

Australian Energy Market Commission

Review of the Victorian declared wholesale gas market

Submission by the
Plastics and Chemicals
Industries Association

December 1, 2016

Overview

PACIA members broadly support the COAG Energy Council's Gas Market Vision, Gas Market Development Plan and Gas Market Reform Plan. The efficient implementation of strategies to increase supply and ensure the market is more competitive will all be needed to deal with what is now a gas supply crisis for industrial gas users in Victoria.

In general, PACIA supports the AEMC's recommendations for reform that would better integrate the Victorian market with the East Coast market.

PACIA recommends that some specific areas of particular interest to its members are fully understood and better explained before the changes are made so that greater certainty is provided about how the transition process would be managed.

PACIA also recommends that the AEMC factor into its final report two additional market conditions that are placing extra and increasing demand and complexity on gas supplies and market balance that may not have been considered in its original terms of reference. The first is the increased electricity supply vulnerability recently evidenced in the South Australian system black event. The second is the loss of coal-fired base load electricity generation in Victoria and role of gas as a transition fuel between coal and renewables. Both of these conditions, and the new inter-operability dynamic between gas and electricity, must be fully understood in the design of any gas market and their reforms.

Key points and recommendations

One thing is clear from the significant changes in the Victorian and broader East Coast gas market – that all participants and stakeholders now require more information and more efficient market processes than was previously needed, and often available, as a result of the market now being internationally linked. This information has a variety of forms to enable participants and other stakeholders to manage business, including risk, in the new economic environment.

Consistent with the COAG Energy Council Vision, PACIA defines a desired outcome as:

A domestic gas market that is deep in capacity, liquid in supply, competitive, transparent, informed and with good price discovery.

PACIA has been a consistent voice for increased gas supply and meaningful gas market reform for major industrial users. PACIA welcomes the AEMC's review and its recommendations to ensure the Victorian gas market is more competitive, transparent and efficient.

It is critical to point out, that in addition to greater competition and efficiency, there is also a need for more gas supply and more suppliers to deal with what is a gas supply crisis in Victoria. We recognise that increasing supply is outside of the direct remit of the AEMC and this review. However, it will be important for a comprehensive state-relevant supply strategy to complement market reforms. Without new supply, the AEMC's welcome reforms are unlikely to deliver the certainty the market requires.

The impact of the challenges facing the largely monopoly-style of market (large number of buyers with limited supply and carriage options) in Victoria cannot be underestimated. A 2014 independent report by Deloitte Access Economics analysed changes in the market place as a result of LNG exporting. They forecast the impact of these changes would result in \$24Bn of economic damage to the Victorian manufacturing sector alone, between 2014 and 2021 in net present value terms.

The AEMC report cites two key changes facing the East Coast gas market as being LNG exporting increasing demand and creating a nexus between domestic and international prices, and unexpected changes in LNG demand with the potential for attendant flow and price volatility.

In addition to these, it is important to understand that no clarity exists for users about when these vulnerabilities and volatility will level off, despite there being often-cited commentary about the “market settling” period of time.

The changes now in place in the Victorian market being experienced by our members can be summarized as follows:

- Sourcing of gas by large users has become increasingly more difficult
- Significant and unprecedented increases in supply contracts, when gas can be sourced, by users across the demand spectrum: large, medium and small
- To respond to the lack of gas availability and what is viewed, by experienced and long terms buyers as being unreasonable, price escalation for traditional style gas contracts, users have needed to become more active, diverse and add more resourcing and costs in their gas buying methods
- Becoming a gas market participant requires adoption of greater levels of risk and exposure which they have been less equipped to previously manage (no gas portfolio to balance different demand), and require more internal resourcing and costs
- Demand (usage) and supply variation requires flexibility to purchase, swap, park and trade gas with 3rd parties.
- Major industrials are more reliant on pipeline network to manage these variations
- Where previous demands on the network may have been placed by a small number of users with capability to manage demand (ie turning down a gas powered electricity generator) now the network is seeing more users with fewer degrees of freedom reliant on the network to support greater transmission complexity
- Current, traditional long term commercial arrangements don't support or reflect the changed demands of the industrial gas market
- Access to under utilised capacity is necessary to manage the increasing exposure mentioned above
- However, access to under utilised capacity should not be at the expense of firm contracted capacity
- This may result in increased revenue for the pipeline owners, however pricing would need to reflect the improved longer term value of the pipelines and prices adjusted accordingly

In addition, there are new electricity market factors which will now place ongoing demand and complexity on the Victorian and broader East Coast gas markets. The first is the increased electricity supply vulnerability recently evidenced in the South Australian system black event. The second is the loss of coal-fired base load electricity generation, already in Victoria and anticipated elsewhere in the national grid, and the consequent role of gas as a transition fuel between coal and renewables. Both of these factors and the new inter-operability dynamic between gas and electricity must be fully understood in the design of any gas market reforms and reform implementation.

With these market conditions and complexities in place, PACIA provides the following recommendations:

1. PACIA agrees with the AEMC’s proposed gas market reforms as set out in the review report.
2. PACIA recommends clarity about some aspects of the transition process, notably:
 - a. AEMC provide further information on the auctioning process and in particular the frequency of the auctions and the term (duration) of any purchase of entry and exit point capacity
 - b. Transitional arrangements between current and new contracts

3. PACIA recommends the AEMC fully identifies and considers the new gas / electricity interoperability dynamic likely to impact the market place as a result of electricity supply vulnerability and the role of gas as a transition between coal and renewable generation. These should be fully understood, both as individual and cumulative issues alongside current market issues already identified. These should be factored into both the design of market improvements and the implementation plan for their testing, introduction and transition. Considerations are likely to include:
 - a. The ability to deal with electricity-side supply shocks
 - b. The ability to deal with gas-side supply shocks
 - c. The ability then of the interoperable market, including its grids, pipelines and hubs, to deal with cumulative gas supply and balance issues:
 - i. including short to medium term shocks from already stated LNG related and /or emerging energy market-related, and
 - ii. medium to longer term limitations including ongoing lack of supply or other dynamics
 - d. The impact on any curtailment protocols such as NGERAC