



EnergyAustralia

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Dear Commissioners

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AEMC, Review of the Victorian Declared Wholesale Gas Market, Draft Final Report, 14 October 2016

EnergyAustralia is one of Australia's largest energy companies with over 2.5 million electricity and gas accounts in NSW, Victoria, Queensland, South Australia, and the Australian Capital Territory. We also own and operate a multi-billion dollar energy generation portfolio across Australia, including coal, gas, and wind assets with control of over 4,500MW of generation in the National Electricity Market.

We thank the Australian Energy Market Commission (the Commission) for their thorough assessment of the Victorian Declared Wholesale Gas Market (DWGM) and development of a comprehensive alternate model for consideration. EnergyAustralia has been engaged throughout the Commission's consultation process including the technical working groups and appreciates the opportunity to provide further feedback in this submission.

The high-level design put forward by the AEMC offers potential improvements to some aspects of the market operation but not without also introducing deficiencies. If tasked with further assessment and potential implementation of these changes by the Council Of Australian Governments (COAG) Energy Council, the Gas Market Reform Group (GMRG) will need to consider a range of difficult issues. Our submission will outline some of these we consider to be risks of the proposed reform approach and model.

We largely support the Commission's broader east coast gas market recommendations to establish a northern and southern hub, improve access to pipeline capacity, and increase transparency through publication of additional information. Combined with the findings of the Australian Competition and Consumer Commission (ACCC) from the East Coast Gas Inquiry 2015¹, we hope to see a national market redolent of the National Electricity Market (NEM) in its transparency and risk management products, consistent with the COAG gas market vision.

Producers with an international focus should not have to devote considerable resources in understanding the current complex Victorian specific arrangements at a level to compete

¹ <https://www.accc.gov.au/regulated-infrastructure/energy/east-coast-gas-inquiry-2015>

equally with experienced players. Simplification and national consistency is important for trade to occur between northern and southern markets with comparable reference prices, aligned contract terms, and shared IT systems.

However, Victorian market reform is challenging. Where the broader east coast reforms aim to introduce transparency and create new markets, the proposed changes in Victoria will require the existing market to be dismantled and reconstructed. Victoria's extant market has demonstrated efficient trading and allocation of gas (including a strongly linked power market) in periods of tight gas conditions over the previous winter. A high bar must be set for wholesale reform which has not been met at this stage.

We have observed both deficiencies and strengths in the current design. EnergyAustralia, along with other Victorian gas market participants, have engaged Seed Advisory to produce a report to ensure that positive elements are retained through any reform, and that major deficiencies are addressed as a priority. The report provides a discussion of the risks and uncertainties involved in pursuing the current reform direction.

Our major concerns are:

- The potential volatility, loss of liquidity, and hence system security issues that will result from removal of defensive gas offers from the market.
- The risks, workload, and under-utilisation of the network resulting from overly complex capacity right processes and allocation mechanisms, including additional fixed costs on Gas Powered Generation (GPG).

The COAG Energy Council and Gas Market Reform Group should seek additional proof and answers to key questions regarding the proposed model before adopting a reform pathway or undergoing further detailed design:

- Will the model provide barriers to efficient utilisation of the pipeline infrastructure?
- Can substantial simplifications be made to the entry-exit model while retaining efficient use and allocation of capacity?
- What will be the effect on liquidity due to hedging gas withheld from the market?
- Can incremental reforms provide significant benefits?

Assuming general adoption of the Commission's recommendations, we provide a number of additional recommendations on the proposed model and implementation strategy, discussed in more detail in appendix A:

Recommendation 1: A voluntary physical forward market is implemented in Victoria immediately

Recommendation 2: Allow gas to be offered on the market for purchase solely by the system operator

Recommendation 3: Introduce capacity allocation by the system operator with increased transparency including open seasons for expansions

Recommendation 4: Retain elements of market carriage model negating the need for interruptible capacity rights

Recommendation 5: Apply fixed charges for firm capacity on interconnection entry/exit points only

Recommendation 6: Historical injections and withdrawals by participant should be published on the Gas Bulletin Board immediately and continuing through any market reform

The Commission may not be able to incorporate these recommendations into their final report but we strongly urge these be considered by the COAG Energy Council and Gas Market Reform Group in their decisions and any ongoing work.

We are keen to continue to participate in the development of these gas market reforms. If you would like to discuss this submission please contact me on 03 8628 1242 or Ben Hayward on 03 8628 4518.

Regards,

Melinda Green
Industry Regulation Leader

Appendix A – Background on Recommendations

Forward market

The retail market, where retailers compete to provide gas to price sensitive commercial customers in future years, provides the only effective Victorian gas forward market. This is not a transparent market. An exchange base forward market - whether financial or physical - will provide long-term price signals for efficient decision making and investment in both upstream and downstream assets.

In our view, longer term products aligned with the electricity market will offer the most benefit. Short-term optimisation decisions will continue to be made on a day-ahead basis due to the improved weather forecasts and usage information available, and the risk aversion of participants.

The introduction of exchange-traded forward contracts for physical delivery can be implemented without risk or material changes to the operation of the current spot market. This allows a staged introduction and a demonstration of the interest in beyond day-ahead trading. A preference by participants for these contracts will remove depth and liquidity from the spot market therefore creating an opportunity for simplification without major disruption.

Recommendation 1: A voluntary physical forward market is implemented in Victoria immediately

Continuous balancing

Continuous balancing will increase the workload on participants. The best outcome is no required action during system normal conditions, and hour-by-hour trading during tight system conditions or curtailment scenarios. Irrespective of whether this balance can be attained in practice, the potential need for action to be taken will require constant vigilance, with additional resourcing deterring smaller participants.

The current market provides a mechanism for a set-and-forget management of load uncertainty. Under-forecasts can be hedged by an offer to sell additional gas at a price which will first offset any un-forecast purchases by the participant. If this hedging gas is not required, it is then available for purchase on the market. The proposed market precludes this hedging gas being offered on the market as it can be purchased by other participants before being used to balance a short position.

This presents a need for a mechanism to hedge exposure to unforeseen interventions. This could be by allowing participants to offer gas for purchase solely by the system operator which will initially offset the participant's liability. Otherwise, limited gas will be available to manage system security issues that arise, and participants will not be able to effectively manage their exposure to the costs.

Recommendation 2: Allow gas to be offered on the market for purchase solely by the system operator

Capacity auctions for interconnection entry/exit points

We believe that auctions occurring 15 years in advance will result in a first-come-first-served allocation at the regulated rate. There is also likely to be increasing prices for late comers due to over-purchase by initial bidders and artificial scarcity caused by reserving capacity for short-term use.

A floating tariff as considered by the Commission may eliminate the price differential between early and late comers; however, the mechanism for this would remove costs of expansion from the decision maker leading to over investment. That is, early purchasers will buy more than they require, late comers will require pipeline expansion but will not face the full costs of the expansion.

Transparency will be provided by auctions, but they lack the inherent flexibility and discretion to adapt to market circumstances provided by direct negotiation. Staggered capacity release by an ascending clock uniform price auction is an overly complex allocation method given the fundamental link to upstream rights² and the limited requirement for new investment given low forecast growth in domestic demand.

There are alternatives to participant led investment in the Declared Transmission System (DTS). The current regulatory and incentive framework on the system owner should be examined. The magnitude of investment required to expand the system does not justify the significant impedance to day-to-day trading imposed by the proposed reform.

Recommendation 3: Introduce capacity allocation by the system operator with increased transparency including open seasons for expansions

Interruptible rights

Under the current market carriage arrangements, capacity is automatically available for use on an interruptible basis. The market operator assigns capacity to low offers and high bids to maximise value, with AMDQ providing firm rights.

The proposed market will require participants to enter daily auctions for an interruptible right to this capacity. This will increase the workload on participants unnecessarily and create a barrier to efficient utilisation of the network. There will now be three options for day-ahead capacity: participant traded firm, auctioned firm, and auctioned interruptible rights.

GPG that only wishes to run on an interruptible basis using its own physical supply will be required to either purchase interruptible entry and exit rights before every gas day, or organise entry and exit capacity when it is needed on the day. Obtaining the necessary interruptible rights on the day will introduce an unacceptable delay given the electricity market operates on a 5-minute basis. Pre-purchasing interruptible rights will introduce an additional fixed cost for little overall benefit.

Recommendation 4: Retain elements of market carriage model negating the need for interruptible capacity rights

² Longford/Longford Dandenong Pipeline, Moomba Sydney Pipeline/ Culcairn, Iona Underground Storage/South West Pipeline)

Firm rights

Capacity rights (AMDQ) and throughput charges are separated in the current market. The introduction of firm rights, consistent with contract carriage pipelines, will allow for market-led investment in the DTS. This may provide some benefit on interconnection entry/exit points but it is an unnecessary introduction of large fixed costs on existing GPG assets for no advantage. Curtailment in the DTS is rare and limited augmentation of the DTS is needed.

Removing the need for generators embedded in the DTS to obtain firm capacity rights will lower the fixed costs of operation without negatively affecting gas market or investment outcomes. These variable cost arrangements exist on contract carriage pipelines and provide favourable outcomes for both the generator and pipeline owner. This will improve competition in NEM, providing benefit to Victorian electricity consumers and aiding the integration of renewables.

Recommendation 5: Apply fixed charges for firm capacity on interconnection entry/exit points only

Pricing and gas flow information

The proposal to remove bid/offer data reduces transparency and the depth of pricing information available to the market. The current market provides an indication of what volume of gas is available at what price through the bid/offer data. The changes will mean there will no longer be pricing and flow data at the participant level.

The quantity and price of gas available to the market is an important consideration of risks faced in the market and provides integral input into negotiations with suppliers. A voluntary exchange will only provide this information at the time the gas is required and we do not see a solution to this at this stage.

Bid/offer data also allows estimation of actual participant injections and withdrawals. This is not commercially sensitive information and brings important transparency to the Victorian gas market.

Recommendation 6: Historical injections and withdrawals by participant should be published on the Gas Bulletin Board immediately and continuing through any market reform