was 24.6 TJ/ day of demand from gas-fired power generation on the peak day of the 17th July 2007. However, we believe that there is up to approximately 270TJ/ day of potential gas-fired power generation demand, and we understand that this peak gas-fired power generation demand occurred in June 2007. IP is concerned that the existing infrastructure does not have sufficient capacity to meet the peak demand requirements of Tariff V and D users as well as gas-fired power generation.

The VENCorp Gas Annual Planning Report 2007 forecasts a reduction in gas-fired power generation demand from 2007 to 2012. Gas-fired power generation demand is forecast to be 32.5 PJ in 2007, and under a medium growth scenario this falls to 21 PJ in 2008 and 14.7 PJ in 2009. Whilst forecasting future demand of gas-fired power generation is not a precise science, IP is of the view that the impact of the drought, the potential effects of carbon trading on gas-fired power generation demand, and the exports of gas into NSW to supply the Uranquinty power station, together are likely to result in similar or increased gas demand from the power generation sector.

IP believes that pipeline infrastructure investment is required earlier to meet the needs of future gas-fired power generation and to facilitate interstate gas flows in the national market.

Please contact David Murphy on (03) 617 8409 if you wish to discuss further any aspect of this submission from IP.

Yours sincerely

Stephen Orr
COMMERCIAL DIRECTOR