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GAS MARKET PROJECT Consultation Paper: Victorian Gas Market – High Level Description of Stage 2

AGL acknowledges the opportunity provided Market Participants to review and comment on the high level description of Stage 2 of the Pricing and Balancing Review. Given the necessarily high level description of Stage 2 at this stage of its development, we make the observation that AGL's comments may need to be revisited as and when further details are made available on the proposed contractual rights and the associated transmission tariffs for GasNet.

As AGL sees it, the challenge will be for GasNet to issue capacity rights, similar to those that apply in a contract carriage arrangement, whilst maintaining elements of a market carriage system by allowing non-contracted Participants to use the transmission system. Incentives are to be created for Participants to contract capacity such that a bid with capacity rights will be treated favourably compared to a similar bid not backed by capacity rights. In principle AGL supports this approach but is not sure whether it will create enough incentive to boost/augment capacity.

AGL's overall position is that the consultation paper has failed to put together compelling reasons for moving away from the transmission regime that we have now.

- Given that gas will still be scheduled on the basis of Participants' price bids, we have not been convinced as to the economic signals and incentives that financial transmission rights (FTRs) will bring to the Victorian gas market.
- Given the oft-quoted physical characteristics of the GasNet transmission network in Victoria (that it is quite unlike the point-to-point feature of most other transmission pipelines), we again have not been convinced that FTRs will enhance correct resource allocation.

- Stage 1 reforms, due for implementation on 1 October of this year, will add an even greater level of complexity to operations in the Victorian gas market. Do we need a further level of complexity that FTRs will necessarily introduce? GasNet's proposal to augment SWP without capacity rights and relying on the roll-in into their regulated asset base suggests that the signals already exist. In addition, introducing capacity rights does not appear to give signals over and above those provided by the current spot market AMDQ uplift regime.
- AGL is not in a position to support the GasNet proposal to go to transmission rights until such time as GasNet provides us with details of the proposed tariffs and associated costs/zones etc. Without this, we cannot evaluate the impact on our business and customers (i.e. cost of delivery to customers and our costs of hauling interstate via Culcairn).
- GasNet have expressed a desire for a Go/No Go decision by July 2006, along with retailer commitment to the new haulage arrangements by then. The timing of the consultation process is unduly brief for such a major overhaul to the existing arrangements. It is incumbent on GasNet to offer more detailed information at the earliest possible date if they wish for retailers to "sign up".
- AGL would also need to understand the tariff structure, the nature of the new charges, and what implications it would have on our delivered cost of gas. If there is a significant change in the cost structure, AGL would need to commence discussions with the Victorian Government about likely impacts on regulated retail tariffs.
- Has the transition to FTRs, with its disruption of existing tariffing arrangements and imposition of potential costs to retailers for IT system changes, been assessed within a broader cost/benefit analysis?

Responses to the specific questions set out in the consultation paper are set out in the attachment. Should you have any queries in relation this submission, please contact George Foley on (03) 9201 7309.

Kind regards,

Tom Leonardi
Acting General Manager Wholesale Gas

Specific Responses

Objectives

Are these objectives satisfactory for your needs as stakeholder?
What other objectives do you consider should be applied to achieve success in Stage 2?

Whilst the objectives appear satisfactory within the context of Stage 2 structural changes as contemplated in earlier discussions, it has not been made clear or apparent to AGL that financial transmission rights are an essential incentive mechanism for ensuring future pipeline investment in Victoria.

GasNet have put up a proposal to the ACCC to have the augmentation of the South West covered under section 8.16(b)(ii) of the Third Party Access Code. Cogent arguments have been put forward for the augmentation to be regarded as having system-wide benefits and hence be eligible for inclusion in GasNet's capital base. Should this meet with approval from the regulator, there would appear to be no compelling case for moving away from existing arrangements.

Primary transportation market

Does the proposed range of services address your needs as a stakeholder?
If not, what are your suggestions as to how these may be provided?
Is the proposed approach to tariffs suitable, or do you have other suggestions as to how the proposed approach to transmission tariffing should be amended?
What are your views on the suitability of this model for future pipeline investment?

Hub capacity rights

The issue here for AGL is around Culcairn injections into Melbourne. Though a firm service is claimed to be offered, it is apparent that the service is dependent on the withdrawals being confined to Wodonga, North Hume, and Murray Valley. In winter particularly, injections into Culcairn may not be able to be physically delivered into Melbourne. A closer reading of section 3.4.1 leads to the conclusion that only backhaul capacity rights apply to the Culcairn-Wollert pipeline.

AGL, given its capacity on EAPL and its supply arrangements at Moomba, requires more information and firmness around Culcairn. AGL would be looking to a level of firm service from Culcairn as an injection point. In our view, we should be able to expect Culcairn to provide some of our uplift hedge in the new gas market. If the service is likely to be non-firm in the critical winter months, this must be reflected in the tariffs, either via compensation for not being able to deliver under a firm service or a discounted tariff.

In the absence of locational pricing, it needs to be ensured that a GJ worth of capacity reserved at one injection point is treated the same as a GJ at another. For example, having 20 TJ worth of capacity at Culcairn should allow AGL to offset corresponding capacity at Longford and not be operationally deprived in accessing it on the day when it is required.

Hub tariffs

Section 3.1.2 of the consultation paper alludes to an eventual prospect of a hub being split into two or more parts. AGL wishes to know what criteria and rules would apply in the decision process of splitting a hub into 2 or more parts. We

also pose the question as to whether hub-splitting might create the potential for pricing inefficiencies, as a single zonal price will apply.

Rebateable revenues

Rebateable tariffs need to have further detail, specifically:

- What is to be the allocation process in cases where multiple users have firm capacity but not all capacity is used?
- A clear definition of "capacity" on the pipeline is sought. Where a pipeline is fully contracted, GasNet can run another compressor and thereby receive the additional revenues instead of the contracted parties on the pipeline. This warrants very clear operational guidelines.

Backhaul tariffs

GasNet suggest that backhaul tariffs be set at 50% of forward haul tariffs. Is there a standard or benchmark on which this is based? Should not backhaul tariffs also reflect the "firmness" of the transmission right? Culcairn may warrant different criteria in view of the suggestion in the consultation paper that its firmness is being confined to withdrawals in the northeastern sections of Victoria.

Summer capacity rights

AGL is of the view that this section needs clarification by GasNet. Whilst the offering of summer tariffs is an acceptable practice, there are limits to reselling of capacity where the pipe is fully contracted. The appropriate arrangement when pipeline capacity is fully booked is to either offer rebateable tariffs or to facilitate/encourage the secondary trading of the capacity, rather than having summer rights.

Curtailment

In the absence of AMDQ, how is curtailment going to be handled, i.e. who gets priority? The consultation paper suggests that reliance will be placed on the Curtailment Guidelines. However, it is possible that the current Curtailment Guidelines may not be in line with how capacity rights are issued.

Furthermore, if the Curtailment Guidelines are to be relied on, AGL would not like to see the introduction of any regulation mandating the contracting of firm service for mass market customers.

Secondary transportation market

Are the proposed arrangements and approach to secondary markets satisfactory?
Will the proposed arrangements facilitate secondary markets?

AGL suggests that VENCORP operate the bulletin board. Participants do not need increased systems requirement and interfaces with GasNet. The matter of secondary capacity trading is best handled by VENCORP as a "one-stop-shop". VENCORP already has established linkages with Participants and it has the further attribute of being an independent market operator. GasNet cannot be regarded as an independent party in a capacity trading market. GasNet, who will have access to confidential information by dint of entering into contracts should FTRs become a reality, should not participate in a secondary market as there may be conflicts of interest.

AGL would also query why intra-day capacity trades are not being permitted and why the minimal trading interval is being restricted to a whole day when AMDQ will be broken down into AMIQ. This would appear to be inconsistent with the changes being rolled out for Stage 1.

Gas market

Is the proposed approach to the spot market suitable?
Are the proposed arrangements and approach satisfactory?

AGL has no comments to offer.

Current gaps in regulations

Are the current regulations satisfactory for the transmission access regime proposed in Stage 2?
Should they be further developed, and if so, in what manner?

AGL has no comments to offer.

Competition concerns

What is your view of the substance and materiality of the concerns raised in this section of the paper?
What in your view is the best approach to managing these issues if you consider them to be material?
Do you consider that further regulation may be required to address any of these concerns, and if so, what do you consider to be the most satisfactory way of approaching this regulation?

AGL notes that there are potential competition issues raised in the Victorian market with a move to FTRs. Hoarding of capacity rights on laterals or holding out of transferring/releasing this to other retailers will impact the ability of retailers to offer "firm" supply in tenders called by end-users. AGL also notes that these competition issues might be confined to regional markets that are dependent on supply through laterals.

In the event that a Participant tries to monopolise the capacity rights, what checks are there to prevent this? This is particularly critical for injection capacity reserved by the producer(s), such as Esso/BHP at Longford.

Implementation

Are the proposed transition arrangements satisfactory?
What other conditions do you consider should be investigated?

The transition from AMDQ Credits to Capacity Rights should still maintain parity between Participants when applying for capacity rights. This will mean that Participants will not be worse off as a result of this change and they will have ample opportunity to cover their capacity requirements in line with their portfolio.

AGL concurs with the view that capacity rights be contracted by Market Participants and that end-users would hold capacity rights only if they are a direct wholesale Market Participant.

The timetable for the transition to FTRs is unduly tight. Participants require much more definition and clarity from GasNet at the earliest possible date if they are to "sign up" to the new arrangements.

Tariff design principles

The consultation cites the facilitation of prudent investment as one of the three design principles to apply to transmission tariffs. AGL contends that tariffs cannot

achieve this — tariffs do reflect the other two design principles of cost recovery and the sending of price signals to users.

The spot market, with price volatility as a proxy for constraints, is the mechanism by which congestion and the resultant need for augmentation is signalled. We also note that VENCORP's annual review of system capacity also works towards this objective by collating a forward view of supply and demand matching. And finally, the regulatory framework set out in the Gas Code provides criteria by which as asset owner can arrange for capacity increase.